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PUBLIC-PRIVATE ROAD BUILDING IN LATIN AMERICA: LEGAL ADVANCES AND CHALLENGES

*Peter Lacina**

I. INTRODUCTION

UPGRADING a nation's infrastructure can yield great dividends in economic growth, resulting in poverty reduction and competition with the dynamic new economies of the world.¹ To enable infrastructure growth, Latin American countries and other developing nations throughout the world have turned to private investment to provide the funding.² The nations' public sector budgets and resources, however, cannot meet the demands placed upon their transportation, utility, and communication networks.³ Within the transportation systems are a web of roadways and railroads connecting seaports, airports, cities, and manufacturing centers. The positive economic benefits of quality roadways on industrial hubs are easy to visualize, but in rural areas, where funding for infrastructure improvement is the most difficult to obtain, roadways also affect citizens' access to schools and health centers, agricultural productivity, and sale of products.⁴ This paper will provide an overview of Latin American nations' problems and progress in developing regulatory and contractual systems to involve private partners in road building.

Developing nations often do not have available funding to build, upgrade, or maintain roadways, and have increasingly looked to the private sector for funding.⁵ During a traditional public-sector roadway project, private entities provide no funding, and act based upon the specifications and approval of a public agency. The private sector consultants or contractors involved in the planning, design, or construction phases of the project work under separate contracts and typically coordinate with the

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1. Marianne Fay & Mary Morrison, World Bank, *Infrastructure in Latin America & the Caribbean: Recent Developments and Key Challenges*, 15 (2007).

2. Multilateral Investment Guarantee Agency, World Bank, *Poor Infrastructure Hobbles Growth in Latin America: MIGA provides impetus for needed investment*, Sept. 20, 2007, available at http://www.miga.org/news/index_sv.cfm?stid=1523&aid=828 [hereinafter MIGA].

3. *Id.*

4. See Fay, *supra* note 1, at 59-60.

5. See *id.* at 59-61.

public agency more than among themselves.⁶ But increasingly, governments are utilizing private investment to finance roadways and other infrastructure in an arrangement characterized as a Public Private Partnership (PPP). Public Private Partnerships are collaborative efforts between a public agency and a private sector entity to provide public services or to improve infrastructure, with the private partner usually assuming more responsibility than is traditional for infrastructure planning.⁷

In a PPP, the public entity competitively selects and contracts with a private firm to deliver services for various needs, whether for a shorter-term specific project, or a long-term license to operate a segment of infrastructure for as long as twenty-five to thirty years.⁸ The private firm not only arranges the financing and completes the construction, but also may agree to manage and maintain the infrastructure asset.⁹ In transportation PPPs, the operation of a roadway entitles a private company to recoup the costs of construction, and to repay investors by collecting toll revenues from the users or payments from the government. The public agency provides oversight of the private firm's performance and regulates other aspects of the agreement, including maintenance, setting of toll rates, and the approval of the engineering design.¹⁰ Many variations of PPPs exist depending on the government agency or type of project. In some arrangements, a major corporation pays the public agency an upfront fee for the contract. In other cases, the public and private partners form a joint venture to share in the risks and toll revenues.¹¹ The contract is often for a fixed term, and upon expiration, the government may renegotiate a contract with the operator, or the private entity may transfer the facility to the government at no cost.¹²

If managed properly, PPPs can be an effective way to provide essential links between communities, while minimizing taxpayer costs and transferring the government's risks to private investors.¹³ In order to allow PPPs to form, governments must enact new laws and regulatory structures that investors view as credible.¹⁴

6. U.S. Dep't of Transp. Fed. Highway Admin., *Public Private Partnerships Defined*, <http://www.fhwa.dot.gov/ppp/faqs.htm#1> (last visited June 30, 2008).

7. *See id.*

8. Fay, *supra* note 1, at 61; Brochure, U.N. Econ. & Soc. Comm. for Asia and the Pac., *Brochure: Guidelines for Documenting Innovative Practices in Pro-Poor Public-Private Partnerships*, at 2, available at <http://www.unescap.org/ttdw/ppp/files/GuidelinesBrochure.pdf> [hereinafter UN ESCAP PPP Guidelines].

9. Fay, *supra* note 1, at 61.

10. *See* Leonard C. Gilroy, et al., *Building New Roads through Public-Private Partnerships: Frequently Asked Questions*, POLICY BRIEF No. 58 (Reason Found.), 2007, available at http://www.reason.org/pb58_building_new_roads.pdf.

11. UN ESCAP PPP Guidelines, *supra* note 8, at 2-3.

12. *Id.*

13. Cesar Queiroz, World Bank, *Launching Public Private Partnerships for Highways in Transition Economies* 8 (2005).

14. *Id.* at 1.

II. LEGAL ASPECTS OF PRIVATE ROAD BUILDING

Several factors bear heavily on the success or failure of highway concessions. A concession under a PPP program is a “legal arrangement in which a firm obtains from the government the right to provide a particular service,” which in the case of a roadway, usually the construction and operation of the highway.¹⁵ The potential parties in a PPP must review three primary factors when entering a highway concession arrangement: the basic economics to determine the return on investment; the risk allocation among the parties under the PPP agreement; and the legal and regulatory structure of the applicable nation or province.¹⁶ Many of the successes and failures in Latin American private road building are due to the implementation of legal or contractual systems. Several significant legal aspects related to the factors listed above include the national government’s approach to developing PPP laws, the dispute resolution systems to facilitate successful highway construction PPPs, and the terms of the PPP agreements. In recent years, Latin American governments have made tremendous strides in addressing past inefficiencies in these areas in order to attract private investment.

The perceived transparency and fairness of a transaction is crucial in shaping public opinion of PPPs. Some recent negative public reaction to private participation in infrastructure may “be due to excessive renegotiations and a few well-publicized failures.”¹⁷ In a World Bank paper, Guasch, Laffont, and Straub note that the public’s negative sentiment of privatization is partially due to many costs that have passed through to users or taxpayers in excess of initial agreements.¹⁸ They provide an extreme example of the failure of the Mexican toll-road program, a massive failure initiated by inaccurate traffic projections, and an agreement hampering the ability of the private firms to recoup their costs over the long-term. It comprised fifty-two highways built under private concessions in the early 1990s, most of which were taken over by the Mexican government during in a massive 1997 bail-out, burdening the government with a debt equal to between one to 1.7 % of the nation’s GDP.¹⁹ Another World Bank study found that parties re-negotiated thirty percent of Latin America’s concessions because of inflexible or unrealistic contracts.²⁰

15. *Id.* (citing Michel Kerf et al., World Bank, *Concessions for Infrastructure: A Guide to Their Design and Award*, Tech. Paper No. 399, 5 (1998)).

16. Jacques Cook, *An Innovative Solution For Financing U.S. Highways: Lessons From Abroad*, Mondaq, Sept. 21, 2007, available at <http://www.mondaq.com/article.asp?articleid=52526>.

17. Fay, *supra* note 1, at 6 (Figure ES.3, titled “Respondents Who Think Privatization Has Been Beneficial,” shows that fifty-six percent of those surveyed thought privatization beneficial for nation in 1998, while only twenty-five percent thought it was beneficial in 2004).

18. J. Luis Guasch, et al., *Concessions of Infrastructure in Latin America: Government-Led Renegotiation 5* (World Bank Policy Research Working Paper No. 3749) (2005).

19. *Id.*

20. Fay, *supra* note 1, at 6 (based on a study by J. L. Guasch, World Bank, *Granting and Renegotiating Infrastructure Concessions: Doing It Right* (2004)).

The contracts generally did not consider unforeseen events, opportunistic behavior on the part of the concessionaires, or interference by the government through regulatory changes or changing the rules of the game because of political motivations.²¹ Marianne Fay & Mary Morrison of the World Bank noted that, “whatever the motivation. . . frequent renegotiations are costly, disruptive, and anticompetitive, and contribute to a perceived lack of transparency.”²² Private firms with political connections may unjustly profit from such renegotiations. In Latin America during the 1990s, continuous renegotiations and several high-profile government takeovers grabbed headlines and highlighted the risks, causing reluctance among private financiers to invest and the public to remain skeptical of the claimed benefits of PPPs.²³

In large part because of government inefficiencies or project failures, public and private investment in Latin America’s infrastructure shrank during the past twenty years. In addition to the reduced public investment resulting from fiscal tightening, the World Bank estimated that the value of private-participation infrastructure projects in Latin America and the Caribbean fell from \$71 billion in 1998 during “a wave of privatizations,” to just \$16 billion in 2003.²⁴ But the Multilateral Investment Guarantee Agency of the World Bank Group notes:

[the] good news is that investors and governments today have a better understanding of what went wrong and of how to mitigate potential risks, and are forging partnerships that bring to the table the know-how and financing of the private sector, as well as the public interest and regulatory backing of the public sector.²⁵

Political leaders in Latin America are strongly backing major initiatives to reduce the barriers between countries through infrastructure growth. A major component of these plans is shared leadership and responsibility between the government and private sector. One regional initiative is the Plan-Puebla Panama, whose purpose is to stimulate integration within Mexico and Central America.²⁶ Another is the Initiative for the Integration of Regional Infrastructure in South America (IIRSA). Both of these programs will create “hubs” to concentrate trade and “corridors” to link the local economies and to access areas previously isolated by deficient infrastructure.²⁷ IIRSA is an ambitious plan, started in 2000 by the leaders of Latin American nations, to create an integrated South American logistics platform with common standards for infrastructure within each

21. *Id.*

22. Fay, *supra* note 1, at 6.

23. MIGA, *supra* note 2.

24. Lucy Conger, *Road Work Ahead: Latin America’s Infrastructure Program is too Modest in Scale and Way Overdue. Plus, It’s Caught up in Politics and Poses Environmental Hazards. Here’s Why it’s so Welcome Nonetheless*, 40 *EuroMoney Institutional Investor* PLC 116 (Mar. 1, 2006), available at 2006 WLNR 7468304.

25. MIGA, *supra* note 2.

26. Vito Tanzi, *Building Regional Infrastructure in Latin America* 6 (Inter-American Dev. Bank, Working Paper No. SITI-10, (2005).

27. *Id.*

region (or hub) and to support specific activities within these hubs.²⁸ Latin American nations designed IIRSA to compensate for years of underfunding infrastructure, and to eliminate bottlenecks and minimize internal barriers to trade.²⁹ One of the larger IIRSA roadway projects is an east-west highway originating on the mountain slopes of Columbia to further link that nation with Ecuador and Peru by connecting the Pacific coastal area to a major interior waterway.³⁰ Another IIRSA project includes an estimated \$1,055 million of improvements on a roadway network in the southern region of Peru that links up to Brazil.³¹ Each of the project's five sections of roadway consists of a separate concession project. The private firms will fund this project through separate concession contracts for each of five sections of roadway, with Peru repaying each contract over twenty-five years.³²

However, the Latin American nations face a compound problem of limited experience with these regional transportation networks and several inherent difficulties faced by the regional projects.³³ One problem is that most traffic on existing infrastructure is still within national borders, so cross-country traffic may take years to generate a sufficient economic return to pay any debt.³⁴ Another problem is that two nations may receive unequal benefits from a project, so an arbiter is needed to avoid the "free-rider" problem that can develop as nations attempt to underestimate their own benefits or attempt to obtain regional program financing for their national projects.³⁵

In addition to the regional coordination to overcome these obstacles, within each Latin American nation, governments and agencies are creating laws, regulations, and sophisticated contracts to facilitate PPPs. Chile has possibly been the most successful with public-private partnerships in Latin America.³⁶ The nation's success is in large part due to the ability to produce "transparent and effective legal and regulatory frameworks."³⁷

A. LEGAL AND REGULATORY STRUCTURES

Private infrastructure projects may disappoint all parties if begun before adequate legal and institutional frameworks are fully functional.³⁸

28. IIRSA, http://www.iirsa.org/index_ENG.asp?CodIdioma=ENG (follow "Institutional" hyperlink at top of page; then follow hyperlinks at left under "About IIRSA") (last visited June 30, 2008).

29. *Id.*

30. IIRSA, *Pasto-Mocoa Road*, http://www.iirsa.org/bancomedios/documentos%20pdf/aic_ficha_proyecto_20_eng.pdf (last visited June 30, 2008).

31. IIRSA, *Paving of the Inapari-Puerto Maldonado-Inambari, Inambari-Juliaca/Inambari-Cusco Leg*, http://www.iirsa.org/bancomedios/documentos%20pdf/aic_ficha_proyecto_24_eng.pdf (last visited June 30, 2008).

32. *Id.*

33. Tanzi, *supra* note 26, at 17.

34. *Id.*

35. *Id.*

36. *Id.* at 16.

37. *Id.*

38. Fay, *supra* note 1, at 60.

Providing a stable business environment when introducing private participation in infrastructure requires “sweeping changes in the region’s institutional, legal, and regulatory frameworks.”³⁹ A critical first step in beginning a highway PPP program is enacting appropriate legislation, including concession and toll road laws.⁴⁰ Although, Marianne Fay & Mary Morrison of the World Bank note a difficulty is that “[e]stablishing regulatory credibility takes time, and involves more than just setting up the institutions needed.”⁴¹ They added that in Latin America, it is quite clear that “analysts and reformers were overly optimistic as to the ability of reforms and regulation to isolate transactions from political influence, and as to the appropriateness for Latin America of models developed for mature infrastructure networks in industrialized countries.”⁴²

Cesar Queiroz of the World Bank notes that an appropriate, well-drafted concession law establishes an “enabling environment for PPPs and it also serves as a possible marketing tool for investors,” and that the law should address the “construction, expansion, rehabilitation, and maintenance of assets providing a public service.”⁴³ Queiroz states that there are several desirable provisions to reassure investors and the public that concession laws are fair and transparent for all parties: public disclosure of agreements; a truly open, competitive bidding process and an ability to accurately compare bids on a net present value (NPV) basis; assurances for the private entity to repay their investment if the government takes over the asset; and a provision for international arbitration to accommodate foreign investors.⁴⁴ A concession law should be “relatively simple and general,” while agencies should use separate regulations to provide the details of the plan that can be amended as the PPP program is implemented.⁴⁵

B. DISPUTE RESOLUTION

In any contract, especially those involving construction or long-term services, parties must plan for opportunistic behavior or disagreements amongst the parties by including clear dispute resolution provisions. Another reason to provide these provisions is that the judicial system is not reliable in many Latin American countries.⁴⁶ Experience shows that where the judiciary is weak, investors not only plan for project profits, but may also anticipate future returns by beating the government granting-authority in a legal dispute.⁴⁷ A World Bank study found that in many recent concessions private firms enter bids at the very limits of

39. *Id.* at 43.

40. Queiroz, *supra* note 13, at 6.

41. Fay, *supra* note 1, at 60.

42. *Id.* at 7.

43. Queiroz, *supra* note 13, at 3.

44. *Id.*

45. *Id.*

46. Fay, *supra* note 1, at 61.

47. *See id.*

profitability, and that at some point afterward, the private operators renegotiated the contracts to provide better terms for themselves.⁴⁸ A study found that a strong regulating agency can reduce renegotiations by approximately forty-five percent and is a “desirable counterpoint to political opportunism.”⁴⁹ Renegotiations have typically been a persistent problem in Latin American PPP agreements, because weak regulations and poorly designed contracts allow bargaining power to become almost as valuable as a firm’s capabilities.⁵⁰

C. THE PPP AGREEMENT

A primary benefit of PPPs is the allocation of responsibilities to a private party that is most capable of providing long-term, cost-effective management while constructing the necessary transportation asset.⁵¹ The risks and responsibilities of each partner are expressed contractually, so that each party assumes the consequences of its actions and has an incentive to maximize performance while retaining flexibility to manage the risks.⁵² “The partnerships vary in structure, but they are all designed to parcel out the risk among the public and the private entities,” explained Lucy Conger of *Institutional Investor Magazine*.⁵³ As example, she pointed to Peru’s Amazonas Norte highway project: a two-lane toll road connecting Yurimaguas in the northwestern Amazon to the Pacific port of Paita, built and operated by a private consortium led by a large Brazilian contractor. This project is an example of allocation of risk to the proper party—with the private consortium assuming the financing risks, while the Peruvian government assumes the commercial risk.⁵⁴ The commercial risk arises because a private party can only minimally influence drivers to use the highway. To offset resulting losses due to low highway usage, the Peruvian government agreed to pay the consortium the difference between the toll receipts and the highway’s maintenance costs.⁵⁵

Parties can also reduce risks by using innovative financing means. The World Bank reports that an emerging trend in roadway projects throughout the world is the use of a variety of financial arrangements to pay off

48. Sophie Sirtaine, et al., World Bank, *How Profitable Are Infrastructure Concessions in Latin America? Empirical Evidence and Regulatory Implications*, 2 Trends and Policy Options at xi (2005), available at <http://www.ppiaf.org/Trends&policyseries/ConcessionsLACpaperNo2.pdf> (citing study by J. L. Guasch, World Bank Institute, *Granting and Renegotiating Infrastructure Concessions: Doing It Right* (2004)).

49. Fay, *supra* note 1, at 38.

50. *See id.* at 37-38.

51. U.S. Fed. Highway Admin., *supra* note 6.

52. Joint Transp. Research Ctr., *Transport Infrastructure Investment: Options for Efficiency* (2007), available at <http://www.internationaltransportforum.org/jtrc/infrastructure/Investment/07TIIsummary.pdf>.

53. Conger, *supra* note 24.

54. *Id.*

55. *Id.*

construction costs.⁵⁶ For toll road projects, such as Peru's Amazonas Norte highway project, this may include periodic government payments to cover the gap between revenues and costs.⁵⁷ For non-toll projects, the arrangement may include periodic payments based upon actual vehicle use or the more traditional approach of payments to cover construction and operational costs.⁵⁸

To leverage project financing on major infrastructure projects, Peru's state agency for promoting private investment ProInversion, created a financial instrument called the certificate of work progress, or CAO (*certificado de aceptacion de obra*).⁵⁹ The president of ProInversion's infrastructure committee explained that a highway project could be divided into benchmarks, for example, 100-mile segments.⁶⁰ First, the private concessionaire expends \$100 million to construct the first segment, prompting the government to issue the CAO stating that the segment was completed; then the concessionaire is "entitled to collect tolls and eventually be reimbursed for the construction and financing, less the toll receipts."⁶¹ Subsequently, another investor can purchase the CAO from the concessionaire and thereby the ability to profit from the roadway tolls. This purchase will provide capital to the concessionaire, allowing the construction to proceed segment by segment, rolling over the investments until the project is complete.⁶²

III. TRENDS IN INFRASTRUCTURE GROWTH

Despite these strides, after the fiscal crisis and tightening of budgets in the 1990s, public infrastructure investment in Latin America has declined in the early part of this decade.⁶³ A combination of infrastructure problems, including poor roads that drive up logistics costs, are now obstructing Latin America's potential to continue reducing poverty and compete in the world market.⁶⁴ Fay and Morrison explain that "[t]otal investment has fallen as a percentage of GDP, as public infrastructure expenditure has borne the brunt of fiscal adjustment, and private invest-

56. The World Bank Group, *Private Activity in Transport Continued at Peak Levels for Second Year*, PPI Data Update note 10 (July 2008), available at <http://ppi.worldbank.org/features/June2008/2007transportDataLaunch.pdf>.

57. *Id.*

58. *Id.*

59. Conger, *supra* note 24.

60. *Id.*

61. *Id.*

62. *Id.*

63. Francisco Rodríguez, *Have Collapses in Infrastructure Spending Led to Cross-Country Divergence in per Capita GDP?* 1 (Wesleyan Economics Working Papers No. 2006-013, 2006) (citing Easterly, W. and L. Servén, World Bank, *The Limits of Stabilization: Infrastructure, Public Deficits and Growth in Latin America* (2003)) [hereinafter Rodríguez].

64. MIGA, *supra* note 2.

ment has failed to take up the slack.”⁶⁵

But Latin America retains the potential for continued growth in private infrastructure investment due to nations' efforts to improve economic and regulatory policies, including those affecting PPPs. Latin American governments realize that PPPs are critical to increasing infrastructure investment and thereby increasing output of their private-sector industry.⁶⁶ Lucy Conger notes that recent success in adopting the PPP format in Argentina, Brazil, Chile, Colombia, Peru, and Uruguay has helped prompt these and other nation to announce programs to increase transportation investments.⁶⁷ President Garcia's government in Peru announced that during 2008, he would emphasize private investment as part of a larger policy to raise the living standard while maintaining fiscal responsibility.⁶⁸ The Colombian government will also continue to emphasize roadway PPPs by continuing current concession projects and improving the concession legal framework.⁶⁹ But the effect of the 1990s recession and troubles with contractors on recent projects have reduced tolls and delayed projects.⁷⁰

Within recent years, Latin American governments are beginning to reverse two decades of neglect in road construction and are trying to connect to their neighbors and to the world through trade.⁷¹ Neglect of the infrastructure is a factor in the divergence of prosperity between Asia and Latin America, with improvements being a necessity if the Latin American nations are to grow their economies and compete with other developing countries.⁷² The future is brighter because the Latin American nations are undertaking these difficult tasks. In addition to the government's attention to PPP projects, the strong economic growth outlook and the resulting need for a modern transportation network is attracting private investors back into Latin American infrastructure projects.⁷³

65. Fay, *supra* note 1, at 28; MIGA, *supra* note 2 (“[I]nfrastructure spending by countries in the region has fallen sharply and currently averages less than two percent of GDP”).

66. See Rodríguez, *supra* note 63, at 3.

67. Conger, *supra* note 24.

68. *Peru: Country Outlook*, Economist Intelligence Unit, EIU ViewsWire, 2007 WLNR 17258104, Sept. 1, 2007.

69. *Columbia: The Operating Environment*, Economist Intelligence Unit, EIU ViewsWire, 2007 WLNR 1872162, Jan. 29, 2007.

70. *Id.*

71. See Rodríguez, *supra* note 63, at 1-2 (citing Easterly, W. and L. Servén, *The Limits of Stabilization: Infrastructure, Public Deficits and Growth in Latin America*, The World Bank (2003)); Conger, *supra* note 24.

72. See Rodríguez, *supra* note 63, at 1-2.

73. Philippe Valahu, *Bouncing Bonds: Demand for New Infrastructure in Latin America is Growing*, 272 Euromoney Institutional Investor PLC 49, 2006 WLNR 14564481 (July 1, 2006).

Updates

