Colombia’s Gradualist Approach to Private Participation in Infrastructure

Like the model adopted by many Asian countries, the Colombian approach to private participation in infrastructure aims to attract project financing for new facilities, leaving most existing assets in state hands. While the approach has been successful in attracting substantial private capital to Colombia, it has been less successful in delivering the potential efficiency gains or the reforms that will ensure that assets remain private and that private sector actions are constrained by a stable set of rules and regulations. Recently, Colombia has moved toward the model adopted by other countries in Latin America—privatizing existing assets—a policy likely to provide a more enduring basis for reform.

Three main factors have shaped the Colombian program. First, for many years, Colombia had the most stable economy in Latin America. A record of high growth and relatively low inflation earned the country an investment-grade credit rating, making it more attractive to foreign private investors (though lately the drug industry has undermined some of this stability). As a result of this record, Colombia has had great success in attracting private investment in infrastructure, particularly through project finance. It led Latin America in project finance in 1995 and ranked fifth in the world, drawing US$1.56 billion of loan finance for infrastructure projects. Private financing has been coming in for new power projects, toll roads, gas pipelines, and telecommunications lines. Some of these projects have been very innovative. For example, at El Dorado airport in Bogotá, a private firm is building a second runway at the airport while operating the existing runway in return for landing fees.

Second, state enterprises and their trade unions have been effective at resisting large-scale privatization of existing assets. An abortive attempt to privatize the state-owned telecommunications company in 1992 led to a week-long disruption of telephone services, weakening the political will for the kind of “big bang” approach that the Argentine government had pursued. So the government has instead chiseled away at the edges of public monopolies by phasing in competition and privatization only gradually. Until recently, privatization was confined to build-operate-transfer (BOT) contracts, although the government also set up private operating concessions in the rail sector and privatized the ports. Third, much of the country’s infrastructure is owned by municipal governments, and the central government has no legal authority to privatize these assets. As a result, it can only indirectly influence most of the privatization process, for example, through advice and financial support.

Colombia’s gradualist approach manifests itself in the three major features of its infrastructure program: the competitive framework, the different forms of private participation, and the development of the regulatory framework.

**Competitive framework**

The competitive framework within which infrastructure is provided is halfway between out-
right liberalization and complete monopoly. In telecommunications, for example, the country opened the sector through a phased program, starting with three regional duopolies in cellular telecommunications (although the cellular market will be opened to further competition in 1999). In each of the three duopolies, one operator has mixed public and private ownership and the other is fully private. A “managed” opening of the long-distance sector has been repeatedly postponed and is now being relegated to further study. The introduction of competition in long-distance services was meant to bring in two new competitors for the incumbent, Telecom, with the entrants to pay a fee for entering the market. The planned policy is similar to the approach taken by the British government, which started with a duopoly in long-distance services and opened the sector to new entrants seven years later. By contrast, Chile opened the sector completely, attracting six new private entrants. The fierce price competition that followed allowed Chileans to enjoy international prices that for a time were cheaper than those in the United States.

In power, the government recently set up a market for generation similar in some respects to those in Argentina and Chile—though it is more open and transparent because it allows generators to bid prices at which they are willing to generate (rather than audited costs) and it allows traders as well as generators to participate. The market has been in operation for only about a year. But most new private generation capacity has been sold through long-term power purchase contracts with public distribution companies at prices well above the prevailing power market price. Part of the reason for the low market prices is that most power is still sold through publicly owned and vertically integrated companies. Another factor contributing to the low prices has been the ample rainfall in the predominately hydro-based system. But the government has taken several steps to ensure that the market becomes more dominant in the future. It has refused to guarantee any future power purchase contracts and forced the distributors to purchase at least 40 percent of their power through the market. It has also adjusted the market rules to ensure that generators can receive a fixed capacity payment regardless of actual operation. This is meant to encourage new private entry into generation by reducing the market risks in the hydro-dominated market.

The shift to privatizing existing generation assets should also lead to more new investment as the new private owners become more comfortable with the market risks they face. Encouraging signs are also coming from new BOT generation deals. In the recent Termovalle project, for example, 20 percent of power generation has not been placed under long-term contracts and is available for sale through the market. Perhaps even more significant, the planned privatization of distribution, starting with the vertically integrated firm EPSA, should lead the way toward the creation of more creditworthy purchasing entities, further promoting the sustainability of reforms.

In contrast to the telecommunications and power sectors, among privatized ports competition has been vigorous. Prices have fallen by some 50 percent a year since privatization, and the quality of port services has improved dramatically, with productivity increasing by 60 percent and handling times cut in half. Even here, though, intervention continues, and temporary price caps and floors have been imposed to prevent competition from completely undermining the position of the highest-cost ports.

Ownership framework

The Colombian approach to ownership is eclectic, using models ranging from joint ventures and leases to outright privatization, with varying success. An important feature of the ownership framework is the degree of municipal ownership, particularly in water and sewerage. Municipal ownership also extends to “multi-utilities,” such as the Empresa Pública de Medellín, which combine electricity, local telephone service, water and sewerage, and other utilities. As mentioned, the extent to which the central government can dictate a privatization strategy to the municipalities is limited—part of the reason for the eclecticism.
The central government can only provide a series of carrots and sticks to try to prompt municipal authorities to move in the direction it wants them to go.

One popular approach to infrastructure privatization among municipalities has been to create “mixed” companies jointly owned by the public and private sectors. This approach allows municipal authorities to involve the private sector without completely losing control of corporate actions. A recent example is the joint public-private company established to provide water and sewerage services in Cartagena under a lease contract. The private operator runs the system and collects revenues, but the municipality retains the responsibility for major new investments. This arrangement has improved operating performance. But experience in other countries shows that separating operations and investment can lead to difficult disputes between the public and private parties because it shares the commercial risks of the contract between the two.1

Mixed companies are a popular transitional step in almost every privatization process. Governments argue that they can extract better value through phased privatization—selling shares in state-run companies in tranches—perhaps because the risk premium demanded by private investors diminishes as governments strengthen their credibility on the regulatory framework. But empirical studies of the performance of mixed companies suggest that they are less effective than either pure public or pure private ownership in the long run, possibly because of the potential conflicts of interest between the owners.2 It is thus unclear whether experiments such as Cartagena will succeed in the long run unless more efforts are made to limit the political interference inherent in the ownership structure.

Another interesting feature of the Colombian system has been the “subconcessioning” by public companies of parts of their services to the private sector. The public entity maintains the main interface with consumers, and the private sector provides a specific input under a contract with the public entity. Examples of such arrangements include the subconcessioning of rail services, the creation of subconcessions known as joint ventures in telecommunications (with equipment providers installing new lines), and the BOT contracts in electricity generation.

Although these subconcessions have had great success in achieving physical targets, they may be the least sustainable part of the program. For example, in the joint ventures set up to install new telecommunications lines, the contracts share the revenue risk associated with each line between Telecom and the private equipment provider, although the private firms receive minimum revenue guarantees. These contracts have been criticized as simply a means for Telecom to avoid budgetary restrictions and as an expensive form of financing. They do not increase competition or private ownership of the system.

In the rail sector, the provision of track and services has been separated, with the public sector retaining responsibility for the track through Ferrovias and private rail concessions providing services. This arrangement has led to disputes between Ferrovias and the private concessionaires over their responsibilities. The condition of the rail infrastructure has declined, and each has blamed the other for the sector’s poor performance. Following the reorganization of the sector, freight declined from 900,000 tons to 300,000 between 1989 and 1992, and passengers from one million to 125,000. The government is now creating a new arrangement allowing vertically integrated concessions of both track and services, which it hopes will overcome the problems in the current arrangement by placing responsibility more clearly in the hands of the private operators.

The electricity generation sector has attracted new generation capacity and private financing, but the government worries that it has been at the cost of excessive guarantees. In the future, new capacity will have to come onstream without extensive government support, relying more on the creditworthiness of the off-takers and revenue streams from the electricity market.
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Regulatory framework

Like other countries, Colombia has developed a series of regulatory commissions to regulate the private infrastructure providers. It now has regulatory commissions for energy, telecommunications, and water and sewerage. Although initially these commissions were to be essentially independent of the government, political fears of lack of control over the sectors led to the establishment of quasi-independent regulatory bodies with ministers sitting on the boards. Most of the commissioners appointed to the boards are independent of the government, however. But because most private participation has been through upstream contracts relatively unaffected by regulation, the actions and decisions of these regulatory bodies have not yet affected private firms significantly.

In the water and sewerage sector, the commission’s role is ill defined because of the dispersed public ownership, with more than 1,000 municipalities remaining the dominant service providers. Until there is greater private participation in water and sewerage, the commission’s functions are unlikely to become any clearer. In fact, unless regulatory decisions come to have a greater impact on private operators, the regulatory system is unlikely to be sustainable: with the regulators acting primarily to discipline public providers, conflicts of interest will arise as sector ministers continue to be both owners and regulators.

As in Chile, there is a division of labor in regulation between the regulatory commissions, which are responsible for developing the pricing and other regulatory rules under which companies provide services, and the Superintendency of Public Services (SPS), which was given a broad mandate in the 1991 constitution to ensure that the rules are adhered to and that the companies provide services efficiently. In practice, the roles of these agencies have not been closely defined, and a turf war could well ensue. Moreover, it is not clear whether such a division of labor makes sense. In describing a similar situation in the United Kingdon, John Kay, director of the Oxford University Business School, said that “separation between policy and administration could never work very well because, in any but the simplest of cases, it was impossible to make sensible decisions about what to do without being involved in doing it and difficult to do it well without some knowledge of and sympathy for the reasons it needs to be done.”

Only as more private providers come under the purview of the regulatory agencies is it likely that strong pressure will be exerted to ensure that the regulatory agencies work efficiently, with greater independence from the line ministries, and that the division of work between the superintendency and the regulatory commissions is clarified.

Conclusion

Colombia has attracted large amounts of private capital into its infrastructure sectors, primarily through project finance, an approach made possible by the country’s investment-grade rating. It has avoided the “big bang” route of outright privatization taken by Southern Cone countries such as Argentina and Chile. But in doing so it has made private participation more complex and potentially less sustainable because of the lack of clarity surrounding the public and private roles in regulation, operation, and investment. These problems have been recognized, however, and Colombia is now moving to privatize electricity generation and distribution and to set up rail concessions that give the private sector full responsibility for sector performance.

1 See, for example, Penelope Brook Cowen, “The Guinea Lease Five Years On” (Viewpoint 78, May 1996).

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