FLUID FOUNDATIONS


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José Luis Vittor, partner at McDermott Will & Emery, considers the sources of investment to fund the expansion of Latin America's water infrastructure

There are few regions of the world where economic development is more directly linked to water resources than in Latin America. The region has 8 per cent of the world's population but holds 31 per cent of its fresh water reserves. Water provides a full 68 per cent of the electricity generated in the region, far more than in many other parts of the world, and plays an important role in economic sectors such as agriculture, energy and mining. Yet water infrastructure remains a major societal concern in Latin America. Even though the region as a whole is in a position to meet the United Nations Millennium Development Goals for access to safe water, statistics from the Inter-American Development Bank (IADB) show that around 85 million persons in Latin America still lack a water connection to their homes and 110 million lack access to proper sewage infrastructure.

The simple fact is that water infrastructure in many countries has not kept pace with growing population needs, which also reflects a failure to fully develop a more comprehensive water regulatory structure. Prior to 1990, many Latin American countries (for example, Argentina, Colombia, Panama and Peru) organised their water industries as national monopolies under the direct control of the central government. State-owned water companies were more often being treated as part of the political apparatus than allowed to function as efficient service providers, leading to overstaffing, artificially depressed tariffs, political targeting of new investments and politicised contract awards.

State ownership often resulted in a high-cost, low-service infrastructure with a scarcity of resources for development. Growing dissatisfaction with the performance of the national monopolies, combined with wider political pressure for decentralisation across all areas of government, created the conditions for a move toward decentralised control in the 1990s. In countries such as Argentina, Colombia and Peru, this entailed a sudden fragmentation of the industry with an increase in smaller municipal providers. Even after reducing private sector participation, many of these countries have unsatisfied basic needs and water and sewage infrastructure seem still to be lagging behind the needs of the population.

Private sector efforts

There have been some notable successes in creating public-private partnership (PPP) initiatives to expand water infrastructure investment. Cities like Santiago, Monterrey, Medellín and São Paulo produced successful models that showed that public, private and mixed capital operators can work together on innovative ways to improve water access sustainably.

There has been significant private investment in water infrastructure throughout Latin America. For example, in 2007 Peru sought to fund a US$4 billion overhaul of its ageing water systems when water regulator SUNASS offered bonds with 25 to 30-year maturities in which the country's private pension funds could invest. This comes as Peru embarks on an expanded programme of drinking water and waste water public-private partnerships, which began with the Huachipa water treatment plant in 2008, and continue with a 25-year bond offering for the Taboada waste water treatment plant, which is due to be tendered next year. The Taboada project is expected to be partly financed by long-dated sol-denominated bonds, with local pension funds again playing a major role as investors. Such investments would help Peru meet international regulations linked to its free-trade agreements, which prescribe that exporters must treat their waste water.

It should be noted that privatisation of water services in Latin America remains controversial. Critics contend that the market rate pricing that comes with privatisation raises water and sewer rates beyond what extremely poor segments of the population can afford, and there have been notable instances in the past decade where privatisation concessions have been reversed.

Argentina's largest privatisation, the Buenos Aires concession, was signed in 1993 and revoked in 2006, an action that went to arbitration before ICSID. Critics and the government contended that the private operator failed to meet expansion and quality obligations; proponents said that Argentina's economic crisis reduced the real value of revenues and made achieving promised results difficult.

In Bolivia the government revoked the El Alto water privatisation concession in 2005 granted to French water company Suez, five

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years after a similar ousting of the US' Bechtel from Cochabamba. Protests over alleged high rates and poor service spurred both moves. In several Mexican cities, water privatisation concessions granted to various international companies have come under fire. The tourist resort of Cancún (concessions granted first to Azurix, then to Suez's water subsidiary), the city of Saltillo (concessions granted to a Spanish corporation, Aguas de Barcelona, another Suez subsidiary), and the city of Aguascalientes (contracts to a subsidiary of French transnational Vivendi) all have seen substantial controversies over both rates and quality of service. And in Uruguay, the transfer of services to the private sector started in the Maldonado department, firstly with the presence of France's Suez Lyonnese Des Aux, followed by Spain's Aguas de Bilbao. Due to high expectations of private providers and several complaints with respect to water-quality standards and tariff increases by a sector of the population used to state-subsidised prices, the resulting backlash caused a referendum that the government of Uruguay passed as a constitutional amendment in October 2004, prohibiting private-sector participation in the water sector and resulting in the withdrawal of concessions to major private companies that same year. Legislation was passed in 2005 to ensure wide participation in the planning, management and control of water-sector activities.

Multilateral investment

Additional water infrastructure capital has also come from such multilateral organisations as the World Bank and the IADB. For example, in 2008 the IADB made a US$200 million loan to expand potable water and sanitation services in Buenos Aires. The project, part of a wider expansion programme, is the first of a US$720 million conditional credit line for investment projects approved by the IADB. Over the past three years, the IADB has approved more than US$4 billion in financing for water and sanitation projects that have benefited at least 30 million persons in Latin America. Part of this investment reflects sovereign wealth funds. Spain in 2008 pledged to donate US$1.5 billion for a fund to improve water and sanitation services for the poorest communities in Latin America and the Caribbean. To date, the IADB and Spain have jointly announced programmes in Haiti, Bolivia and Paraguay. In all, Spain and the IADB will mobilise US$620 million for projects that will benefit 4 million people, of which US$420 million is being contributed by Spain.

Montero, a town of around 90,000 people in the tropical lowlands of eastern Bolivia is home to an example of a recent successful multilateral project. Montero's water and sanitation services are provided by the Cosmol water cooperative. Plagued by poor service, inefficient management and inadequate investment, Cosmol underwent a thorough reorganisation in the early 2000s, which included raising water rates, raising several million dollars in local investment capital and securing a US$6 million IADB loan to improve water and sewer capabilities. Today Cosmol is self-sustaining, and 97 per cent of the families in its region have quality water and sewer service.

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Foreign investment

Latin America's infrastructure investment picture could improve as more capital comes from other sovereign wealth investors – particularly China, which is becoming an increasingly important player in the region. China now does more than US$100 billion in trade with Central and South American countries (20 times more than just 10 years ago) and is making substantial sovereign wealth investments in the region. Much of China's current Latin American investment is aimed at energy infrastructure development, but Chinese companies also have a promising role in other basic, regional utilities and infrastructure projects. There have already been Chinese investments in ports in Brazil and hydroelectric power in Ecuador. Moreover, now that China has joined the IADB and assumed a role in the IADB's socially conscious projects, the country will invest a further US$350 million, including efforts to mitigate poverty and to provide potable water and infrastructure improvements.

There are other national investment sources that are pursuing an increased Latin American presence, including from Asia (such as Korea, Vietnam and India), Russia and the Middle East. These countries are already present as investors in the region, a change from three years ago.

For such foreign investment to continue, Latin American countries must convince investors worldwide that the region as a whole is very sensitive to political change, and that in the long run, Latin America is a good place to be – even though certain countries may still have some political risk. European investors have traditionally been more accustomed than Americans to working within the frameworks of Latin culture. Significantly, Latin America has not entered into a forecasted deep recession during the financial crisis, so the region is emerging stronger than anticipated from the current crisis and is poised to show the world that the region offers good investment opportunity. The high level of economic activity in the region is typified by the findings of the Organization for Economic Cooperation and Development (OECD) assessment of the regional economy, released in November 2009. According to that assessment of the Latin American region, in 2009 the region's GDP declined by less than half of the average for OECD countries and the region's economic recovery in 2010 is expected to be substantial.

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Regional water trends

This discussion of private sector, multilateral and foreign investment makes it clear that the major regional trends on water infrastructure development that have already emerged will continue to advance. Fundamentally this means that, while privatisation of water infrastructure has not been eliminated, the trend toward privatisation has greatly diminished since the 1990s. According to the most recent information from the World Bank's Private Participation in Infrastructure database, during 2008 in Latin America and the Caribbean only Brazil and Guatemala had new private water projects reaching financial or contractual closure. Brazil had seven, with investment of US$800 million. Most of these involved concession contracts between the federal and/or state governments with both local and foreign private water companies for water and sewage utilities. In Guatemala the departmental government of Izabal signed a 25-year concession with the Uruguayan Grupo Seinco for the water and sewerage utility of the municipalities of Santo Tomás de Castilla and Puerto Barrios.

Although transnational water companies have suffered setbacks in places like Puerto Rico, Bolivia and Uruguay, they still continue with plans to develop the region's hydrological resources – rivers, aquifers, wells and aqueduct systems. However, "privatisation" has become a loaded term in the water business, and these companies more often refer to their projects as "sustainable development" or similar politically neutral phrases. It is unquestionable that privatisation is more controversial now than it was a decade ago. There is no question that privatisation will continue, but it will be only one of multiple infrastructure financing sources, along with foreign, multilateral and joint public-private sources.

Effective public policy is the best assurance that water infrastructure investment in Latin America will continue to expand. Government spending has played and will continue to play a major role, and private water infrastructure spending should be substantial. Latin America stands to benefit from both multilateral development agencies and from foreign investment, with China a growing source of the latter.

Achieving more infrastructure spending beyond that of these sources depends on the balanced use of public-private partnerships (PPPs) as a tool for government access to private-sector capital to develop public infrastructure projects that historically required government development. The public-private partnership process is moving forward in Latin America, reflecting the demand for infrastructure development and investment. Countries like Chile and Brazil are attractive markets for Latin American investment preferences with strong internal investment capacity. Peru's largest bank has recently made a debt placement in Chile, raising US$110 million. The money came from institutional and private investors in Chile, because in Chile, the pension system currently has a huge investment capacity due to the country's substantial pension savings. Such developments, in which investment comes from within the region itself, are the best assurance that Latin America's infrastructure investment needs could be met.

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