Leveraging Public-Private Partnership Projects to Modernize Infrastructure: The Case of Chile

Context
On its return to democracy in the 1990s, Chile’s economy was growing at a rapid pace. But like many countries in the region, it had chronically underinvested in infrastructure during the economic doldrums of the 1980s. Roads, ports, and highways were decades old and inadequate for the growing economic activity. Also, from 1982 to 1992, private car ownership had grown by 45 percent to a total of 1.3 million vehicles (National Institute of Statistics, various years). Congestion and traffic accidents nearly doubled during that period. The Chilean government recognized the need for significant economic investment, particularly in roads and highways, to ensure continuing economic development. However, the government did not have sufficient capital or the technical know-how to carry out public works projects at the scale required.

Development Challenge
The challenge for Chile was to build cost-effective infrastructure projects to help maintain rapid economic growth.

Intervention
Considering its fiscal constraints, the Chilean government designed a pioneering program of concessions and private capital investments to modernize its aging infrastructure. This public–private partnership (PPP) system sought to increase investments in infrastructure without increasing taxes or depriving the government of funds to deliver promised social sector investments in health care, education, and housing. The need for a modern and efficient infrastructure was recognized as critical to expansion of the export-based industries that had propelled the country to a sustained 6 percent annual average rate of gross domestic product (GDP) growth by 1990.

To deliver on the PPP program, the Chilean Ministry of Public Works was tasked with managing infrastructure concessions through a system of competitive bidding, in partnership with other government agencies. The public works ministry was responsible for assessing the profitability of projects, appraising risk, determining penalties for breach of contract, and supervising construction and completion of bids. The PPP program was later managed specifically by a dedicated PPP unit, with 300 staff members with specialized expertise in legal, environmental, and engineering issues (IGC 2011). Infrastructure projects were also evaluated by the Chilean Ministry of Finance to validate their financial and environmental viability. In 1991, those tasks and responsibilities were codified into a regulatory framework with the passage of Special Decree No. 1946, the Concessions Law (Lorenzen, Barrientos, and Babbar 2004).

Since creation of the PPP program, the Chilean government has worked with the private sector on 50 PPP projects costing US$11 billion dollars (IGC 2011). The PPP program has significantly improved the country’s infrastructure, creating modern airports, highways, and jails and building more than 2,000 kilometers of roads throughout the country.
Delivery Challenges

This delivery note analyzes key implementation challenges and examines how they were overcome.

- **Lack of regulation and legislation.** With the launch of the PPP program, Chile’s government intended for most of the needed funding to come from domestic capital markets. The plan was to support the growing local economy and simplify contract and procurement processes. However, the country’s financial regulatory framework constrained capital uptakes and inhibited financing for PPP infrastructure projects. In particular, prudential regulations related to portfolio diversification prevented the country’s banks from investing more than 15 percent of their capital in infrastructure projects. Given the capital requirements for larger projects, such as dams and cross-country highways, project bidders were discouraged from or unable to compete in early concession rounds without international financing, limiting the diversity of project proposals and increasing the risk of higher costs.

- **Cumbersome reporting and supervision systems.** Despite the Chilean Ministry of Public Works purview over infrastructure projects, the presence of multiple government stakeholders in the design, planning, and implementation of PPP projects complicated the projects’ review and approval. Multiple agencies had to coordinate with each other to assess the financial merits and environmental safeguards of any given project. The bidding procedures and concessions needed to be closely coordinated with the Chilean Ministry of Finance. Likewise, the Ministry of Planning played a critical role in the creation of bids and infrastructure priorities for the country. Although thorough, this supervision matrix increased the risk of delays and of potential safeguard oversights that could result in strong public opposition or costly contract renegotiations.

- **Inefficient procurement mechanisms.** In the early stages of the PPP program, the complexity of early engineering projects and PPP bids led to the approval of projects affected by revisions and delays. Unclear institutional arrangements and lack of risk assessment during procurement forced the Chilean government into costly renegotiation efforts for several contracts. Moreover, although many PPP projects in Chile—particularly highway projects—generated sufficient revenue to pay for themselves, some ultimately required government subsidies to operate successfully.

Addressing the Delivery Challenges

The following steps were undertaken to mitigate the delivery challenges related to **lack of regulation and legislation:**

- To achieve its ambitious infrastructure goals through the support of PPPs, the government of Chile recognized the limitations of its legal framework for local investments. In 1995, the government introduced a series of financial-sector reforms designed to promote greater participation from local banks and institutional investors in national concession projects. The changes expanded the pool of domestic financing entities and increased the lending limits on infrastructure projects as part of a lender’s capital reserves (Lorenzen, Barrientos, and Babbar 2004). In addition, the government began releasing infrastructure bonds to crowd in investments from institutional investors (pensions funds and insurance companies) that, up to that point, had limited participation in companies not listed on the stock exchange.

- In 1999, the Chilean government established a mechanism to provide exchange rate insurance for debt raised by concessionaires in foreign capital markets. That move was intended to protect local concession bidders who were capable of attracting capital from international markets from the risk of foreign exchange fluctuations (IMF 2004).

The following steps were undertaken to mitigate the delivery challenges related to **cumbersome reporting and supervision systems:**

- In 1999, a special unit called the Coordinación General de Concesiones was created in the Ministry of Public Works to streamline the concession process for PPP projects. The new unit was divided into three departments covering projects, construction, and operation. The unit’s departments would also take care of sundry issues related to environmental, sociological, and engineering matters and do liaison work with corresponding ministries, depending on the project. The new unit was also responsible for producing detailed design and engineering studies during the tendering of PPP projects, with a view toward promoting greater participation from smaller firms and increasing competition.
Over time, the government of Chile has given more autonomy to the Ministry of Public Works to update the bidding processes, depending on the infrastructure project. Despite these advances, concessionaires have expressed the need for greater support in contractual matters during project implementation, which usually still requires approval from several government agencies.

The following steps were undertaken to mitigate the delivery challenges related to inefficient procurement mechanisms:

- In 2010, the Chilean government passed a revised PPP law that sought to limit and regulate the renegotiation of contracts, which by some estimates had affected an average of 24 percent of the country’s PPP projects (IGC 2011). The government also increased the robustness of its institutional safeguards in the aftermath of a high-profile corruption case on a PPP project. The improvement also sought to introduce greater cost-benefit analysis into the design stage of PPP proposals.
- Moreover, to ensure that PPP programs and bids are aligned with the government’s fiscal priorities, a Ministry of Finance officer with veto power was permanently assigned to the Ministry of Public Works to further ensure the financial viability of projects (IGC 2011).

References


