



SPECIAL REPORT

Factors limiting the implementation of Public-Private Investments in Peru

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1. WHAT IS THE CURRENT SITUATION?
2. PROBLEMS DELAYING THE START OF THE IMPLEMENTATION OF INVESTMENTS

AUTHOR

I. WHAT IS THE CURRENT SITUATION?

Much has been said and analyzed about the great need of the State to speed up the implementation of public investments in Peru and the urgency of addressing the gaps in infrastructure.

According to the data published by the Association for the Promotion of National Infrastructure (AFIN), between 2005 and 2013 the State undertook to invest over USD 15 billion, but has only allocated 50% of the aforementioned amount until the present day. Just in 2014, ProInversión awarded over USD 10 billion in the field of infrastructure through Public-Private Partnerships (PPP), in addition to USD 15 billion during the eight previous years. Among the most important works, the following should be highlighted: transmission lines, airports, road networks, metro line –accounting for 60% of the investment committed for 2014– and a gas pipeline.

These allocations were the result of highly complex processes of private investment promotion and tendering, even defined as controversial by some people, which entailed delays in the award of contracts. Due to these cases and similar past situations, the Public-Private Partnership Act and additional Laws were amended to improve and streamline these procedures in order to ensure more efficiency. Major efforts have been made to achieve this objective.

In fact, Peru is now well-qualified in terms of progress and reforms of its legal framework for PPP's, to the point of ranking first in the list published by "Infrascope 2012" –a position shared with Chile–. Infrascope 2012 is a tool developed by The Economist to evaluate the climate and environment to carry out private investments in PPP's.

Analysts and professionals specialized in the awarding process in Peru therefore agree that the problem is not regulatory, but operational; indicators also confirm this theory, as the country ranks fourth in institutional and operational maturity in relation to the development of PPP's.

Problems can be clearly detected already at the pre-award stage, where the decisions of the various sectors are not sufficiently aligned for the processes to flow smoothly: the lack of national, regional and local plans for infrastructure investment hinders the decision-making processes, since the priorities are not seen as a State policy. This translates into isolated actions and a

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duplication of the use of public resources. Moreover, promotion mechanisms are insufficient to generate greater interest among the private companies which build infrastructure globally and this, again, leads to the absence of public infrastructure projects selected and prioritized in an attractive portfolio for the private sector.

Despite all the problems that the awarding processes entail, post-award processes are even worse. The obstacles of this procedures greatly delay the start of the works and therefore the implementation of the investment, reducing its capacity to reactivate the economy and diminishing its potential to promote a GDP growth.

2. PROBLEMS DELAYING THE START OF THE IMPLEMENTATION OF INVESTMENTS

There are several factors, but we will focus on the four most critical elements:

- Faulty design of the awarding contracts
- Informality in the ownership of Properties, Expropriations and Interferences
- Environmental Impact Assessments (EIA)
- Approval by the Local and Regional Governments

2014 PPP's Investment (USD Million)

SECTOR	COMMITTED INVESTMENT	CURRENT INVESTMENT	PENDING INVESTMENT
Energy	642	0	642
Hydrocarbons	3.643	0	3.643
Real Estate	6	0	6
Penitentiary	4	0	4
Harbors	129	0	129
Health	94	0	94
Telecommunications	179	0	179
Transport	5.612	188	5.424
Tourism	18	0	18
TOTAL	10.327	188	10.139

(1)Includes road, airport and rail projects.

Source: Regulatory Organizations, ProInversión, Sectors

Drafted by: Association for the Promotion of National Infrastructure (AFIN)

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FAULTY DESIGN OF THE AWARDING CONTRACTS

When an awarding contract is signed it is difficult to have a clear picture of what will happen in the economic, social and political sphere during the life of the project. This is due to the characteristics of each case and the territorial differences in the areas where the works are carried out. This problem is even worse due to the long duration of the contracts.

Even during the phases of prefeasibility and feasibility studies there could be reasons to include addenda in the agreements, whether by the need to carry out further works, advance them or other reasons. However, not all applications submitted by either party end up as an addendum, since all parties must agree for it to be accepted.

If we take a closer look at the available data, the main factor for these addenda refers to the terms of construction of road infrastructure and the rehabilitation of roads, accounting for over two-thirds of the concession addenda signed so far. This shows that there are severe deficiencies in the information (indexes) used to establish the terms of reference for the construction of these works.

Furthermore, there are the background addenda and the definitions, the awarding

terms and guarantees; points contained in the addenda of almost 50% of the awarded agreements. Definitions are a common problem due to the various possible interpretations of the terms of the contract.

Deadlines and guarantees are often affected by the delays in the expropriation of the land where the roads will be built. Thus, terms need to be modified and, consequently, so do guarantees. In this sense, for example, there are no mechanisms to ensure that the grantor hands over the land in a timely manner.

INFORMALITY IN THE OWNERSHIP OF PROPERTIES, EXPROPRIATIONS AND INTERFERENCES

If there is a bull that the State has yet to take by the horns, that is the expropriations and sanitation of land necessary for the development of projects; the obstacle par excellence. There are many cases of contracts that were awarded years ago which have suffered delays due to this problem. If we wish to obtain better results, we need to tackle this problem differently. Like most countries with mature and successful PPP programs, our system needs to manage this task since the contracts' design stage.

Several experts and regulators such as OSITRAN (Supervisory Agency for Investment in Transport) suggest that

“The procedure to obtain the rights of way is very complex”

ProInversión should have a special unit to identify, manage and structure the role of the State in this matter. In this way, once the agreements were signed, there would be mirror units in the sectors to take the next step and continue –and not start over again– the development of the project –and thus avoid the aforementioned addenda–.

Overcoming this problem and other related obstacles is crucial at this particular time in our history, because in no other period have so many projects been awarded as in the present moment. For example, just in PPP's, ProInversión allocated USD 11 billion in 2014, an increase of 134% compared to 2013. Among the most important projects are the South Peru Gas Pipeline, the Line 2 of Lima's Metro, the International Airport of Chinchero, the General San Martín Port Terminal in Pisco and the Transmission Line Moyobamba-Iquitos. Some of these projects have even already started, but the works will take several years to complete, while others must focus on the short-term, facing a series of obstacles that generate delays, unpredictability and above all, suspicion.

In all these projects, and even in those who were awarded many years ago, the processes of expropriation of land are usually so complex and slow –even though the State

undertook to deliver the land– that it ultimately needs to sign a series of addenda which will just delay the start of the works. As an example, we only need see what happened with the second runway of the Airport Jorge Chávez or Line 2 of the Metro in Lima.

To this should be added the fact that the procedure to obtain the rights of way is very complex as well, particularly in relation to transmission lines and national roads. This is due to the lack of clarity in the deadlines, the repeated consultations with involved entities and the excessive freedom that the involved sectors have; making it impossible to see the light at the end of the tunnel.

Analysts are warning about the lack of tools to overcome the problems in the expropriation processes. Some are linked to the formalization of the ownership of the land, which makes expropriations even more difficult, since property is not defined. And this is not a Law-related or regulatory problem, the problem lies in the way in which the State implements this policy and the management of the processes, as previously stated.

A more efficient option would be to give the management of the expropriations to the private sector once the award has been granted. This would allow them to be faster. The costs of private

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investment in these processes of expropriation could be covered by the State through a Fund, Trust or any Multilateral Agency. AFIN even suggests that the Fund could be possible by allocating 5% of the awarded investment – value of the work–.

ENVIRONMENTAL IMPACT ASSESSMENTS (EIA) FOR MINING ACTIVITIES

The Ministry of Economy and Finance (MEF), in its latest package of measures to reactivate the economy of Peru, included a set of initiatives which were sent to the Congress, with elements such as the consolidation of the processes prior to the approval of the Environmental Impact Assessments (EIA). The Objective of the MEF is to integrate a series of permits which came from outside the EIA to strengthen the EIA process.

Currently, if a company requests an EIA it needs to obtain several permits, such as water and forest resources' permits and these need to be obtained in sequence –that is, not at the same time– which greatly delays the process to obtain the EIA and, therefore, the implementation of the mining investment. Now, this package of reforms seeks to synthesize these procedures, to integrate them into a complete environmental license which should be approved at the same time by all competent

authorities, including the Ministry of Environment.

The project also expects several companies to share the environmental baseline. At present, all projects in the same geographical area must invest time to carry out the exact studies. But now, thanks to the regulatory change and the subsequent simplification, the first company needs to carry out this study and the information becomes public, so that the second and third companies can use the previous approval and integrate it into their study to speed up the process. This is expected to reduce the duration of the process by three and a half years.

Finally, to speed up the management, several penalties and procedures have been introduced in order to ensure that public servants meet the deadlines in the approval of licenses for investment projects.

PPROVAL BY THE LOCAL AND REGIONAL GOVERNMENTS

We cannot fail to highlight the approval by regional governments, the studies and opinions –binding or non-binding– carried out by several national and sub-national state bodies which quite often voice their opinions in an untimely manner, or do not say anything, or discuss issues outside of their competence.

“Our economy has grown at a fast pace but the regulatory framework and the bureaucratic processes have not kept up”

During the 2014 CADE event, Álvaro Quijandría, regional manager of investment climate in Latin America and the Caribbean of the International Finance Corporation (IFC) of the World Bank, suggested generating a shock to foster investments until 2021.

The IFC stated that in recent years, huge efforts have been made to streamline procedures so as to attract investment and this has helped the country climb positions in the Doing Business ranking. However, the huge growth of the economy calls for a faster advance.

The goals of the competitiveness agenda have been met by 70% and that is good news for Peru, who seeks to achieve the global levels. Between 2007 and 2014, great progress has been made: for example, the time needed to start a business has been reduced from 72 days to 26, according to the IFC.

Likewise, according to the Doing Business Report, the reforms implemented to date, which range from opening a business with fewer costs to removing the requirement of obtaining several pre-approvals to start a business, have entailed positive results.

However, Peru is lagging behind in the management of regulatory processes compared to other countries. Our economy has grown at a fast pace but the regulatory framework and the bureaucratic processes have not kept up.

In line with the simplifying approach and speeding up in the bureaucratic processes, the World Bank suggests a shock to foster investment between 2014 and 2021 to tackle three elements: large projects, sector procedures and massive investment.

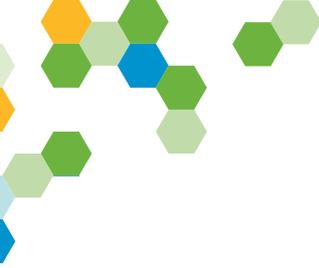
In this sense, the IFC argues that the plan must include two main points: alignment and leadership. Alignment for the institutions to correct cross-cutting issues and leadership at the highest political level to track progress.

In relation to the large projects, the IFC considers that works such as the Investment Monitoring Special Team of the Ministry of Economy and Finance (MEF), led by the Minister Alonso Segura, should be institutionalized so as to provide assistance to investors during the whole cycle.

As regards sector procedures, the Minister of Production has done a good job by analyzing the processes that delay the permits and other sectors should do the same.

Finally, in the case of massive investment, the municipal permit procedures should be merged so that all 180 municipalities of the country have the same procedure. At the same time, it should be done via the new online platforms.

While our fragmented policy makes reforms and improving



“Peru should try to be a member of the OECD by 2021”

the procedures more complex, the pending amendments could be based on two points according to the IFC:

- **First:** Peru should achieve the best practice in Latin America as regards critical procedures to start businesses and obtain construction permits.
- **Second:** Peru should try to be a member of the OECD by 2021, reinforcing the following pillars: payment of taxes, enforcement of contracts, resolution of insolvency and management of construction permits.

To conclude, it should be noted that reactivating the “animal spirit” of investors calls for an ambitious reform program with clear and measurable goals, clear deadlines and a high-level leadership: a “facilitator shock” and a “trust shock”. This is the main challenge for the remainder of the Humala Administration and, even more, for the next party in office, regardless of its political ideology.

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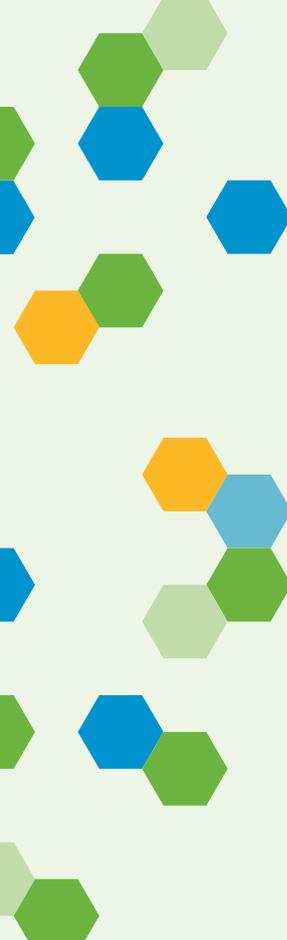
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