

UK-Brazil Infrastructure Task Force 2018

This paper sets out key issues emerging from the 4th meeting of the Task Force in London on 11th May 2018. These recommendations will feed into discussions at the upcoming UK-Brazil Economic and Financial Dialogue (EFD).

The Task Force was very successful in reinforcing two important points: infrastructure is an attractive asset class, and that Brazil has the ability to attract significant capital - despite its credit rating sitting below investment grade and that its rating is unlikely to change in the near future.

1. The Infrastructure Programme and Planning

Context

Brazil has successfully demonstrated capacity to implement a model of Private-Public Partnerships in large strategic infrastructure projects.

The evidence for this is:

- In 24 months Brazil has been able to auction 100+ projects in diverse segments as O&G, Power Infrastructure and Airports. Contributing reasons for this:
 - The creation of PPI and the Special Secretary with Minister status.
 - An improvement on the quality of the projects (Legal, Regulatory, Environmental Financial/Economic Model and Engineering Definitions);
 - Commitment of talent and experience: a small group of project finance and infrastructure professionals procured from many different areas of government, academia and even selectively from the private sector;
 - Strong political articulation with other Ministries (Secretary linked to the President and to a Minister with high delegated power).
- Recognition at a State level that São Paulo, Bahia and Piauí are also following the same route and achieving success (i.e. São Paulo concessions of Subways and Roads).
- Many of the projects cited above were done without the presence of any subsidy or public enterprise. There is evidence that some of the States are already addressing local capital markets and raising debentures.

Recommendations

Brazil must achieve scale (more projects) and breadth (more types of infrastructure assets and more regions and municipalities) – and the UK can help achieve this.

- On geographical expansion: The UK should investigate how the UK Prosperity Fund could be used to support the Brazil PPP programme and in particular how to support state and municipalities develop frameworks for PPPs and actual projects.
- To achieve scale, the Brazilian Government (Federal, State and Municipal) need to:
 - i. Further develop technical teams on 2nd and 3rd levels of government hierarchy;
 - ii. Standardise processes to create, structure, regulate, evaluate, bid and finance, and ensure that processes are consistent with international best practice, so as to encourage international investment;
 - iii. In view of the fact that State and Municipal levels of indebtedness have reached their limit, explore mechanisms to facilitate investment within these limits.
- To help encourage UK participation in Brazilian infrastructure projects, establish a matchmaking system – attracting companies and establishing linkages between UK and Brazilian private sector interests. This should be led in the UK by DIT, particularly the Sector teams, and supported by Taskforce members.
- Develop a National Infrastructure Plan for Brazil. Leverage the private sector to engage in this vision, to buy in and maintain the governance of this. The UK have had a National Infrastructure Plan since 2010 with multiple iterations and so this experience can be leveraged as well. IPA can coordinate the UK Government support working with the National Infrastructure Commission.
- As part of the National Infrastructure Plan, publish a pipeline of diversified projects at both a national and sub-national level, covering all major sectors and regions. Sufficient detail (project information, support package, etc) should be available to allow effective promotion of the projects. The Taskforce can support any roadshows in the UK.

2. Attracting private finance into infrastructure

Context

The Infrastructure financial instruments and markets are in the midst of a difficult transition – leveraged by a new lower real interest rate and by a new role of the federal banks (BNDES, Caixa and Banco do Brazil)

- Federal banks are finished with subsidising loans, and at the same time, the capital markets are not providing sufficient liquidity
- Currency volatility (of the Real), particularly in the current context of the world political economy is a large deterrent to foreign investment in Brazil.
- There is a significant opportunity to use guarantees, credit enhancement structures and ECAs.
- There is a need to establish a liquid secondary market for equity investments. This will help encourage more foreign investment.

Recommendations

- On currency risk instruments Brazil should develop a suite of financial instruments to offer currency protection to international investors and so help create more liquidity in the forex market. UK Export Finance can provide guarantees to banks who provide loans in local currencies, such as Reais, to buyers who need to borrow to purchase goods and services from UK contractors. This does not provide a full foreign exchange solution but it does allow that buyer/borrower to fix the amount of its borrowing in Reais at the time it pays for the goods.
- Brazil should develop a suite of guarantee and credit enhancement products designed to create more liquidity in the capital markets and attract foreign capital including through specific projects related to sustainable infrastructure. The IPA can share UK's experience with the UK Guarantee Scheme and Green Investment Bank.
- Brazil should explore mechanisms for establishing a liquid secondary equity market. Any approach needs to recognize the dependence of a liquid secondary market on a liquid forex market and availability of longer term loans. The investment members of the Taskforce can assist with this.
- Nowadays infrastructure debentures are issued mainly focusing the domestic market and the demand by individual investors. Due to significant international liquidity, it is appropriate to stimulate the placement of debentures in international markets, extending the income tax exemption. Furthermore, this benefit could be extended to domestic pension funds to promote the demand for this type of asset.

3. Public procurement

The public procurement approach in Brazil was based around a domestic infrastructure market. A combination of Lava-Jato and the need to attract international suppliers and investors means reform is needed.

Context

- After Lava-Jato, Brazilian society will be focused on fair competition for its public procurement and total transparency.
- Brazil is in the process of developing advanced bilateral international agreements and all of them include bilateral governmental purchasing agreements. Brazil also just signed a Double Taxation agreement with Switzerland.
- Brazil is reviewing its public purchasing laws – insurance rating will play a very relevant role in these new processes, particularly in completion guarantees.
- However, the fiscal situation of the Brazilian treasuries (at all levels - Federal, State and Municipal) is problematic.

Recommendations

- Brazil should consider establishing a procurement approach based on the Competitive, Dialogue mechanism adopted in the UK off the back of EU Procurement legislation. The UK has practical experience of how this should be best used on PPP projects.

- Brazil should leverage international best practice and global standards in contract drafting, negotiating, management and design, together with capacity building measures. Brazil should also look to improve certainty around contract enforcement.
- Brazil should look to reduce the “red tape” associated with private sector involvement and investment in infrastructure in particular in the areas of procurement, consents/permitting, tax and insurance. Brazil should consider how standardization could be used to make procurements more efficient – recognizing that standardization has to be used selectively.
- Brazil should consider the appropriateness of the regulatory model to the infrastructure programme recognizing that it will not be suitable for all sectors.
- Consideration should be given to the use of surveyors and the certification of “Ready to BID Documents and Plans” (as per the RICS in the UK). This would go a long way to increasing the attractiveness of Brazilian assets.
- To support all this activity Taskforce members can help facilitate and run a programme of workshops to help educate stakeholders.

4. Other general points:

- There is scope for more collaboration between the relevant institutions in Brazil and the UK; i.e. IPA, NIC, ITRC in the UK and PPI and ABDIB in Brazil. Consideration should also be given to including representation from state PPP units.

5. Conclusion

- The Taskforce were keen to meet again and provide support for the follow up on these recommendations as well as debating other issues.
- The next step would be for a small group to come together to agree priorities and next steps.