Contract Renegotiation: Chilean Case

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Agenda

• Chilean PPP System
• Current regulation
• Some Results
• Case: Contracts Renegociation
• New regulation
• Conclusions
Chilean PPP system

Problems to solve (early 90’s):

- Infrastructure deficit
- Barriers/bottlenecks to economic growth

Solution:

- Promote private participation in infrastructure provision
- Public-Private Partnership (PPP or concession)

Concession: Private company (design) finance, build and operate during a pre-established term and then return the infrastructure to government.
Chilean PPP system (continuation)

Conditions:

- Maintain fiscal discipline
- Maintain process of reducing the public debt
- Improve efficiency: Bias in investment v/s maintenance
- Financing by users
Chilean PPP system (continuation)

Implementation:

- Infrastructure bond.
- Institutional side: Concessions Unit at the Ministry of Public Works.
Current Regulation

Key features:

- Ad-hoc legal framework
- Open to competition
- Open to private initiative
- Concessions can be sold
- Clear conflict resolution system
- Finance guaranties
Current Regulation (continuation)

Actors involved:

• Concessions Division at Public Works Ministry
• Finance Ministry
• Planning Ministry (Social Evaluation)
• Comptroller General of the Republic
• Other Ministries (constituents)
Some Results

Public Infrastructure Investment 1990-2005

- Inv. Privada
- Inv. Pública
Summary of Results

US$ 10 billion investment

- 1.520 km Ruta 5 interurban highway
- 400 km other highways
- 6 urban highways (free flow toll system)
- 6 Jails and the Justice Center
- 8 Airports
- Various other public infrastructure
- Deepening financial markets
Case: Contracts Renegotiation

Problems observed:

- Gran número o grandes montos
- Overruns on average from 30%
- In some cases reaching 100%
- Difficult to predict – fiscal surprises?
- Payment is a result of bilateral negotiation (no competition)
Case: Contracts Renegotiation
(continuation)

General explanations:

• Contracts are incomplete
• Long term contracts
• Variables with uncertainty (demand, demography, economic growth, macroeconomic variables, politics)
Case: Contracts Renegotiation
(continuation)

Some concrete reasons:

- Needs of expansion
- Aspects not covered by the contract
- Incomplete studies
- Conflicts between government and dealers
- Enhanced standard
- Social needs
- Politics decisions
- Emergency political concessions
- Opportunities
Case: Contracts Renegotiation  
(continuation)

Current Regulation:

• Looking after “Restoring the financial balance of the contract”

• Characteristics
  • Any change could have financial impacts on the contract
  • Must be authorized by the Finance Ministry
  • Protracted negotiations, so there must be a quick reaction mechanism

• To restore the balance we can establish:
  • Payments of the government
  • Increased tariff
  • Time extension.
Case: Contracts Renegotiation
(continuation)

However...

• Government captured by the company (urgent works, works already undertaken, etc.).
• Sometimes it is aimed to correct a problem generated by pre-contract studies, then traded fast and therefore, the results are not the best
• Asymmetry of information about the real costs (labor, financial)
New regulation

Unilateral modification:

• Government can ask for better levels of services
• During both construction or operation stage
• Maximum of 15% of the initial budget
• Before 75% of the term of concession
• If during operation, works must be bidded.
New regulation (continuation)

Agreement modification:

• During construction, if it’s more than 25% of the initial budget, concession is terminated
• During operations, no limit, but works have to be bidded
• Net present value of the marginal project must be zero
New regulation (continuation)

General improvements:

- Government can terminate the contract if it’s necessary (of course with compensations for the concession company).
- Concession must be terminated if modifications during contruction are over 25% of initial budget
- Council of concessions must approve modifications
Conclusions

Despite good regulations, the efforts to avoid contract modifications should be oriented to:

• Good quality engineering studies
• Correct contract specification
• Efficient risk allocation
• Correct contract selection (BOT, DBOT, PBC)
• Feedback
• Budget provisions
Conclusions (continuation)

- Realistic times
- Look at short and long term
- Flows have to be estimated not expected
- Disclosure of information
- Comparations between public or private provision
- Check & balance
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