

Public Private Partnership (PPP) in Latin America's Infrastructure Market and Policy Suggestions for Korea

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I. Introduction

Traditionally Korean construction firms have actively invested in Middle Eastern countries. However, the centralization of investment in the region is not sustainable for Korea since the economy of the region is vulnerable to oil price fluctuations and keen competition among Korean firms is being witnessed in the market. Korean construction enterprises are faced with the challenge to find a new investment destination to replace the Middle East. Latin America has emerged as an alternative. The purpose of this study is to suggest policy and business recommendations for Korean companies to identify investment opportunities in Latin America, especially in Public Private Partnership (PPP) projects. This study focuses on four countries – Chile, Mexico, Peru and Columbia – where PPP laws and institutions are relatively well developed.

II. Features and Development Potential of Latin American Infrastructure Market

In Latin America, the investment in infrastructure has been led by governments. However, the importance of PPP is growing, as fiscal revenues are decreasing in many countries due to the fall of commodity prices. Private investment in infrastructure in Latin America is outpacing other emerging economies. Latin America accounts for about 43% of the total private investment in infrastructure among developing economies.

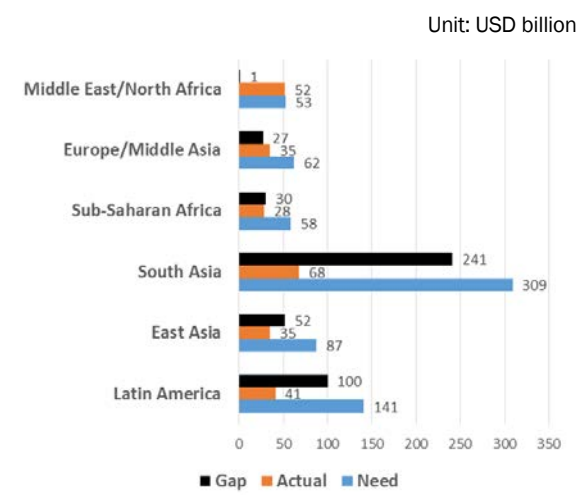
Table 1. Share of Private Investment in Infrastructure among Developing Countries

Region	Unit: %	
	1990-2010	2011-2015
Latin America	37.7	43.1
East Asia/Pacific	19.5	11.9
Europe/Central Asia	14.8	20.9
Middle East/North Africa	4.9	3.3
South Asia	16.6	14.0
Sub-Saharan Africa	6.5	6.8
World	100.0	100.0

Source: World Bank, PPI Project Database (accessed July 29, 2016).

PPP is especially active in Brazil, Colombia, Chile and Peru. Among foreign firms, Spanish companies have the strongest presence in the PPP market of Latin America. Yet the competitive landscape is changing; while Spanish and European firms are losing their market share, Chinese and American enterprises are broadening their presence. Traditionally, investment in infrastructure has been concentrated in the ICT and electricity sectors but investment is being diversified into other sectors such as airports, railway, road, water and sanitation.

Figure 1. Demand for Investment in Infrastructure by Region



Source: Ruiz-Nunez et al. (2015), p. 15.

In Latin America, the share of investment in total GDP is about 3%. However, this share should be raised to 5% for the region to maintain an economic growth rate of at least 3%. Thus the development potential of infrastructure is high in Latin America and many countries demonstrate a strong political will to implement their development plan. When considering each country's need for economic development, there is a high demand for investment in such economic infrastructure sec-

tors as water and sanitation, roads, urban transportation, and social infrastructure sectors such as trade, and health and medical treatment.

III. The Environment for PPP and Successful Investment Cases by Foreign Firms

Latin America has a less favorable PPP environment compared to other regions such as Asia. However, Chile, Brazil, Peru, Mexico and Colombia show promising conditions for PPP and hold a high rank among all developing countries. This is because these five countries have clear laws and institutions regarding PPP, and abundant experience with PPP projects. This study focuses on Chile, Peru, Mexico and Colombia and finds some similarities among these nations: 1) they have exclusive organizations for PPP, 2) projects with private initiatives are encouraged, 3) risks are transferred more to private sectors and subsidies from government are decreasing, 4) and there are growing projects in social infrastructure.

We select some subsectors of infrastructure which have high demand for PPP projects. We also study several cases of foreign investment in each subsector: electricity in Mexico, transportation in Peru, health and medical treatment in Chile, and water and sanitation in Colombia. In the first case we examine Iberdrola, a Spanish electricity company operating in Mexico, and its success factors. Iberdrola built up a network with CFE (Federal Electricity Company) by conducting technical cooperation, anticipating demand in renewable energy and development-related projects, winning contracts by offering low prices and then recovering its losses through re-negotiation. The sec-

ond case is a Spanish-Italian consortium in Peru which was awarded the Metro Line 2 Project in Lima. The consortium attained world-level competitiveness with ample experience in metro projects in other countries. It carried out a feasibility study for the Lima Metro Line 2 and this experience gained it a favorable position at the bidding competition. The third case is the San Jose Group in Chile, which won the project of establishing hospitals. The success factors for this company are localization and risk diversification. The company localized itself in Chile and continuously participated in bidding projects. The developer, investors and Chilean government worked closely together and successfully dispersed the investment risk among themselves. The fourth case is a Spanish firm in Colombia which engages in water and sanitation projects. Finding itself with insufficient funds to carry out a project to expand water treatment facilities, the Spanish firm successfully negotiated with the local government to attain a subsidy. The case shows the importance of government subsidies.

IV. Role of Multilateral Development Banks (MDB) in PPP Projects

Latin America has several regional MDBs, such as the Inter-American Development Bank (IDB) and Development Bank of Latin America (CAF). These banks play a crucial role for PPP projects: they finance projects, support member countries to improve their PPP environment, and provide PPP-related information. IDB manages an infrastructure fund to finance projects and feasibility studies. CAF places more of an emphasis on infrastructure projects than other MDBs. The bank has high potential for collaboration with Korean firms since it allows access to firms from

non-member countries, such as Korea, should they conduct projects in Latin America.

V. Recommendations for the Korean Government and for Korean Firms

Korean firms' investment is concentrated in the Middle East and Asia. During January of 2012 and September of 2016, investment in the Middle East accounts for 54.5% of total investment and flows to Asia take a share of 30.8%. Korean firms need to diversify their investment destinations. We recommend for them to find opportunities in Latin America.

Table 2. Korean Firms' Overseas Investment in Construction

		Unit: USD billion, %
Region		2012-2016.9
Total	Amount	7,406.6
	Share	100.0
Middle East	Amount	4,038.9
	Share	54.5
Asia	Amount	2,279.0
	Share	30.8
Latin America	Amount	382.1
	Share	5.2
North America	Amount	298.5
	Share	4.0
Africa	Amount	219.6
	Share	3.0
Europe	Amount	188.5
	Share	2.5

Source: International Contractors Association of Korea (accessed September 28, 2016).

We offer four suggestions for firms: 1) firms need to understand the change in the infrastructure market toward more projects being planned in a PPP scheme rather than solely financed by the government, 2) the development level of the PPP environment differs by country, and thus firms need to prepare a cus-

tomized strategy by country, 3) strategic alliance with local or foreign companies is crucial since they understand the local market well, 4) collaboration with regional MDBs, such as the IDB, CAF and CABI, is recommended. This study also suggests the following policy recommendations for the Korean government: 1) The government can establish a government-business council and support Korean firms to win PPP contracts; 2) Incentives need to be provided to promote joint overseas business between conglomerate and small and medium-sized firms (SMEs); 3) ODA projects can be planned to identify infrastructure development demand in Latin America, and then the projects can be developed into PPP projects later, or feasibility studies for privately initiated PPP projects can be financed by ODA funds; 4) A formal cooperation system can be built between the Korean government and MDBs to facilitate Korean firms' access to MDBs; 5) Exchange of personnel from PPP-related institutions from Korea and Latin America can support Korean firms to acquire information and win projects. **KIEP**