
**SUMMARY REPORT OF THE FIRST DIALOGUE OF THE ASIA PACIFIC
INFRASTRUCTURE PARTNERSHIP WITH PERU AND MEXICO, CONVENED IN
LIMA ON 24TH AUGUST 2011.**

Introduction

Members of the panel met with the Minister of Economy and Finance of Peru, senior officials from Peruvian and Mexican agencies and the Inter-American Development Bank (IADB). The meeting benefitted from a preparatory meeting with officials, business representatives from Peru, Mexico and Chile and the IADB on the preceding day when the structure and approach to the dialogue was discussed.

Mr Mark Johnson chairman of the Advisory Board on APEC Financial System Capacity Building chaired both the preparatory meeting and the dialogue. He noted that this first meeting of the panel, supported by APEC Ministers, was the beginning of a journey and that at some point there would need to a discussion on how to formalize APIP within APEC.

The Minister and officials strongly endorsed the dialogue with the private sector panel members and the IADB.

The Minister noted the importance of investment in infrastructure as a key aspect of policy to maintain high growth and low inflation and that private sector investment is a critical component of policy. Public private partnerships contributed to efficiency and helped reduce the cost of capital to government. While the focus had been on roads, airports and water, PPPs in social infrastructure would contribute to social inclusion. He recognised the role of PPPs in regional economic integration and noted that Peru was willing to act as a platform for Latin America in building links with Asia.

The dialogue confirmed the importance of PPPs in infrastructure to the development of both Peru and Mexico. Both are deeply committed to PPPs and for the same reasons: the financing gap between government financial sources and the needs for infrastructure financing are large and will continue to be so for the foreseeable future.

Attracting private finance to contribute to those needs is therefore a critical aspect of government policy in both economies. Peru and Mexico encourage the role of private investment in the development process and value the efficiencies gained by involving private sector expertise and finance.

Both encourage the private sector through public guarantees and the investment of public funds related to risk sharing in the construction and operational phases of PPPs. Both have established public funding mechanisms to this end. Peru has established a tax for infrastructure scheme which provides tax offsets to the private sector for investments in approved projects in remote areas of the country.

(Drawing on experiences in Asia, the dialogue noted that in Thailand, financial support is available to health and care institutions through a double tax deduction for payments by patients where subsidies are insufficient to cover patient costs).

Both Peru and Mexico have innovative approaches to promoting PPPs. Specialist government agency representatives provided useful data on their approaches to PPPs.

The IADB provides guarantees, financial support and technical advice to governments and private parties to PPPs throughout Latin America. IADB has already participated in the financing of several PPP transactions in the region. It has developed a most useful comparative tool, “Infrascop: An Innovative Learning Tool for Evaluating Country Capacity for PPPs”.

The dialogue considered a range of topics vital to promoting confidence in PPPs. They included the scope of PPPs, risk sharing from government and a private sector perspectives, political risk, contractual responsibilities, the protection of lenders’ interests in contract variation and termination, government information to promote bidding interests, municipal and sub-national level of government involvement in PPPs, government management of contingent liabilities and preferred bidding arrangements, the relevance of common standards and regulation throughout the region and the need for human capital training such as that provided by the APEC mentoring scheme and training courses organised by the Australian APEC Study Centre at RMIT University. Similarities and contrasts between Latin American and Asian experiences were considered.

Key points.

- Widening the scope of PPPs.

Clever packaging of public and private sector interests would create opportunities for private sector investors in Peru. Pro Inversion, the investment and promotion agency, would contribute by deepening its promotional activities. Apart from PPP investments in hard infrastructure – roads, energy and communications - other opportunities will be explored including privatization and PPPs in health and education. Packaging investments in rural areas would involve multidisciplinary approaches.

Improving the management and the level of skills in PPPs is an important challenge in Peru.

Peru is encouraged to draw on the experiences of Mexico in health and education sectors. Pension funds invest in both sectors in Mexico and focus on long-term financing of the operational aspects of such projects; banks are involved in leveraging funding for the construction phase. Pension funds are comfortable with risk taking in the provision of services in the health and education sectors, including building and equipment maintenance, secured by payments for services by the government.

In both sectors in Mexico, the government has the responsibility to provide core functions - teaching and curriculums, in education - and in medical treatment of patients in the health sector. This division of responsibilities is critically important as a means of risk sharing and the allocation of responsibilities to those best equipped to bear risk. Essentially this relates to political risk sharing.

Such a division of responsibilities in Peru could help minimize resistance to performance indicators in the educational sector by teachers' unions and facilitate the involvement of private capital in the sector.

Further work could usefully be undertaken to compare ways in which economies handle the division of responsibilities as described above with a view to minimizing political risk.

There are examples in Latin America where students and patients pay for services they receive and the framework for this in the PPP context are matters to be negotiated politically and between the relevant parties.

- **Risk sharing – what the government can do**

Approaches to risk sharing may differ among economies although funds/guarantees of various structures are provided in both Peru and Mexico to support private investment in PPPs as noted above. Because project structures change over time, changing approaches to risk sharing are to be expected.

Mexico considers risk sharing on a case by case basis. There is considerable flexibility available to relevant agencies in their relationships with the private sector. Good project design, consultation between the government and the private sector, land acquisition by the government are essential ingredients to risk sharing.

The broad approach is open dialogue with the private sector to understand what the private sector can and can't do in respect of a particular project. The government benefits from knowing what is the financial appetite of the market – whether prospective projects are too large or too small – and these are factors in

ensuring a high level of confidence in PPPs, combined with reputable and transparent bidding processes .

The flexibility in this approach has much to commend it in attracting private investors into the PPP space. Regional economies could usefully encourage private sector specialists to promote the design of potential projects; there may be advantages in design and development not being the sole preserve of the public sector.

Opportunities could also be explored to develop revenue producing activities beyond those of the immediate core service provided by a PPP. For example, a school might also be utilised for the provision of other services such as child minding or youth centres.

- Risk sharing – what the private sector seeks

Pension fund investors require security of payment over the long-term of a project, guaranteed by a government. The preference is to fund operational activities where the long-term payment streams accord with business models. It is fundamental to pension investment that there is a secure legal framework in place to adequately protect the investor against changes in government or changes in policies .

Where municipal or sub-national levels of government are involved, the private sector requires a clear understanding of the relationships between relevant levels of government and the responsibilities for guarantees and warranties.

Bidding processes are enhanced where detailed data – for example forecasts of traffic flow in a road project – is available for all parties to a PPP. Investing in good data acquisition is commended to governments.

The capacity to make variations to a contract over the long-term of a project life-cycle is important – these may reflect physical changes to the capital stock or to services.

It is recognised that a government must have the right to undertake changes and to recover costs arising from an adjustment either from a concessionaire or from its own resources. Rigorous administration over the life-cycle of a contract helps avoid “modification creep”.

A transparent approach by government in dealing with adjustments is highly relevant.

- **Concluding suggestions/recommendations**

Important concepts, experiences and ideas were exchanged in a frank and highly constructive manner. Further work was identified to be undertaken by APIP and which could involve on-going dialogue with Mexico and Peru and which would also be of considerable value to the APEC community broadly.

Specifically, APIP should consider:

- *A review of the IADB's Infrascopes Learning Tool to consider its value to the APEC region more broadly. Such a review should take into account any similar work that might be undertaken by other multilateral development banks.*
- *A comparative study of the examples of legal frameworks aimed at protecting the long-term investor interests of pension funds in PPPs should be usefully pursued.*
- *A comparison of contractual clauses to provide for the smooth adjustment of physical infrastructure and services through the life of a project would usefully contribute to ways to enhance the confidence of both the public and private sectors in PPPs.*
- *A comparison of best practice taxation measures in regional economies to support PPPs*

It is hoped that this initial phase of work of APIP will contribute to building confidence in PPPs in the region and will supplement the work being undertaken by APEC officials aimed at supporting regional economic development and integration.

This report and the report of the dialogue with the Philippines, scheduled for 5th October, will form the basis of the ABAC's report to APEC Finance Ministers and Leaders at the November meeting in Honolulu. Endorsement at that meeting for the formalisation of APIP, this series of dialogues and for a secretariat function within APEC, in cooperation with the World Bank, the ADB and the IADB, would signify the value attached to this initiative by ABAC.

With the agreement of relevant agencies, it is proposed that presentations be included in a dedicated web-site to be developed at the Australian APEC Study Centre at RMIT University, Melbourne, and to be freely available to interested parties. The site will be developed as an information service to officials and business representatives of APEC economies.