Argentina
Special Report

Infrastructure in Argentina: the Path Forward

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Related Research

- Newsletter, Latin America Quarterly, "Argentine Construction Sector: Lower but Sustainable Growth," May 23, 2007.

Overview

Through public-private partnerships (PPPs), private investors played a key role in the development of many infrastructure projects in Argentina during the 1990s. Many of these investors were forced to renegotiate the terms and conditions of their initial tariffs and concessions during the economic crisis, resulting in large losses on their investments. As a result of the continued regulatory risk, they have largely stayed on the sidelines since the crisis, placing the financial burden of infrastructure growth on the government.

The government has responded by increasing its spending on public works from about ARS4 billion in 2004 to more than ARS13 billion in 2006. While an active role from the government is certainly needed, both for the supervision of infrastructure expansion plans and for the partial funding of these plans, attracting as much private financing as possible would allow the current infrastructure deficit to be closed sooner. GDP growth in excess of 7% per year during the past four years makes the need for reform increasingly urgent, as large investments in roads, ports, railways and power need to be made to sustain economic growth and compensate for a shortage of private investments in recent years.

As we approach the upcoming Argentine election, no major headway is expected to be made in the creation of a solid and predictable framework for infrastructure concessions and project selection. Consequently, in the near term, Fitch Ratings expects additional investment requirements to be financed by the public sector, either through fiscal surplus or financial structures such as public trust funds.

In the post-election environment of 2008, some reform could take place. As a starting point, the public sector must better understand the benefits in terms of quality and efficiency that occurred from most PPP projects. Until they become convinced of the benefits of private participation in these projects, the public sector will remain concerned about the private sector's incentives to participate in public service projects. In the interim, the private sector will remain skeptical of participating in projects due to their distrust of the weak regulatory systems, late contract enforcements and possible political intervention.

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Infrastructure Financing: How Much Investment Is Needed?

Studies carried out by international organizations indicate the importance of infrastructure development. The report, "Infrastructure in Latin America and the Caribbean: Recent Developments and Key Challenges," of the World Bank (2005) specifies that the region needs to spend more money on infrastructure, not only to compensate for the existing shortages but to assure sustainable growth. The World Bankestimates that Latin American countries need to spend between 4%–6% of GDP per annum on infrastructure projects. Currently, Argentina spends about 2%–3% of GDP on such projects.

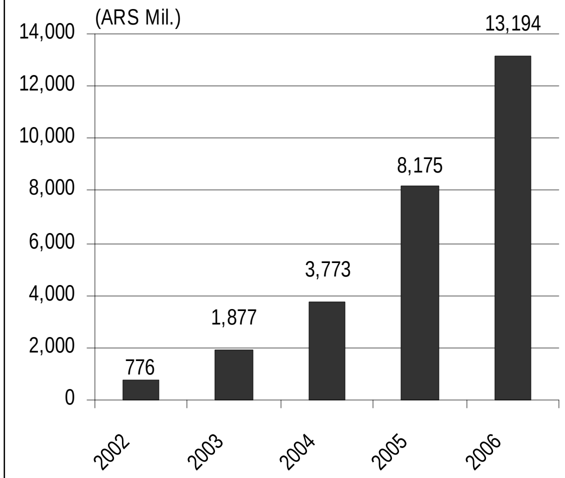
Among the sectors affected by infrastructure shortages, energy appears as the most critical, as the energy shortage threatens to limit future industrial growth. Current power capacity is nearly 18,000 megawatts (MW), which is close to peak demand. The system is running without any capacity reserves, and the current situation is similar to that of the early 1990s. GDP has grown at a fast pace and power capacity has not expanded over the past five years, resulting in demand for high- and medium-voltage transmission lines significantly in excess of capacity. Consistent with the continued expansion of the economy, annual investment needs are estimated at US$1 billion.

The agriculture sector is another example of an industry whose growth could be restricted due to infrastructure constraints. Production of agriculture-related products requires the support of facilities such as roads, navigable ways and ports, and storage centers. Lack of these facilities negatively influences competitiveness, as it affects costs, transportation and the use of potential production fields. Faced with an expected record harvest of nearly 100 million tons of crops during the 2007/2008 season, the importance of a developed road network becomes evident as more than 70% of the grain crop requires transportation via truck.

Change in Investment Patterns: the Role of Public Works

Patterns of infrastructure investment have significantly changed since the macroeconomic crisis of 2001. Due to the uncertain regulatory framework, private investors' appetite for local development has dropped, and as a result, the government has assumed a much more active role.

Public Works Spending

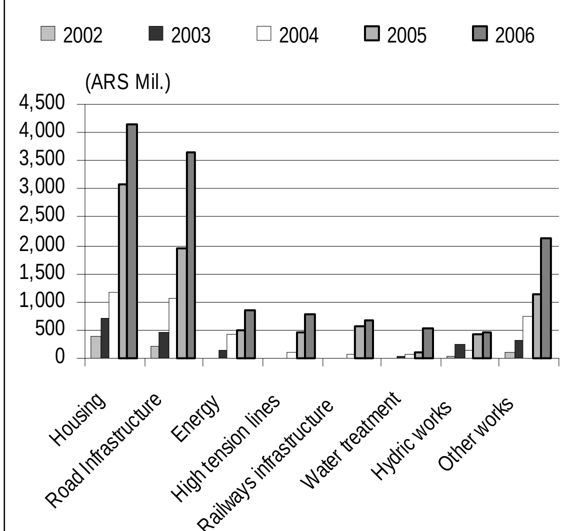


ARS – Argentine peso. Source: The Ministry of Federal Planning, Public Investment and Services.

Between 2003 and 2008, the Ministry of Federal Planning, Public Investment and Services is slated to spend about ARS60 billion on infrastructure. Projects included in these government programs include housing construction, road programs targeted to maintain and expand the existing network, and energy and public transportation.

During 2006, investments made by the Ministry exceeded those completed in 2002 (during the economic crisis) by 16 times (x).

Public Works Spending by Industry



ARS – Argentine peso. Source: the Ministry of Federal Planning, Public Investment and Services.

During 2006, housing and road construction represented 31% and 28%, respectively, of the total expenditures in public works, followed by investments in energy and high-tension lines, which together accounted for 12% of the outlays. When comparing these percentages with figures as of the first half of 2007 (+50% compared to the first half of 2006), the same pattern is observed, except that energy-related works increased to nearly 17% of total budget execution. With power capacity reaching its limits and affecting industrial growth, Fitch anticipates public spending going forward will be more focused on energy-related developments.

Contrary to what was observed during the 1990s, public works have been mostly financed through fiscal surpluses or financial vehicles such as infrastructure public trust funds. These funds are defined as when the government acts as the seller, transferring the collection of a certain tax or service fees to the trustee, with the purpose of applying them to finance specific infrastructure works. In some cases, funds for the construction of works are advanced by private players (i.e., potential corporate users) and are later repaid with the proceeds of such collections (after the public offering of the trusts).

The role of international organizations is also important for the development of infrastructure projects. As an example, in June 2007, the World Bank approved additional funding for the following projects: US$400 million to support the second phase of the National Highway Asset Management Project (following the completion of the first phase of the program, originally financed by a US$200 million World Bank loan that was approved in 2004) and US$270 million for the second phase of the Buenos Aires Infrastructure Sustainable Investment Development Project (key investments in the road sector to strengthen productivity in the province of Buenos Aires).

Despite spending by the government and the support of international organizations, it is critical that as much private financing as possible is attracted toward infrastructure projects to expedite the completion of energy and transportation projects. While the government has established the Regimen Nacional de Iniciativa Privada (the Private Initiative System) to encourage individuals to submit infrastructure projects (either for the construction of public works, concession of public works or services, licenses or any other procedure), a stable regulatory framework seems critical to stimulate private-sector interest. As of 2006, 18 projects were presented to the Ministry of Federal Planning, Public Investment and Services as part of the Private Initiative System and only three were approved as public interest projects.