

**PUBLIC ASSETS FINANCING IN NIGERIA: THE IMPERATIVES FOR  
LEGAL REFORMS TO UNLOCK DOMESTIC FINANCIAL RESOURCES  
AND FOREIGN CAPITAL FOR INFRASTRUCTURE DEVELOPMENT**

**by**

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## **DECLARATION**

I, the undersigned, hereby declare that this thesis submitted for the award of degree of **Doctor of Laws** is my original work and has not been previously submitted for the award of a degree at this or any other University.

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## **DEDICATION**

To God and father of our Lord Jesus Christ; the Alpha  
and Omega, and he alone that does great wonders.  
Blessed be your name forever.

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## **LEGAL INSTRUMENTS AND TREATIES**

Banks and Other Financial Institutions Act, Laws of the Federation of Nigeria, 2004  
Bureau of Public Enterprises (Privatization and Commercialization) Act 1999  
Bureau of Public Enterprises Decree No. 78 of 1993  
Central Bank Act No. 24 1991  
Central Bank Act No. 7 of 2007  
Constitution of Federal Republic of Nigeria 1999  
Cooperative Development Act, 1990  
Debt Management Office (Establishment, Etc.) Act, No. 18 of 2003  
Electric Power Sector Reforms Act, 2005  
Fiscal Responsibility Act 2007  
Foreign Exchange (Monitoring & Miscellaneous Provisions) Act, 2004 (“Forex Act”),  
Highways Act 1971  
Infrastructure Concession Regulatory Commission Act 2005  
Insurance Act 2003  
Lagos State Metropolitan Area Transport Authority Law 2007  
Lagos State Roads, Bridges and Highway Infrastructure (Private Sector Participation)  
Development Board Law  
Lagos State Water Sector Law 2004  
Lagos State Waterways Authority Law 2008  
Land Use Act 1978  
Nigerian Cooperative Society Act 1993  
Nigerian Investment Promotion Commission Act of 1995  
Pension Reform Act 2004  
Privatization and Commercialization Act, 1999  
Privatization Decree No. 25 of 1988  
Public Procurement Act, 2007  
Utilities Charges Commission Act 1992

## **Treaties**

United Nations Commission on International Trade Law, United Nations, New York, 2011

United Nations Conventions on Contracts for International Sale of Goods

Unidroit Convention on International Financial Leasing

## **LIST OF ABBREVIATIONS AND ACRONYMS**

|         |   |
|---------|---|
| ACH     | Automatic Clearing House  |
| ADA     | Austrian Development Agency                                       |
| ADF     | African Development Fund  |
| AFDB    | African Development Bank  |
| AICD    | Africa Infrastructure Country Diagnostics                         |
| BPE     | Bureau of Public Enterprises                                      |
| BPP     | Bureau of Public Procurement                                      |
| CAC     | Corporate Affairs Commission                                      |
| CBN     | Central Bank of Nigeria   |
| CGAP    | Consultative Group to Assist the Poor                             |
| CRMS    | Credit Risk Management System                                     |
| DFI     | Development Finance Institutions                                  |
| DFID    | Department for International Development                          |
| DGIS    | The Netherlands Directorate-General for International Cooperation |
| DMO     | Debt Management Office  |
| DPRs    | Diversified Payment Rights  |
| ECA     | Excess Crude Account  |
| ECAs    | Export Credit Agencies  |
| ECIC    | Export-Credit Insurance Corporation                               |
| e-FASS  | enhanced Financial Analysis and Surveillance System               |
| EFIC    | Export Finance and Insurance Corporation                          |
| EPRIC   | Electric Power Reform Implementation Committee                    |
| EPSPA   | Electric Power Sector Reform Act                                  |
| EBRD    | European Bank for Reconstruction and Development                  |
| ETF     | Exchange Traded Fund  |
| FDI     | Foreign Direct Investment   |
| FEC     | Federal Executive Council   |
| FIL     | Financial Intermediary Loan Facility                              |
| FMO     | The Netherlands Development Finance Company                       |
| FRC     | Fiscal Responsibility Commission                                  |
| FSS2020 | Financial System Strategy   |
| GBP     | Great Britain Pound   |
| GDP     | Gross Domestic Product  |
| GDR     | Global Depository Receipts  |
| GSM     | Global System of Mobile Telecommunications                        |
| IBRD    | International Bank for Reconstruction and Development             |
| ICA     | Investment Climate Assessment                                     |
| ICR     | Insolvency and Creditor Rights                                    |
| ICRC    | Infrastructure Concession Regulatory Commission                   |
| ICT     | Information Communications and Technology                         |
| IDA     | International Development Agency                                  |
| IDB     | Inter-American Development Bank                                   |
| IFC     | International Finance Corporation                                 |
| IFI     | International Financial Institutions                              |
| ISA     | Investments and Securities Act                                    |
| JBIC    | Japan Bank for International Cooperation                          |

|          |  |
|----------|--|
| LSPPPL   | Lagos State Public Private Partnership Law             |
| MDAs     | Ministries, Departments and Agencies                   |
| MDG      | Millennium Development Goals                           |
| MIGA     | Multilateral Investments Guaranty Agency               |
| MTEF     | Medium Term Expenditure Framework                      |
| NAICOM   | National Insurance Commission                          |
| NCC      | Nigeria Communications Commission                      |
| NEEDS    | National Economic Empowerment and Development Strategy |
| NELCO    | National Electric Liability Management Company         |
| NEPA     | National Electric Power Authority                      |
| NEPAD    | New Partnership for Africa's Development               |
| NEPP     | National Electric Power Policy                         |
| NERC     | Nigeria Electricity Regulatory Commission              |
| NESG     | Nigerian Economic Summit Group                         |
| NIP      | National Infrastructure Plan                           |
| NIWA     | National Inland Waterways Authority                    |
| NPC      | National Planning Commission                           |
| NRC      | Nigerian Railway Corporation                           |
| OAGF     | Office of the Accountant General of the Federation     |
| OBC      | Outline Business Case                                  |
| ODA      | Overseas Development Assistance                        |
| OECD     | Organization for Economic Cooperation and Development  |
| OPIC     | Overseas Private Investment Corporation                |
| PCGs     | Partial Credit Guarantees                              |
| PENCOM   | Pension Commission                                     |
| PFAs     | Pension Fund Administrators                            |
| PHCN     | Power Holding Company of Nigeria                       |
| PIDG     | Private Infrastructure Development Group               |
| PPP      | Public Private Partnerships                            |
| PPA      | Power Purchase Agreement                               |
| PRGs     | Political Risk Guarantees                              |
| PRI      | Political Risk Insurance                               |
| REA      | Rural Electrification Agency                           |
| ROSC     | Report on the Observance of Standards and Codes        |
| SACE     | The Italian Export Credit Agency                       |
| SEEDS    | State Empowerment Development Strategies               |
| SIDA     | Swedish International Development Cooperation Agency   |
| SME      | Small and Medium Enterprises                           |
| SMEEIS   | Small and Medium Industry Equity Investment Scheme     |
| SPV      | Special Project Vehicle                                |
| SSA      | Sub-Saharan Africa                                     |
| SWF      | Sovereign Wealth Fund                                  |
| TCN      | Transmission Company of Nigeria                        |
| TFMF     | The Federal Ministry of Finance                        |
| ULBs     | Urban Local Bodies                                     |
| UNCITRAL | United Nations Commission on International Trade Law   |
| UNCTAD   | United Nations Conference on Trade and Development     |
| USAID    | United States Agency for International Development     |
| USD      | United States Dollar                                   |
| VFM      | Value-for-Money  |

VGf            Viability Gap Facility  
WBES        World Business Environment Survey  
WBG        World Bank Group

## **SUMMARY OF THE THESIS**

Infrastructure is one of the main parameters of economic growth and a country's competitiveness depends on the provision and maintenance of efficient and productive infrastructure assets. However, Nigeria, like most countries in Sub-Saharan Africa has the lowest quantity and poorest quality of stocks of infrastructure assets in the world and this phenomenally poor infrastructure has remained an impediment to development in the country. Decades of sub-optimal investment, poor maintenance culture and the fact that the required infrastructure investments could not be accommodated within the available fiscal space as a result of budgetary constraints have all contributed to the Nigeria's infrastructure deficit. The immediate outcome of this however is that the available infrastructure assets across the Nigerian landscape are in decrepit state and absurdly inadequate. Besides, the present demand for basic infrastructure services has grown astronomically out-stripping the supply capacity of the existing ones. Closing the infrastructure financing gap will however require increased investment by private investors through creative financing in an enabling legal and financial environment.

Outside the budgetary constraints, the absence of efficient maintenance and management of infrastructure assets and quality service delivery by the public sector are some of the reasons why procurement of public infrastructure stocks by government through the traditional approach is no longer plausible and hence, the general appeal of the public-private partnership framework.

However, despite all the potentials, the public private partnership technique in Nigeria has not made an appreciable impact in closing the infrastructure gaps due to lack of access to long-term financing.

It is against this back-drop that this study has sought to investigate how reforms of the legal and financial infrastructure could widen access to financing through innovative financial resource mobilization in scaling-up infrastructure development and service delivery to the teeming Nigeria population.

Therefore, the central thesis of this study is that the inadequacy of appropriate laws and inefficient financial system are partly responsible for the huge financing gaps in the Nigeria's infrastructure market and with the legal and financial reforms, an enabling legal and financial environment that would open up space for resource mobilization through innovative financing techniques and sources will be created thereby widening access to long-term financing and increasing the appetite for private investment in the nation's public infrastructure assets and services.

So, the overarching objective of this thesis is to explore how legal and financial system reforms can facilitate the development of financial models and instruments that can help mobilize financial resources to fund infrastructure and bridge the huge infrastructure financing gaps in Nigeria in a sustainable fashion.

Given the infrastructure poverty that constrains economic growth and development in Nigeria, the outcomes of this proposed study would help inform the need for the legal and financial system reforms to unlock resources in addressing the problems of financing gaps in infrastructure projects development in Nigeria. Besides, such outcomes based on the Nigerian experience in infrastructure financing and development may be turned into valuable knowledge for policy –making and further research in Nigeria.

## **KEY WORDS AND PHRASES**

Concession, financial infrastructure, financial sector, infrastructure financing, infrastructure asset, innovative financing, legal, project finance, public infrastructure, public-private partnership,

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## **CHAPTER 1**

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### **INTRODUCTORY OVERVIEW**

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- 1.12 Research problem
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## 1.1 Setting the scene

Traditionally since independence, Nigerian state has been the sole financier of public infrastructure assets as well as having the responsibility for implementation, maintenance and operations. However, decades of sub-optimal investment and poor maintenance culture have all contributed to the nation's infrastructure deficit. The immediate effect of this is that the available infrastructure assets across the entire country remain terribly inadequate and in a critical state. Over time, demand for basic infrastructure services has grown out-stripping the supply capacity of the existing ones and this phenomenal poor state of infrastructure in the country remains an affront to the efforts at dealing a mortal blow on general poverty and a major challenge undermining the nation's capacity to compete in global markets.

Thus, one of the daunting development challenges facing the three tiers of government in Nigeria<sup>1</sup> is this huge infrastructure deficit which has remained a major constraint in the march towards economic growth and development and the attainment of the national vision to be among the top twenty economies of the world by the year 2020.<sup>2</sup> To upscale the nation's infrastructure level and therefore open up the country's potentials for rapid economic growth and development, massive investments must be made in the provision and expansion of infrastructure assets and services which are well beyond the resources and capacity of the government. As put by the Director-General of Nigeria's Infrastructure Concession Regulatory Commission (ICRC),<sup>3</sup> the 'rapidly declining financial resources make the option of capital infusion through the fiscal budgets to rehabilitate, replace instead of maintaining infrastructure less feasible, thereby accelerating infrastructure deterioration'. Mobilizing the huge

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<sup>1</sup> Under the Constitution of the Federal Republic of Nigeria, 1999, three levels of government are recognized: federal, state and local with specific and sometimes over-lapping powers and functions

<sup>2</sup> Nigerian Infrastructure Concession Regulatory Commission: National policy on public private partnership (2009) 9

<sup>3</sup> Ahmed M (2011) New approaches to project & trade finance ICRC publication 1

infrastructure requirements<sup>4</sup> therefore from internal sources has remained a daunting task for the governments at all levels.

Besides, the sheer depth and breadth of infrastructure investment requirements in Nigeria in the wake of the population explosion, increasing urbanization, contraction of fiscal space for infrastructure development which is as a result of the dwindling public income coupled with the poor regime of tax revenue collection and official corruption and profligacy, have created the impression that engaging private investment in infrastructure projects would allow for the fiscal consolidation of the public budget, freeing resources for other expenditures, enhancing the allocation of resources, transferring the cost of infrastructure projects to the users or beneficiaries, thus improving the efficiency and quality of its use. This will also be implicated in the fact that private infrastructure projects offer value for money at a lower cost than public infrastructure projects due to the different incentive structure.<sup>5</sup>

Aside the budgetary constraints, the absence of efficient maintenance and management of infrastructure assets and quality service delivery by the public sector are some of the reasons why procurement of public infrastructure stocks by government through the traditional approach is no longer plausible.

The Debt Management Office<sup>6</sup> has established the fact that Nigeria's current infrastructure deficit requires capital investments to the tune of US\$100 to US\$111 billion,<sup>7</sup> and as pointed out above, the magnitude of financing required to bridge the country's infrastructure deficit currently outstrips the supply of capital available from the public sector.<sup>8</sup>

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<sup>4</sup> The Debt Management Office has established the fact that Nigeria's current infrastructure deficit requires capital investments to the tune of US\$100 to US\$111 billion. See generally the World Bank Project Appraisal Document (2011)

<sup>5</sup> 'Infrastructure project and economic growth-the role of the private sector' The Guardian (Nigeria) Monday July 5 2010 29-30

<sup>6</sup> Established by the Debt Management Office (Establishment, etc.) Act 2003 to, among other functions, 'maintain a reliable database of all loans taken or guaranteed by the Federal or State Governments or any of its agencies and also verify and service external debts guaranteed or directly taken by the Federal Government or by the State Governments and any of their agencies where such debts are guaranteed by the Federal Government'. See section 6 (1) of the Act of the Debt Management Office (Establishment, etc.) Act 2003

<sup>7</sup> (n 4 above) 6

<sup>8</sup> Ibid.

So, given the scale of the nation's infrastructure requirements and the ever-widening investment deficit in provision of public assets and service delivery in an environment of budgetary constraint, lack of capacity, general incompetence and the endemic corruption, the governments at all levels in Nigeria are drawing on private initiatives and capital to tackle the menace of infrastructure deficits and lack of financing. This entails leveraging on private sector resources and capacity for provision of infrastructure assets and services to the public through the public private partnerships to bridge the widening infrastructure financing gap and open up the country's vast economic potentials and fast-track development process.<sup>9</sup>

The government has been optimistic that this paradigm shift from the traditional method of procurement of public infrastructure stocks to that of privately financed procurement approach generically described as: public private partnership framework, would provide the needed investments.

Reasonably, with a large population of about 160 million, 13<sup>th</sup> largest producer of oil and gas, 10<sup>th</sup> largest in oil and gas reserves and a considerable infrastructure deficit that spans the critical sectors of the economy coupled with existence of a potential for high returns on investment, there lurk within the infrastructure landscape huge opportunities and Nigeria should be a destination of choice for private investments in infrastructure development.<sup>10</sup>

In this regard and in tandem with the global practices, the Federal Government came up with a policy prescription for the use of public private partnership framework to address the infrastructure deficit and the financing requirements across the infrastructure landscape in Nigeria. According to the projections of the policy thrust, 'this will enable the government to:

- mobilize private sector money, expertise and capacities for public sector's infrastructure development;

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<sup>9</sup> Delaine E (2008) 39-40

<sup>10</sup> Ahmed M (2011) PPP for infrastructure development: The Nigerian experience ICRC publication

- develop long-term relationship with private sector (10 or more years);
- share risks and rewards and avoid lop-sided agreements (that is, privatizing the profits and nationalizing the losses), which has been prevalent in most of the previously attempted PPPs;
- ensure private sector complies with the agreed Key Performance Indicators (KPIs), hence allowing for monitoring the performance of private companies; and
- allow it to use and perform life cycle costing in order to understand maintenance which is seriously lacking at the national level, resulting in deplorable and derelict transport infrastructure and inefficient and obsolete power sector that delivers only about a third of installed capacity'.<sup>11</sup>

Pursuant to the above, the government enacted the Infrastructure Concession Regulatory Commission Act (hereinafter referred to as ICRC Act) to provide the legislative framework for the participation of the private sector in financing the construction, development, operation, or maintenance of infrastructure projects in Nigeria through concessions and other contractual options allowed by the Act.<sup>12</sup>

## **1.2 Research problem**

Despite all the potentials, the public private partnership mode of financing infrastructure assets and services in Nigeria has not made an appreciable impact in closing the infrastructure gaps due to lack of access to long-term financing. The fact is that private investors are in dire need of long-term funds for investments in infrastructure in Nigeria. With easy access to finance, the appetite for private investment in the nation's infrastructure market will increase exponentially. For example, banks in Nigeria tried in the past to fix these gaps in financing for long term infrastructure projects with short term loans which ended up in cost over-run by pushing up the cost of borrowing and leaving many projects 'unbankable' or financially unviable before even getting underway.

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<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

This financing problem presented itself in the concessions of the new domestic terminal at the Murtala Mohammed Airport (MMA2) and the Lagos-Ibadan expressway. In 2003, at the commencement of the implementation of the reform agenda in the aviation sector which has at its heart, the transfer of the responsibility for development, financing and operations of the airports in Nigeria to private investors, Bi-Courtney Limited, a limited liability company, was awarded the concession of the Federal Government of Nigeria to develop, finance, manage and operate the Lagos Airport Terminal 2 (and ancillary assets) under a Build-Operate-Transfer ('BOT') arrangement. This was the first of its kind in Nigeria. The project comprises an airport terminal building, a multi-storey car park and an apron. This project was almost 'ambushed' for lack of access to long-term financing. After an initial estimate of over N15 billion, and by early 2007, six banks arranged a syndicated loan of N20 billion to part finance the project. However, shortly after the completion of the project, the concessionaire became embroiled in string of court cases instituted by six of the domestic banks. The bone of contention was the default of the concessionaire in repayment of the syndicated loans used in financing the construction of the new domestic terminal at the Airport.<sup>13</sup>

In the same vein, the second example where the research problem presented itself was the Lagos –Ibadan Expressway Concession which, incidentally involves the sister company to the concessionaire in first example cited above. Under the concession contract, Lagos-Ibadan Expressway, a major artery that links Lagos, the Nigeria's commercial capital with other parts of the country, was awarded the concession of the Federal Government of Nigeria under the DBOT Toll Road Agreement between the Federal Ministry of Works, representing the Government of Nigeria and a consortium, Bi-Courtney Highway Services Limited, to rehabilitate and manage the ever-busy expressway. In the concession contract, the 110 Kilometre Expressway is to be rehabilitated and covers the 'full reconstruction of the failed existing carriage-ways, construction of additional two lanes to four lanes coupled with the provision of ancillary facilities like parking areas for heavy duty vehicles, rest areas with eateries

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<sup>13</sup> Bi-Courtney Aviation Services website- <http://www.mma2lagos.com/-last> accessed 7 May 2012

and conveniences as well as emergency communication equipment, all for the welfare and the security of the highway users'. The contract was almost dead on arrival! The reason: lack of financing. Because of this, the implementation of the concession contract has suffered delay for over three years until recently, in April 2012, when the management of the concessionaire firm disclosed that it had secured the financial backing of a foreign bank and a reputable construction company, both of which are of South African extraction, the Rand Merchant Bank and Group 5 respectively. According to the statement issued by the management of the concessionaire firm: 'Rand Merchant Bank of South Africa is funding the project and Group 5, a South African multi-disciplinary construction group engaged in resources, energy and infrastructure delivering, along with some local contractors, are doing the construction'.<sup>14</sup>

Apparently, the delay was as a result of lack of funding from the domestic financial market which then necessitated the concessionaire firm to look across the border for the financial succour. The inability of the concessionaire firm to raise the needed financial resources was because of its lack of reputation collateral<sup>15</sup> which was the fall-out of the default of concessionaire firm's sister company regarding the credit obtained in execution of the infrastructure project in the first example cited above.

It is against this back-drop that this study seeks to investigate how creative reforms of the legal and financial infrastructure could be used for innovative financial resource mobilization to scale-up investments in procurement of public assets and service delivery to the teeming Nigeria population.

### **1.3 Research questions**

Central to the mobilization of domestic and foreign financial resources is the imperatives for creative legal reforms and development of a sound and wide-ranging financial sector, which means, a diversified, well regulated and inclusive financial

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<sup>14</sup> 'The long-road-to-renewing-Lagos-Ibadan-expressway' Thisday Newspaper May 7 2012-  
[www.thisday.com/articles//108076](http://www.thisday.com/articles//108076)

<sup>15</sup> It means a good payment record which may be used in applying for new credit. See 'Guidelines for the Licensing, Operations and Regulation of Credit (2008) Central Bank of Nigeria-  
[www.cenbank.org/documents/bsdcirculars.asp](http://www.cenbank.org/documents/bsdcirculars.asp)?

system that would promote savings, deepen domestic capital market and channel the resources to sound infrastructure projects and initiatives. In other words, provision of an enabling environment targeted at harnessing the available idle funds for investments in infrastructure projects through the instrument of law!

Thus, broadly speaking, this study will seek to explore how an appropriate legal environment and a sound and wide-ranging financial sector could unlock domestic financial resources and attract foreign capital investment to finance sound infrastructure projects and initiatives in Nigeria. Specifically, the thesis will strive to answer the following questions:

- i. which theoretical constructs underpin the fundamental assumptions and provide analytical framework in support of the thesis statement of this study;
- ii. what is the correlation between provision of infrastructure assets and socio-economic development in an emergent nation like Nigeria;
- iii. what does the policy environment for private investment in public infrastructure in Nigeria look like?
- iv. what are the related laws governing the private sector participation in the provision of infrastructure and service delivery in Nigeria?;
- v. how has the legal environment constrained access to adequate financing for infrastructure development and how the country's legal infrastructure can be reformed to unleash innovative financing solutions to fund the critical infrastructure in Nigeria;
- vi. how can the financial system reforms and development widen access to market-driven financing for private investment in public infrastructure in Nigeria? and
- vii. what are the innovative techniques and sources that could be used in bridging the huge financing gaps in Nigeria's infrastructure landscape?

#### **1.4 Thesis statement**

The inadequacy of appropriate laws and inefficient financial system are partly responsible for the huge financing gaps in the Nigeria's infrastructure market and with the legal and financial reforms, an enabling legal and financial environment that

would create space for resource mobilization through innovative financing techniques and sources thereby widening access to long-term financing and increase the appetite for private investment in the nation's public infrastructure assets and services.

### **1.5 Objectives of the Study**

The overarching objective of this proposed enquiry is to explore how legal and financial system reforms can facilitate the development of financial models and instruments that can help mobilize domestic financial resources and foreign capital to fund infrastructure in bridging the huge financing gaps in infrastructure development landscape in Nigeria in a way that will be sustainable.

Other objectives of the study are:

- i. to highlight the problems of infrastructure deficit, the financing gaps and the financial market constraints in infrastructure development in Nigeria;
- ii. to examine the existing legal framework relating to infrastructure development in Nigeria and the need for reforms to open up the space for private investment and involvement in provision of public assets;
- iii. to explore how law can be used to facilitate the bridging of the financing gaps through the development of creative financial instruments; and
- iv. to explore how reforms of the legal and financial infrastructure can enhance the development of a wide-ranging financial sector that will promote savings, deepen domestic capital market and attract foreign capital for investment into sound infrastructure projects and initiatives.

### **1.6 Research methodology**

Essentially, the study is desk-top and library based and the approaches will be descriptive, prescriptive and analytical. Drawing on all the available online resources, newspapers reports and multilateral organizations' reports, published articles and textbooks, the study will attempt to review the state of infrastructure in Nigeria by describing the depth of the deficit and the financing gaps; examine the various efforts that the three tiers of government in Nigeria have made toward addressing the

infrastructure deficit and come up with creative solutions to the problem of lack of access to long-term finance in the Nigeria's infrastructure market.

More importantly, it will critically analyse the legal environment for infrastructure procurement and private sector investment in infrastructure development in Nigeria.

The problem of weak, shallow and ineffective financial sector that inhibits the flow of capital for infrastructure development will also be examined with a view to prescribing solutions.

In other words, the study will both be descriptive and prescriptive; descriptive in that it will prove the existence of facts, such as the state of infrastructure in Nigeria, and prescriptive in that the study will end up prescribing remedies to the legal problems identified at the outset in the study, like suggesting the use of different innovative financial instruments that are well-suited for infrastructure financing will also be explored.

Great reliance will however be placed on primary sources like the provisions of appropriate legislation relevant to the study. Also, reportorial and features in magazines, newspapers (both Nigerian and foreign), working papers, textbooks, published reports from reputable organizations and articles generally will also be used.

### **1.7 Significance of the study**

Infrastructure is one of the main parameters of economic growth and poor infrastructure has remained an impediment to development in Nigeria. A country's competitiveness depends on the provision and maintenance of efficient and productive infrastructure assets. Nigeria, like most countries in sub-Saharan Africa has the lowest and poorest quality of stock of infrastructure in the world. Closing the infrastructure financing gap will require increased investment by private investors through creative financing in an enabling legal and financial environment.

Given the infrastructure poverty that constrains economic growth and development in Nigeria, the outcomes of this proposed study will help inform the need for the creative

legal and financial system reforms to unlock resources in addressing the problems of financing gaps in infrastructure projects development in Nigeria.

Besides, such outcomes on the Nigerian experience in infrastructure financing and development may be turned into valuable knowledge for policy –making and further research in Nigeria.

### **1.8 Literature review**

This study presents a stew of many complex issues, hence most of the literature relating to this proposed work is written from interdisciplinary prisms ranging from law to economics to development finance to banking and finance and even political economy and they focus primarily on infrastructure projects and public private partnership mode of financing infrastructure projects. However, the difference between this proposed study and those previous works is that this study intends to focus on narrow confines of the law-related aspect of infrastructure financing specifically the imperative of the use of appropriate legal reforms to facilitate the mobilization of domestic financial resources and foreign capital in a bid to close the huge financing gaps that constrain infrastructure projects development in Nigeria.

Generally, writers in this area of enquiry tend to focus on the broad debate of the problems of infrastructure deficit and the need to leverage on the private sector funding and expertise for infrastructure development without averting their minds to the fact that private sector participation in the provision of infrastructure and services on its own without the required supportive legal and financial infrastructure that would facilitate financial resource mobilization for unrestricted access to an adequate long-term financing would not solve the problem of poverty of infrastructure.

The approach to be used in this research will be novel and will inform a rigorous debate in this field of study and open up the opportunity for more enquiries into other narrow areas that are hindering private participation in infrastructure investments.

The outcomes of this study will also explain why in spite of the adoption of the public private partnership model in some countries, it has refused to deliver the anticipated results.

It is however instructive to state here note that this review is not comprehensive but largely selective: it only captures the most relevant literature to the central theme of this study.

The review will start off with Grimsey and Lewis' book<sup>16</sup> which provides an excellent insight into the workings and different issues affecting public private partnerships across the board. The book considers the recent trend in which governments look increasingly to private sector finance provided by private investors to construct and manage public infrastructure facilities in partnership with government agencies. It also examines the nature and characteristics of public-private partnerships (PPPs). Therein, the concept of PPP is defined with all the general distinguishing features of what is meant by a partnership and all the intricacies. It goes on to inform the readers about what PPP is and what it is not. In examining the nature of PPP, the book also discusses the variety of forces that are behind and have come together to underpin and inform this trend. Then also the historical evolution of private sector involvement in infrastructure development is also explored.

The book also gives space to examine procurement by means of a PPP compared with that by conventional means in terms of its intricacies like the steps to be taken, procedures to be followed and above all, reiterating some of the reasons that have led to PPP's deployment for infrastructure projects. The difference between this proposed investigation and the book under review is that while the book discusses issues related to public private partnership from largely non-legal multidisciplinary perspectives, the proposed research seeks to look at the problem of financing for infrastructure from a legal prism. The authors also describe the structure of partnership agreement.

In a book edited by Graeme Hodge and Carsten Greve<sup>17</sup>, the discussion touches on the recent thoughts on public private partnerships and traverses issues that border on risk transfer, financial implications, contractual matters, politics, management and

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<sup>16</sup> Grimsey D & Lewis M (2004)

<sup>17</sup> Hodge G & Greve C (eds) (2005)

accountability. The book provides strong thread of accountability; synthesizing common issues, separating the rhetoric from performance reality and providing strategies for better analysis of the various international challenges for future PPPs. It compiles different national experiences of application of public-private partnerships model in infrastructure provision, financing and maintenance. Due to the multi-national perspectives approach, it also presents wide and varied views about the challenges encountered in different climes and jurisdictions. There is a presentation on the historical evolution of the public-private partnerships in which the writer of the chapter traces the roots of PPP to the 20<sup>th</sup> century. Political issues touching on the model are also discussed. Importantly, there is a chapter on legal issues that border on contractual arrangements of the public-private partnerships. Here, the said chapters only discusses the issues common to the legal framework for typical public private partnerships and not the narrow issue of the use of law in facilitating and mobilizing resources for private investors to fund public infrastructure development. This is the point of departure between the textbook and this proposed study.

Stephen Spratt in his book<sup>18</sup> examines the subject of development finance, at both a global and local level, particularly how financial systems can help or hinder the process of human development. The book has as its overarching objective, the introduction and analysis of issues and debates around development finance. The thesis of the book is to prove that the development of an effective financial system is an essential prerequisite for growth. As a prelude, the book discusses the financial theories and the major schools of thought that underpin the central thesis of the book. Importantly, the author explains the fundamental theory that views the market, rather than the state, for an instance, as the best performer of the role of an intermediary between those who possess surplus funds and those who wish to borrow, which is expressed in the Efficient Market Hypothesis (EMH),<sup>19</sup> which underlies several assumptions that have been made about how markets, in particular, financial markets, function. He also reviews the components of the domestic and international financial systems, and considers reform options objectively against the

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<sup>18</sup> Spratt S (2009)

<sup>19</sup> It is a proposition that the current market prices of stocks fully are fully reflective of all available information about the value of the concerned firm. See Lo A Efficient Market Hypothesis-  
[web.mit.edu/alo/www/Papers/EMH\\_Final.pdf](http://web.mit.edu/alo/www/Papers/EMH_Final.pdf) –last accessed 16/07/2012

central theme of human development. The book also focuses on the roles of the World Bank and the International Monetary Fund and Spratt also explores developing countries' engagement with the international financial system and its influence on the process of human development, both positive and negative. He argues further that success or failure of financial systems and reforms can be judged against the benchmark: do they positively contribute to poverty reduction and human development, or not? He opines that reforms that pass this test are to be welcomed whilst those that do not should be dispensed with regardless of the ideological garb in which they are decked. Besides, the book also discusses in depth the issue of development finance reviewing the components of domestic financial system, its key functions and institutions of the financial sector and the relationship between financial sector development, economic growth, and poverty reduction, the issue of financial repression and liberalization, among others.

The author also goes ahead to examine the relationship between economic growth, financial sector development and poverty reduction and concludes that though the relationships between these factors are far from being straight-forward, but generally, economic growth will reduce poverty and financial sector development would lead to higher rates of economic growth.

The key features of the domestic financial system in developing countries are also interrogated and the author opines that the financial systems in many countries including the developed ones have 'deep-seated problems and are failing to perform the functions of the financial sector well' and hence, reforms are therefore critical. On this, there appears to be a platform for convergence between the book under review and this study in that this study too intends to argue in favour of financial sector reforms and development as a critical prerequisite for market-driven resource-mobilization through the Nigeria's financial system and largely diverges in the sense that the research is more about infrastructure financing as against the broader issue of development finance.

Ketkar and Ratha<sup>20</sup> in their jointly edited book, focus on market-based mechanisms for raising development finance. The book presents various recent innovations in international finance that may allow developing countries to tap into global capital markets in times of low risk appetite thereby reducing their vulnerability to booms and busts in capital flows. All the contributors agree that developing countries, especially the Sub-Saharan Africa, need additional cross-border capital to be channelled to the private sector. They note that lacking credit history and the poor perception by investors that investments in these countries can be risky, the developing nations are critically in need of innovative financing mechanisms. According to the editors of the book, ‘innovative financing involves risk mitigation and credit enhancement through the provision of collateral (either existing or future assets), spreading risk among many investors, and guarantees by higher-rated third parties’. So, innovative financing is not limited to financial engineering, they observe. The contributors agree that innovative mechanisms permit lower-cost and longer-term borrowings in international capital markets.

Thus, the book is lending ‘a helping hand to the need for innovative financing mechanisms’ by putting in a compilation papers on various innovative market-driven methods of raising finance for development.

In its introduction, a brief historical review of early innovations in financing was made. Different types of more recent financial innovations such as securitization of future receivables, diaspora bonds, and GDP-indexed bonds are examined. Besides, other credit-enhancement mechanisms like sovereign ratings which facilitate access to international capital markets are also discussed in the book. The book also evaluates the significance of the various innovative financing mechanisms in mobilizing additional capital for development in Sub-Saharan Africa.

The nature of capital flows to and the scope for innovation in raising additional cross-border financing for Sub-Saharan Africa also come under focus in the book. Additionally, the authors also explore the role that partial risk guarantees plays in raising innovative development financing. The authors all agree that from all

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<sup>20</sup> Ketkar S and Ratha D (eds) (2009).

indications, increasing the investment rate above domestic saving rate, the financing gap has to be bridged with additional financing from abroad.

The main point of departure from the theme of this book is that this study intends to approach the research largely from the legal perspective as against the chosen approach of the book which was largely multi-disciplinary. Besides, the book discusses the broader topic of development finance as against the proposed thesis of this research that narrows down on the imperative for legal and financial system reforms to improve access to infrastructure financing. Importantly, though the book dwells more on innovative market-based methods of raising development finance, the methods can also be applied for infrastructure project development financing.

Foster and Briceno-Garmendia<sup>21</sup> in another jointly edited publication argue that sustainable infrastructure development is vital for Africa's prosperity. They examine the full extent of the challenge in developing Sub-Saharan Africa's infrastructure sectors which include information and communication, irrigation, power, transport, and water and sanitation. The collection which is more of a report also provides a baseline against which future improvements in infrastructure services can be measured, making it possible to monitor the results achieved from the donor support. The publication is an 'unprecedented attempt to collect comprehensive data on the infrastructure sectors in Africa' and it covers critical infrastructure sub-sectors such as power, transport, irrigation, water and sanitation, and information and communication technology (ICT), with the view to provide 'an integrated analysis of the challenges' facing these specific sub-sectors of infrastructure in Africa.<sup>22</sup> Flowing naturally from the 'extensive fieldwork across Africa' the following deductions were made about infrastructure in Africa:

- i. that infrastructure is 'responsible for more than half' of recent improved growth performance in Africa with 'the potential to contribute even more in the future';

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<sup>21</sup> Foster V & Briceno-Garmendia C (eds) (2010).

<sup>22</sup> Ibid. 2.

- ii. that it is no longer news that infrastructure networks in Africa are way behind ‘those of other developing countries and are characterized by missing regional links and stagnant household access’;
- iii. that Africa’s problematic economic terrain is a challenge for the continent’s infrastructure development;
- iv. that comparatively, ‘Africa infrastructure services are twice as expensive as elsewhere, reflecting both diseconomies of scale in production and high profit margins caused by lack of competition’;
- v. that power challenge remains the main constraint concerning infrastructure in Africa. This is characterized by the fact that 30 countries are presently being challenged by power outages and many forced to pay exorbitantly for ‘emergency power’;
- vi. that Africa’s infrastructure investment requirement is around USD93 billion annually and one-third of this will go into maintenance; among others.<sup>23</sup>

While this book touches on the broad spectrum of infrastructure in Africa from an inter-disciplinary stand-points, the proposed investigation is limited to Nigeria geographically and specifically on law-related aspect of infrastructure financing.

Yescombe<sup>24</sup> defines ‘project finance’ as ‘a method of raising long-term debt financing’ for vital projects through a process referred to as ‘financial engineering’ which is based ‘on lending against the cash flow generated by the project alone’. The book examines all aspects of a project development and contractual arrangements. The core thesis of the book is to provide a guide to the principles of project finance and to practical issues that have the potential to create problems in the commercial and financial negotiations. The author gives a general background and the recent developments in project financing landscape especially its market and roles of the main players. The book provides invaluable insight on the markets for raising project

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<sup>23</sup> Ibid. 2-3.

<sup>24</sup> Yescombe ER (2002).

finance debt. Importantly too, the author reviews the different types of agreements involved in typical project financing transactions both in the domestic and international markets-agreements that are strategic in many project finance structures including those for construction and operation.

The author also explains how lenders analyze and mitigate the commercial risks inherent in a project. The presentation is quite revealing and touches on all the vital aspects of project finance transaction in domestic and international markets. The difference, however, between this book and the proposed study is that the book solely examines the subject of project finance from both the economic and finance prisms, while the study seeks to dissect the subject from the legal angle.

In another book,<sup>25</sup> Yescombe reviews ‘the general policy issues which arise for public sector in considering whether to adopt the PPP procurement route, and the specific application of this policy approach in PPP contracts’. The author also presents ‘a systematic and integrated approach to financing PPPs within this public-policy framework’

In tandem with the thesis of the book, the author explains what the term ‘ PPPs’ means and interrogates their functions in the context of public infrastructure provisioning and the development of current policies for PPPs in some selected countries. Additionally, the book also gives an insight into cash-flow analysis; reviews how the public sector uses the financial models to make decisions to invest in infrastructure project development and public sector-sector procurement and management of PPP projects. Importantly also, the author spurs no effort in explaining project-financing techniques and why and how they are used for PPPs. Also on the issue of financing, the book takes a look at the identified sources of project finance and the procedures for raising funds. Other financial issues like hedging, the effects of interest-rate movements and inflation on a PPP project and its funding are also examined. Lastly, the book reviews the different alternative routes for funding of PPP projects.

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<sup>25</sup> Yescombe ER (2007).

While the book dissects the thorny issue of PPPs financing from a non-legal angles of policy and finance, the study departs from this by seeking to look at the legal point regarding the role that law and a sound financial system can play in mobilizing financial resources for infrastructure financing.

In a book edited by Michael Likosky,<sup>26</sup> the writers of the chapters seek, specifically, to interrogate ‘the global shift away from the development approach towards the global project finance approach to infrastructure projects.’<sup>27</sup> The editor, in particular, alludes to the fact that under the development approach, the state solely funded infrastructure projects with the World Bank making available ‘supplementary funding’ in contrast to the approach under the global project finance, where market-driven financing solutions are deployed through the private entrepreneurs to build, manage and operate projects and rake in profits to recoup investments made into the projects. Apparently, the approach of the book as could be gleaned from the chapters written by different contributors is ‘to provide a systematic and comparative examination of transnational privatization processes with a specific focus on global project finance from an interdisciplinary perspective’ with contributions from different legal academics and social scientists.

Another prominent concern that the writers express is: what does this paradigm shift from publicly financed projects to privatized ones portend for the protection of human rights? The conclusions of the various contributors to the publication is that privatization is an on-going process rather than as a legislative *fait accompli*. The chosen approach was human-rights based. The area of convergence between this textbook and the proposed study is that the issues are legal based but divergence is in the fact that the proposed study is intended to dwell on legal issue related to infrastructure finance as against the textbook approach which is substantially rights-based.

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<sup>26</sup> Likosky M (ed) (2005).

<sup>27</sup> Ibid. xi

In ‘Law, Infrastructure, and Human Rights’<sup>28</sup> the author also writes from the prism of human rights. He argues that infrastructure projects are sites of intense human rights struggles. He argues further that human rights are handled in varied contexts and considers the possibility of a common international solution under the aegis of the United Nations to resolve the problem of the inability to translate human rights into practice. In the main, the book examines how human rights issues are handled in the context of international privatized projects through the introduction and the application of the three concepts-public private partnerships, compound corporations and human rights risk-to some infrastructure-related case studies.

The author states in the book that ‘a PPP refers to how governments and companies partner with one another either through financing, construction, or operating stages of a project’.<sup>29</sup> According to him, the benefit of introducing ‘the PPP approach to understand privatized projects lies in its focus on the defined roles within privatization of both government and companies’.<sup>30</sup>

On the application of the second concept, the particular companies that do the work under PPPs are called the compound corporations or companies that materially mix public and private laws to achieve specific aims. The author argues that the purpose of adopting a compound corporation approach lies in the need ‘to focus on how the public-private relationships characteristics of PPPs express themselves through hybrid corporate forms’.<sup>31</sup>

On the concept of human rights risk, the author writes that it gives an insight about ‘the strategic dimensions of human rights law as it relates to trans-national PPPs’.<sup>32</sup> According to him, a human rights risk ‘is the likelihood that a human rights problem will disrupt the plans of project designs and operators’. Although ‘a human rights risk has normative implications, it is something that is strategically constructed’.<sup>33</sup>

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<sup>28</sup> Likosky Michael (2006).

<sup>29</sup> Ibid. 11-2.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid. 12.

The main difference between this proposed study and the book under review is that while the legal problem addressed in the book relates to associated human rights abuses in infrastructure development through the privatization, the legal problem in this investigation relates to law could be used to solve the problem of lack of access to long-term capital for financing of infrastructure projects.

Also in a book authored by Irene Hadiprayitno,<sup>34</sup> the author reveals the complex interface between human rights and development in practice. The book in general, interrogates the impact of development-oriented projects on the lives of the people. The book argues that contrary to the generally positive connotation of development as structural improvement in people's well-being, development policies, programmes and projects often affect people's lives in a negative way. The argument continues that millions of people annually enter the cycle of forced displacement and relocation due to development projects. This, the author hinges on partly the lack of access to decision-making on development policies and opines that contextually, the internationally declared right to development might offer a solution as it stipulates free and meaningful participation. The author cites the example of Ke dung Ombo Dam Project in Central Java in native country, Indonesia, which was partly funded by the World Bank which by its design, aimed to provide 22.5 megawatts electricity, supply irrigation to 87,000 farms on 59 hectares, to control flooding, and to supplement municipal water supplies for urban centres. Ironically, according to the author, 'the project that the Indonesian government and the World Bank claimed was successful in reaching the set goals, only succeeded in displacing 33 villages in 3 regions in Central Java of Sragen, Boyolali and Grobogan'. The author goes on to aver that 'most families were not aware of the relocation plans and the compensation paid by the government was too low'. She further argues that payment of a low amount as compensation by the government was as a result of lack of prior negotiation or discussion with the owners of the land. She indicates further that though the affected families displaced went to court and won the case at the apex court in Indonesia, they were yet to reap the fruits of their litigation in that the government refused to enforce the Supreme Court judgment. According to her, this case was illustrative of what she described as 'downside of development: negative

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<sup>34</sup> Hadiprayitno, Irene (2009).

effects on entitlement positions of people at the grassroots'.<sup>35</sup> The author says the example cited above shows clearly 'that what is done in the name of development does not automatically bring improvement of entitlements for its supposed beneficiaries but instead...victimizes them, as a result of misinterpreted development policies'.<sup>36</sup> This phenomenon, according to her, could be described as 'a development hazard'. She claims that 'development hazards occur when development policies are imposed from above, without any opportunity to participate for those affected at the grassroots'.<sup>37</sup> The author then remarks that usually, it is 'particularly large scale development project that tends to entail such negative consequences for people'.<sup>38</sup>

Though the book presents a rights-based approach to infrastructure projects development, the fact still remains that the approach in this proposed study departs from the perspective of the book in the sense that the study intends to look at how law can be used to address the issue of financing constraints in infrastructure development.

Hoffman, in his book<sup>39</sup> written from both legal and practical perspectives, supplies well-rounded information on the business, practice, law and practical use of project finance as a financing vehicle for capital-intensive projects like infrastructure projects. It captures every facet of project financing from the time of conception to negotiation and financial close. Approached from a professional point of view, it presents a holistic manual for international project financing transactions. Apart from the technical issues discussed, the presentation also covers some legal-related matters.

The book also gives insight into the legal aspect of transnational project by identifying the applicable laws in any transnational project which are: the laws which apply domestically and sometimes extraterritorially and regulate international transactions or disputes in a project host state; the laws of foreign states; rules of public international; and the conflict of law rules which may come into the picture to determine laws which are applicable to a particular dispute with foreign elements.

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<sup>35</sup> Ibid. 1.

<sup>36</sup> Ibid.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid. 2.

<sup>39</sup> Hoffman S (2008).

The books also presents the three general sources that provide for legal and structural framework for project finance which are: project finance legislation and regulations, developed by the host government; standard contractual and financing requirements developed by the private sector; and project finance standards established by multilateral institutions like the United Nations Commission on International Trade Law.

The book also indentifies law and legal system's risks. These are legal-related risks associated with foreign investment, lending infrastructure, regulatory and other laws or lack of them, and differing legal systems and cultures. Other significant and related risks that the author argues that must be considered include: access of foreign entities to the judicial system; enforceability of foreign judgments, whether arbitration is permitted for disputes resolution; and enforceability or arbitral awards. Choice of law is also included in the discussions on legal risks.

The main difference between this study and the book is that while the focus of the study is on how to leverage on legal and financial system reforms to unlock financial resources for infrastructure financing in Nigeria, the focus of the book is more on the project financing which is an aspect of structured financing used in financing projects of whatever shade and not just infrastructure projects alone.

John Niehuss in a book<sup>40</sup> writes on the legal aspects of international project finance from a largely practical perspective. The book, in the main, discusses how 'funds can be raised for the construction and operation of major projects' with the use of one of the structured finance techniques called project finance. With a legal focus, the author examines the main legal issues that are common to each phase of a typical transaction in international project finance. In the introductory chapter, explanations are given as to what international project finance implies and importantly, it examines project finance as a genre of structured finance and goes ahead to draw the line between types of structured finance and traditional forms of finance. Several inter-related elements that characterize all domestic and international project financing which then add to their legal complexity are also examined. Participants in the project finance

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<sup>40</sup> Niehuss J (2010).

transactions are also identified with all the stages involved in the process. Importantly, legal issues that underpin all project financing both domestic and international like the project contract; concession agreement with the anticipated legal issues; operating agreement, financing agreements and the agreements on dispute settlement are also discussed. A well-thought-out presentation, the book makes a manual for professional involved in project finance landscape.

The book also differs from this thesis in that it only discusses project finance as a subject though largely from a legal perspective as against how financial resources could be unleashed through legal and financial system reforms in Nigeria.

### **1.9 Limitations**

Typically, discourse on infrastructure project financing is largely interdisciplinary and dominated by literature written by non-lawyers and expectedly from non-legal perspectives. However, in a clear case of departure, this study seeks to unpack infrastructure project financing from a narrow legal prism that interrogates how to leverage legal and financial reforms in the Nigerian context to broaden access to market-driven funding for infrastructure development. To a very large extent, the available literature substantially discusses the technical issues relating to public private partnership such as its nature and characteristics and in some instances, attempt to integrate human rights concerns into its general framework. Hence, the research is inherently limited by sheer dearth of legal-focus scholarly literature and the fact that it is tied to the Nigerian context. Nevertheless, collateral economic and financial issues that underlie this study will still be approached from interdisciplinary standpoints. Importantly too, by its conception, empirical field study will not be applicable to this research; it is strictly desk-top and library-based.

### **1.10 Structure of the thesis**

This study is structured into nine chapters.

Chapter 1 sets the scene for the thesis. It discusses the introductory matters such as research problem, research questions, thesis statement, objectives of the study, research methodology, significance of the study, literature review and organization of the thesis.

Chapter 2 examines the different strands of theories that underpin some fundamental assumptions that will form the substratum of the study and provide analytical framework in support of the thesis statement.

Chapter 3, a factual chapter, presents an overview of public infrastructure assets and interrogates the correlation between provision of infrastructure stocks and development in a given society. It also gives a sector-level analysis of the country infrastructure landscape with a view to graphically describe the parlous state of the infrastructure in Nigeria.

Chapter 4 reviews the policy environment for the private investment in public infrastructure in Nigeria. In the chapter, the engagement of private capital in addressing the infrastructure deficit and the financing gaps is examined. It unpacks the reasons for public private partnership in Nigeria and the strides that the government has taken thus far in closing the infrastructure and the financing gaps.

Chapter 5 focuses on the legal framework for investment of private capital in public infrastructure assets. In the chapter, all related laws, the regulatory framework and the governance structures are discussed.

Chapter 6 extends the discussion in chapter 5 on legal framework and goes on to prove that the inadequacy of appropriate laws is partly responsible for the huge infrastructure and financing gaps in the Nigeria's infrastructure landscape and that with appropriate legal reforms, the untapped domestic resources will be mobilized and foreign capital attracted to fill the gaps for the procurement of public infrastructure and service delivery.

Chapter 7 discusses how the weak and shallow financial system hinders flow of both the domestic and foreign financial resources for public assets funding in Nigeria and investigates how the reforms and development of the financial sector in Nigeria could assist in the resource mobilization for infrastructure development and financing.

Chapter 8 explores how financial resources for infrastructure financing can be mobilized through innovative techniques and sources. Other forms of public-sector

debt funding including foreign-based sources like oil for infrastructure deals are also discussed.

In drawing the curtain on the study, Chapter 9, as the concluding chapter, pulls the different strands of arguments and conclusions together to make the entire study a coherent whole. It starts with the reason for the investigation; summary of findings; the final conclusions and the recommendations.

## CHAPTER 2

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### THEORETICAL UNDERPINNINGS

2.1 Introductory remarks

2.2 Rationale for the choice of the theories

2.3 Theoretical constructs

2.3.1 Law and development as the legal theoretical framework for this study

2.3.1.1 Perspectives on law and development

2.3.1.2 The interface between law and development

2.3.1.3 Deductive reasoning approach to the study

2.3.1.3.1 The critical imperatives for legal reforms

2.3.1.3.2 Making case for institutional reform

2.3.2 Neo-classical economic theory

2.3.3 Financial theory

2.4 Concluding remarks

## 2.1 Introductory remarks

The main research question that this chapter will seek to answer is: which theoretical constructs support the fundamental assumptions that underpin this study and provide analytical framework in support of the thesis statement of this enquiry.

Three fundamental assumptions and backstopping theories will course through the entire gamut of this study and form the ‘golden thread’ through all the chapters in this investigation to make a coherent whole. It is however pertinent to state here at the onset that these fundamental assumptions and theories are legal and non-legal and the non-legal in particular add the multi-disciplinary flavours to the theoretical approaches to this study.

The first assumption is that with appropriate legal and institutional reforms, whether in reforming the existing laws and the legal institutions or enacting or creating new ones, the untapped domestic financial resources can be mobilized and cross-border capital attracted for infrastructure development in Nigeria. The supportive theory here is that which underscores the role of law and legal institutions in development or social change. Its main thesis is the idea of ‘legal liberalism’ that sees law as a means of social engineering and as a tool for achieving developmental objectives.

The second assumption is that private sector management in a competitive environment is intrinsically more efficient than the public sector, consequently private sector involvement in procurement, management and maintenance of public assets will improve the public allocation of resources, efficient maintenance and management of infrastructure assets for quality service delivery to the public. The theoretical construct that supports this assumption is the neo-classical economic theory one whose core thesis is the emphasis on efficiency of markets and free competition and the primary role of individuals in determining optimal economic outcomes.

The third assumption is that the development of a sound and wide-ranging financial system that is modern, diversified, well-regulated and inclusive will promote domestic savings, deepen capital market and broaden access to domestic and foreign capital for

infrastructure investments in Nigeria. This assumption, like many others, enjoy the backing of dominant financial theory that postulates that ‘the market, rather than the state is the best performer of the role of intermediary between those who possess surplus funds and those who wish to borrow’ as expressed in the Efficient Market Hypothesis (EMH) which also underlines many fundamental assumptions about how markets operate, financial market, in particular.<sup>41</sup>

Thus, this chapter will set the tone for this study by considering the underpinning theories enumerated above. As a run-up to this, the chapter will examine the reasons for the choice of these theories and interrogate the correlation between these theories and the butts of argument of this study.

It is instructive to note that these theoretical underpinnings provide logical constructs that in turn provide guide, the intellectual muscle and sinews needed to tread through the complex mazes of reality involved in this field of study which in itself represents a ‘stew of many complex issues’ on infrastructure development landscape in Nigeria.

## **2.2 Rationale for the choice of the theories**

From the outset, it is important to note that theoretical constructs are basically hinged on sets of assumptions and represent attempt to capture the essence of the complex environment by abstracting from reality through simplifying assumptions. This is against the backdrop of the fact that the world system is complex and its complex description difficult, if not impossible.<sup>42</sup>

Hence, these three theories are very relevant to this study in the following senses: the first theory underscores the instrumental role of law in bringing about creative changes and development in a given society and correlates the provision of infrastructure in a country and its socio-economic development, which in the context of this study, is that infrastructure enables development and that law can be used to creatively to unlock resources for infrastructure development in Nigeria; the second theory gives justification to the prevailing critical policy prescription in Nigeria which

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<sup>41</sup> Spratt (n 18 above) 11

<sup>42</sup> Seidmann A & Seidmann R (1994) 59

entails a shift from public sector to private initiatives in procurement, management and maintenance of public infrastructure assets, the policy shift which is evidenced by the adoption of public private partnership model; and the third theory indicates the role of financial system in facilitating the flow of funds in terms of its allocative efficiency and the imperative for financial system reforms and development in enhancing financial sector capacity to fund and support infrastructure projects development in Nigeria.

## **2.3 Theoretical constructs**

### **2.3.1 Law and development as the legal theoretical framework for this study**

Law and development has been subject of intense legal study and research for over three decades. There are however many perspectives on law and development and they are still evolving.<sup>43</sup>

In every society, laws are needed to ensure the institutional changes needed to implement more effective development strategies. This forms one of the core theoretical constructs central to the theme of this thesis.<sup>44</sup>

Exploring the facilitative role of law as an instrument of social change in a book, scholars are unanimous as to its facilitative role and explain that development implies social change which in turn implies institutional change. They submit that, ‘to bring about social change, government has no other instrument than the law, broadly conceived’ and ‘to transform an institution that perpetuates a social problem a government can only use law’.<sup>45</sup> Two reasons for this are: first, with the complexity of the present society, it is imperative for the government to ‘promulgate and effectively implement rules that...prescribe and contribute to shaping the relevant social actors’ behaviours in desirable ways’; second, with recognition of the doctrine of ultra vires as an integral part of the rule of law, ‘a government official has no power except what the law permits’.<sup>46</sup> The line of argument above forms the core theoretical assumption of this thesis.

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<sup>43</sup> Tamanaha B (1995) ‘The lessons of law and development studies’ AJIL 470-86 89

<sup>44</sup> Ibid.

<sup>45</sup> Seidmann A et al (eds) (2007) 20

<sup>46</sup> Ibid.

However, before getting down to the brass tacks, it is imperative to spare some thoughts on the definition of the key words under this segment, ‘law’ and ‘development’.

Seidman et al define law as ‘a normative rule promulgated by the state and ultimately implemented by state officials’ and ‘may take many forms: a statute, a local ordinance, subsidiary legislation, a ministerial rule, an administrative regulation, a military junta’s decree’.<sup>47</sup> In every society, primitive or civilized, there must be body of rules which members of the society must regard as the standard of behaviour without which there may be anarchy or state of anomie. In other words, law is aimed at social arrangement for human existence.

On ‘development’, the preamble to the United Nations’ General Assembly’s Declaration on the Right to Development<sup>48</sup> underscores a wider all-embracing components of the term ‘development’ by defining it as-

a comprehensive economic, social, cultural and political process, which aims at the constant improvement of the well being of the entire population and all individuals on the basis of active, free and meaningful participation in development and in fair distribution of benefits resulting there from.

Amartya Sen explains development ‘as a process of expanding the real freedoms that people enjoy’. According to him the focus ‘on human freedoms contrasts with narrower views of development, such as identifying development with the growth of gross national product, or with the rise in personal incomes, or with industrialization, or with technological advance, or with social modernization.’<sup>49</sup>

Theo Scheepers proffers a definition for ‘development’ simply as-

Development is a people-centred process of change depending for its ultimate success on the capacity of people to manage the process through a variety of critical steps and phases within the limits of an institutional and

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<sup>47</sup> Ibid. 6

<sup>48</sup> United Nations General Assembly Resolution 41/128 of 4 December, 1986

<sup>49</sup> Sen A Development as freedom (1999) 3

value framework that will guarantee meaningful and lasting improvement of quality of life for all in a peaceful, stable and well-governed environment.<sup>50</sup>

Having spared some thoughts on these key terms or words, the focus shifts to interrogating the perspective on law and development.

### **2.3.1.1 Perspectives on law and development**

Law and development is a social theory of law which has as its core the idea of legal liberalism<sup>51</sup> that views law as means of social engineering and as a veritable tool for attainment of development aspirations and objectives.

The central thesis of this theory explores the interface between law and development or social change in a given society and the development functions of law and argues that laws and legal institutions can play an independent instrumental role in achieving development or bringing about a social change.

Commenting on the evolutionary trend of legal liberalism, Lawan<sup>52</sup> remarked that legal liberalism ‘came in three phases: the Law and Development Movement (LDM) of the 1970s, the legal reforms under the Structural Adjustment Programme (SAP) of the 1980s and the World Bank’s rule of law project which started in 1990.’ According to him, ‘the last phase was introduced as one of the four elements of good governance which the World Bank identified as relevant for development. The other three elements are public sector management, accountability and transparency and information’.<sup>53</sup>

Law and development started as a specialized academic study in the United States primarily concerning the relationship between the legal systems and development,

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<sup>50</sup> Scheepers T (2008) 8

<sup>51</sup> W Simon explaining the term ‘Legal Liberalism’ observed that ‘[T]here is no canonical definition’ of the term, but explains that ‘[I]ts explicit indicia include predispositions in favour of plaintiffs in tort and civil rights cases, defendants in criminal cases, consumers in commercial cases, and workers in employment cases’. See Simon W ‘Solving Problems versus Claiming Rights: The Pragmatic Challenge to Legal Liberalism’ 46 William & Mary Law Review 127 (2004), at <http://scholarship.law.wm.edu/wmlr/vol46/iss1/4>, last accessed on 9<sup>th</sup> August 2012

<sup>52</sup> Lawan M ‘Liberal Legalism and the Challenge of Development in Nigeria’ 2009 (2) Law, Social Justice & Global Development (LGD)-[http://www.go.warwick.ac.uk/elj/lgd/2009\\_2/lawan](http://www.go.warwick.ac.uk/elj/lgd/2009_2/lawan)

<sup>53</sup> Ibid.

that is, the social, economic and political changes taking place in the developing countries.<sup>54</sup> Relying on modernization theory,<sup>55</sup> the Law and Development Movement emerged and gained acceptance in the United States in the 1960s. The law and development theorists ‘adopted the notion that evolutionary progress would ultimately result in legal ideals and institutions similar to those in the West’.<sup>56</sup> They argued that the diffusion of Western law to the Third World would aid its modernization and that modern law was the ‘functional prerequisite of an industrial economy’.<sup>57</sup> The chief exponents of this school of thought, Trubek<sup>58</sup> and Galanter,<sup>59</sup> contributed significantly to the knowledge of law and development through literature and proved, though theoretically, that law is essential to economic development in as much ‘as it provides the necessary support for the functioning of a market system’.<sup>60</sup>

According to their thesis, they made a prediction that when rules that are universal in nature are uniformly applied, they would give birth to predictability and make room for planning. They gave examples: contract law would secure expectation; property law would protect assets, and in theory would assist political development by providing the support required for a political democratic state. Besides, that government would be able to achieve its vision through law and that law would prevent arbitrariness and oppression on the part of the government.<sup>61</sup>

Just like the fate of modernization theory, the law and development movement was short-lived in that it was contradicted by the events in the developing countries during that period that it held sway. By the mid-1970s, it was obvious that the theory was sterile in that law was not achieving its intended objectives and failed to function as it

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<sup>54</sup> Zagaris, B (1988) 549 at 551.

<sup>55</sup> Modernization theorists contended that a society’s underdevelopment was both caused by and reflected in its traditional (as opposed to modern) economic, political, social and cultural characteristics or structures; that in order to develop, underdeveloped societies would have to undergo the same process of transition from traditionalism to modernity previously experienced by more developed societies.

<sup>56</sup> Zagaris, B (1988).

<sup>57</sup> Trubek D (1972) 82 YLJ 44.

<sup>58</sup> Ibid.

<sup>59</sup> Galanter M (1972) 156.

<sup>60</sup> Scheepers (n 50 above).

<sup>61</sup> Ibid.

was anticipated in the theory. The two leading figures in the Movement, Trubek and Galanter, signalled the death of this movement in their article published in 1974.<sup>62</sup> According to the duo, it failed because it was said to be an ‘ethnocentric and naïve’ school of thought.<sup>63</sup> Their judgment of its failure was based on the observation that the theory contrasted sharply with the realities in developing countries, such as typical authoritarian governments and disparities between the wealthy and the extremely poor, where it seemed as if laws were made to serve the interests of the economic elite and that the courts were weak and irrelevant. Another reason for the failure of the theory was that once law as an instrument of development or social change fell into the hands of an authoritarian and weak government, it was used to set and achieve goals supported by that government.<sup>64</sup>

The decline of this school of thought could be traced to the American experiences with the civil rights movement and the Vietnam War. The experiences, most likely, must have led to an awareness of the gaps between the ideals of America and the reality of her legal system.<sup>65</sup> In the words of Scheepers, the criticism of the Law and Development Movement brought to the fore five issues of utmost importance to ensure ‘an effective role for law in the development process in developing countries’. First, there is need for empirical knowledge about developing countries. Second is the realization that the picture of legal liberalism in the United States will be at variance with the reality in the developing world. Third, there are doubts about the universality of experiences of developed countries. Fourth, there also exists scepticism with regard to the policy objective of the advanced countries, and lastly, ‘an acceptance that instrumentalism is merely an aspect of law, not the essence of the rule of law’.<sup>66</sup>

There are however, wide and varied perspectives on development that offer insights or give a peep into the relationship between law and development. These perspectives have made considerable influence on the thinking about development in general and about the symbiotic association between law and development and they include modernization theory; dependency theory which has had much influence on the law

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<sup>62</sup> Trubek & Galanter (1974) WLR 1062 at 1075-6.

<sup>63</sup> Scheepers 10

<sup>64</sup> Ibid.

<sup>65</sup> Davis K & Trebilock MJ (1999) 14

<sup>66</sup> Tamanaha B (1995) 470-86

and development thinking; economic perspectives; welfarist perspective; feminism; and sustainable development perspective. These perspectives will not however be investigated because they fall outside the focus of this enquiry.

### **2.3.1.2 The interface between law and development**

So, based on law and development thinking to date, it could be argued that law has an inherent development function. Law is generally multi-functional in a contemporary society; it regulates, controls, creates order, determines outcomes, prescribes penalties, outlaws certain acts or actions, among many others. It could be used as tools of administration, control, crime prevention, rehabilitation and justice, and for collecting revenue and taxes.<sup>67</sup> A law may either promote or restrict development. This depends on its aims and objectives as well as the manner in which legal rules are implemented.<sup>68</sup>

In a way, all laws impact on the development of a country and its people, one way or the other. In most cases, most laws will affect development indirectly; only few laws are deliberately targeted at achieving specific development goal and objectives. Such laws are referred to as laws that have a development function or development driven. These laws provide the legal framework within which development within a particular country is driven, and these are generally called ‘development law’.<sup>69</sup>

Development law is based on development policy; development policy comes into existence through a policy-making process. This process starts when political leaders decides to respond to the needs, problems, ideals and aspirations of the citizens of a particular country. These issues and problems are identified by way of research inquiries and a consultation process in response to which a general discussion document is drafted.<sup>70</sup> Official policy is translated into written laws and policy becomes law through a law-making process. Development policies become development laws through a similar channel or process.<sup>71</sup> Examples of development

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<sup>67</sup> Scheepers 18

<sup>68</sup> Ibid.

<sup>69</sup> Ibid.

<sup>70</sup> Ibid.

<sup>71</sup> Ibid.

laws include the laws that drive infrastructure development, investment (domestic and foreign), and procurement to mention few.<sup>72</sup>

However, policy, no matter how well-researched and drafted cannot bring about development alone; policies and laws will only bring about the desired change only when they have been implemented effectively.<sup>73</sup> Therefore, laws outline and define principles, procedures, mechanisms and action to be taken in order to achieve a predetermined policy goal. The implementation process, however, is a dynamic process that involves people, communities and organizations from all strata of a given society.<sup>74</sup> People should be the central theme in development process. Policy becomes law; and in order to make laws effective, people become involved in the implementation process, and the implementation of law and policy always depends for its validity and successful implementation on being constantly in congruence with what the people need.<sup>75</sup>

Development laws also prescribe the rights and duties of all the role-players involved in the development process. All individuals, communities, organizations and other role-players have rights, duties and obligations as defined in these laws. Because development is an inclusive process depending on the input of people and organizations for its success, development law describes the role and function of each of the role-player.<sup>76</sup>

### **2.3.1.3 Deductive reasoning approach to the study**

As pointed out in the introductory remarks, one of the fundamental assumptions that will course through the entire gamut of this study is that with appropriate legal and institutional reforms, the untapped domestic financial resources can be mobilized and cross-border capital attracted for infrastructure development in Nigeria. This is supported by the dominant theory which underscores the role of law and legal

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<sup>72</sup> Ibid. These laws are ‘development laws’ because they are aimed ‘at the constant improvement of the well being of the entire population’. See the definition of ‘development’ in the preamble to the United Nations’ General Assembly’s Declaration on the Right to Development, Resolution 41/128 of December, 1996.

<sup>73</sup> Scheepers 18.

<sup>74</sup> Ibid.

<sup>75</sup> Ibid.

<sup>76</sup> Ibid.

institutions in development or social change and have as its main thesis the idea of ‘legal liberalism’ that sees law as a means of social engineering and as a tool for achieving developmental objectives.

So, using the deductive reasoning approach and against the backdrop of having discussed the general theoretical frameworks for the study, the focus of this study at this point shifts to the particular by investigating the critical imperatives for legal and institutional reforms in widening access to long-term financing and increasing the appetite for private investment in the nation’s public infrastructure assets and services.

### **2.3.1.3.1 The critical imperatives for legal reforms**

Critical to the entrenchment of private involvement in infrastructure procurement and service delivery is an appropriate enabling legal infrastructure. This is underscored by the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects which states that the existence of an appropriate legal infrastructure is a critical imperative to creating an environment that enhances private sector investment in infrastructure sectors of the economy.<sup>77</sup> The level of development of a host state’s laws relevant to private sector investment in public infrastructure coupled with the stability of its legal system and how adequate are the available legal remedies for private investors are essential components of the entire spectrum of the legal infrastructure for private sector participation in public assets financing.<sup>78</sup>

Thus, by reviewing and improving the relevant laws as appropriate in those areas of immediate relevance for private investment in public infrastructure, the host state would have made a vital impact in securing a positive legal environment for attracting private capital in infrastructure development.<sup>79</sup> As further underscored in the study, ‘greater legal certainty and a favourable legal framework will translate into a better assessment of country risks by lenders and project sponsors’<sup>80</sup> alike. The implication of this is that it will have a correlative positive impact on the cost of mobilizing

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<sup>77</sup> Ibid.

<sup>78</sup> Ibid. 189

<sup>79</sup> Ibid.

<sup>80</sup> Ibid.

private capital and scale down the imperative for support or guarantees from the government of the host state.<sup>81</sup>

However, in reviewing the adequacy or otherwise of the legal infrastructure, some legal parameters must be put into consideration. One of these legal parameters is transparency. As observed in the UNCITRAL Legislative Guide, ‘a transparent legal framework is characterized by clear and readily accessible rules and by efficient procedures for their application’.<sup>82</sup> As succinctly put in the Guide:<sup>83</sup>

...transparent laws...create predictability, enabling potential investors to estimate the costs and risks of their investment and thus to offer their most advantageous terms. Transparent laws...may also foster openness...help to guard against arbitrary or improper actions or decisions by the contracting authority or its officials and thus help to promote confidence in a country’s infrastructure development programme. Transparency of laws...is of particular importance where foreign investment is sought, since foreign companies may be unfamiliar with the country’s practices for the award of infrastructure projects.

The second legal parameter that must be put into consideration in reviewing the adequacy or otherwise of the legal infrastructure is: fairness. Ordinarily, the legal framework provides the means by which government regulates and ensure the provision of services to the public and it is also the means by which public service providers and their customers may protect their rights. Thus, an appropriate legal infrastructure should capture issues like ‘the private sector’s business considerations, the users’ right to adequate services, both in terms of quality and price, the government’s responsibility for ensuring continuous provision of essential services and its role in promoting national infrastructure development’.<sup>84</sup>

The third consideration is long-term sustainability. Thoughts should be given to an enduring provision of services to the public by paying attention to environmental

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<sup>81</sup> Ibid.

<sup>82</sup> Ibid. 23

<sup>83</sup> Ibid. 23-4

<sup>84</sup> Ibid. 24

sustainability. As observed in the Guide: ‘inadequate arrangements for the operation and maintenance of public infrastructure severely limit efficiency in all sectors of infrastructure and result directly in reduced service quality and increased costs for users’.<sup>85</sup>

Obviously, the transfer of public infrastructure assets from state control and operation to the private sector entities triggers a paradigm shift in a nation’s socio-economic development strategy and leaves at its trail the need for a wholesale reform of the country’s legal landscape.<sup>86</sup> It may also require amendment of the existing relevant laws and enactment of the new ones. It is needful to appreciate the fact that lack of a clear, predictable, transparent and fair legal framework would lead to legal uncertainty, hinders the ‘bankability’ of projects and the flow of the required domestic resources and cross-border capital into the infrastructure development landscape.<sup>87</sup> For an instance, in the granting of concession rights on public infrastructure asset to a private investor, a legislation would be required to vest in the private investor the exclusive legal right to operate, maintain and earn stream of revenue through the collection of end-user fees during the period of the concession in order to recoup its investments in the public infrastructure asset. Aside, legislation would also be needed to protect the public end-users from exploitation ‘by setting limits on adjustments of end-user fees and other contingent charges which the private sector entity may charge.’<sup>88</sup>

Rules are therefore very significant in defining the terms and the templates upon which financial capital flows. It is the legal framework that breathes the ‘breath of life’ into the entire gamut of the policy framework for private participation in procurement of public infrastructure. As argued by the former General Counsel of the World Bank in 1995 ‘a legal and regulatory framework...is a fundamental element in the stability and flexibility needed for the investment environment’.<sup>89</sup> Hence, the need to reform institutions and particularly the legal framework cannot therefore be over-

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<sup>85</sup> Ibid.

<sup>86</sup> Tanyi 1

<sup>87</sup> Ibid.

<sup>88</sup> Ibid. 6-7

<sup>89</sup> Shitata, (1995) ‘World Bank in a changing world’ The World Bank 234

emphasized. Besides, clear rules based on clear policy framework will enable the Infrastructure Concession Regulatory Commission to superintend the PPP procurement transactions while the Bureau of Public Procurement will oversee the traditional public procurement. This also must be incorporated in the suggested new legislative framework.<sup>90</sup>

### **2.3.1.3.2 Making case for institutional reforms**

As explained by Seidman and Seidman<sup>91</sup> the word ‘institution’ denotes more than a self-contained organization. To them, ‘a bank, a factory, or a university does not constitute an institution simply because it conducts its business in a building; it constitutes an institution because its personnel-sweepers, presidents, accountants, and securities-behave in repetitive, interacting patterns’. They claimed that in that sense, property ownership and contractual relations also constitute institutions in that they too consist of people acting in repetitive patterns. So in that regard, these institutions constitute the modalities by which people relate to each other. They argued further that regardless of their personal characteristics, people occupy specified roles, defined by norms determined by state, private authority or social processes and that it is these role-occupants and their interactions that therefore constitute institutions.<sup>92</sup>

However, to make a giant stride in overcoming underdevelopment, change in the institutions is needful and to bring about change in these institutions, it is imperative for the legal order too to change.<sup>93</sup> Thus, the institutional landscape must be changed to attract private capital, both domestic and foreign. To create conducive institutional environment, a process of institutional reforms must necessarily take place and this process must proceed in two fronts. First is in the area of regulatory environment and second is the judicial system. The reforms in these two fronts will ultimately impact either in the positive way or negative manner on the operating business environment which could either attract or scare capital away.

Institutional uncertainty persists in Nigeria and the weakening of the rule of law has discouraged investment flow into infrastructure sectors. There is also the institution of

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<sup>90</sup> Ibid.

<sup>91</sup> Seidman and Seidman 40

<sup>92</sup> Ibid. 41

<sup>93</sup> Ibid.

the judiciary which is critical to protecting property rights and law enforcement regulations.

It is however instructive to note that ‘a well-developed collateral framework also has synergies with important aspects of the legal framework such as contract enforcement and insolvency/bankruptcy. When creditor rights are clearly established, contracts are more easily enforced and disposition of assets of distressed borrowers can proceed more efficiently and systematically.’<sup>94</sup>

### **2.3.2 Neo-classical economic theory**

As articulated in the introductory segment, the theme of this assumption is that private sector management in a competitive environment is intrinsically more efficient than the public sector, consequently, private sector involvement in procurement, management and maintenance of public assets will improve the public allocation of resources, efficient maintenance and management of infrastructure assets for quality service delivery to the public. The theoretical construct that supports this assumption is the neo-classical economic theory one whose core thesis is the emphasis on efficiency of markets and free competition and the primary role of individuals in determining optimal economic outcomes.

The neo-classical economic theory promotes the philosophy that the distribution of social resources produced by market exchanges is innately fair and just when it is allowed to work ‘without friction’. The theory argues that ‘free competition and market mechanisms, in all countries and under all circumstances, would bring about a more optimal distribution of commodities, than a regulated economy with administrative control and central planning’.<sup>95</sup> The sub-set of the assumption is that private sector management in a competitive environment is intrinsically more efficient than public sector management.<sup>96</sup>

Regarding the public sector’s procurement of the infrastructure, the argument is that the public sector generally has a legacy of poor performance and has always

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<sup>94</sup> Ibid. 18.

<sup>95</sup> Martinussen J (1995) 66

<sup>96</sup> Ibid.

functioned ineffectively and inefficiently. Besides, the public sector lacks both the financial and technical wherewithal and capacity to handle the task involved in the procurement of public infrastructure and service delivery.<sup>97</sup> This line of thought could be traced to the first formulations of neo-classical theory and to the later rejection of Keynesian notion of the appropriateness of relatively extensive state's interventions.<sup>98</sup>

Based on the extensive literature on the neo-classical paradigm, the notion was pushed by the theorists for the greater part of the 1970s until it enjoyed wide acceptance in 1980s amongst the policy makers in the OECD countries and the Bretton-Woods institutions. This triumph came as a result of the ascension to power in the United States, United Kingdom and West Germany of the trio-Regan, Thatcher and Kohl respectively almost at the same time.<sup>99</sup>

Neo-liberalism as a subset of neo-classical economic theory has link with the Chicago School of Economics which also emphasized the efficiency of markets and free competition, and stressed the primary role of individuals in determining optimal economic outcomes. According to Payne and Phillips, 'an amalgam of currents in neo-classical economics and associated theoretical tendencies in political science' is what came to be referred to 'simply, and pervasively, as neo-liberalism'.<sup>100</sup>

Neo-liberalism was grounded in neo-classical theory and "associated most visibly with the elaboration of the so-called 'Washington consensus' agenda in the 1980s and its dissemination across the developing world by a powerful nexus of governments, institutions and market actors".<sup>101</sup> The concretization of the neo-liberal principles from the 1960s onwards was hinged on the grand rejection of Keynesian growth theory and 'a forceful challenge to the nascent field of development economics' as put by Payne and Phillips.<sup>102</sup> The duo is of the opinion that 'the theoretical foundations of the perspective were initially laid as a theory of advanced capitalism and specifically

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<sup>97</sup> Ibid.

<sup>98</sup> Ibid.

<sup>99</sup> Ibid. In all these countries, the change in regimes led to change in the national financial advisers who were in favour of monetarists and micro-economists with neo-classical orientations.

<sup>100</sup> Payne A & Phillips N (2010) 86.

<sup>101</sup> Ibid.

<sup>102</sup> Ibid.

as a critique of the experiences of Keynesian growth strategies in the advanced industrialized economies of Western Europe'.<sup>103</sup>

The central theme of neo-liberal perspective was that there was no need for government to intervene in the economy to ensure full employment, for instance, in a free market situation, prices will adjust to ensure adequate supply and to ensure that all the factors of production are employed, that is, markets automatically adjust to full employment and attempts to use monetary or fiscal policy to achieve these ends creating inflation. In contrast, government interventions in markets were viewed with suspicion, being largely seen as distorting markets and preventing these optimal outcomes from occurring.<sup>104</sup>

In summary, the kernel of the neo-liberal pre-disposition hinged on 'the prioritization of capital as money over capital as production and the consolidation of market-led mechanisms or resource allocation as the most effective means of stimulating industrialization and development'.<sup>105</sup> This is then implicated in the prescriptive emphasis falling on 'getting the prices right' which means "freeing markets to set prices rather than maintaining systems of 'political prices'", creating competitive markets integrated into the international economy, and positioning the private sector as the engine of accumulation and growth.<sup>106</sup>

Thus, the mainstream current of the theory strived to radically rearrange the relationship that existed between markets and states to preserve the dominance of money capital in national and international economic organisation and eliminate the disabling political consequences of excessive rent seeking for economic growth. State would, for this purpose, be relegated to roles consistent with the philosophical position advocated by Friedman<sup>107</sup> in a statement which has come to be seen as the emblematic summary of neo-liberalism: 'To the free man, the country is a collection

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<sup>103</sup> Ibid.

<sup>104</sup> Ibid.

<sup>105</sup> Ibid. 93. As noted by Payne et al., this means 'the rise to prominence of finance capital which ended the post-war international regime of fixed exchange rates and the concomitant unleashing of a contemporary phase of globalization associated with high levels of global capital mobility' in a capitalist system that is considerably unregulated.

<sup>106</sup> Ibid.

<sup>107</sup> (1962), 2 cited in Payne, A and N Phillips (2010), *ibid.*

of individuals which compose it...The scope of government must be limited...to preserve law and order, to enforce private contracts, to foster competitive markets'.<sup>108</sup>

This theory seems to justify the prevailing critical policy prescription in Nigeria which entails a policy shift from public sector to private initiatives in procurement, management and operation of public infrastructure assets evidenced by the adoption of public private partnership as a financing technique.

The transformation of the telecommunications industry in Nigeria is the most practical proof of the veracity of this assumption and theoretical construct. Until 2001, the Nigerian telecommunications industry was dominated by a state-owned telecommunications company and the industry was characterized by poor and high cost of telecommunications services. However, since the total liberalization of the industry, the market has witnessed dramatic change driven by the introduction of mobile licences. This is implicated in the removal of barriers to market entry and creating space for market forces to ensure market stability through competition.

### **2.3.3 Financial theory**

According to Spratt, 'the hypothesis postulates that capital markets will be optimal in terms of 'allocative efficiency' if prices fully and accurately reflect all the relevant information, thereby ensuring that price signals correctly direct equilibria'.<sup>109</sup> The fundamental theoretical construct supportive of financial liberalization as a policy prescription is 'the fundamental theorem of welfare economic, and the efficient market hypothesis'. The theorem states that 'competitive markets yield Pareto optimal equilibria'<sup>110</sup> whilst the efficient markets hypothesis states that financial markets use information efficiently'.<sup>111</sup> Mavrotas citing Eatwell<sup>112</sup> posited that 'the combination of the two ensures, by definition, efficiency of the real economy and also ensure the

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<sup>108</sup> Ibid. 93.

<sup>109</sup> Ibid.

<sup>110</sup> It means where no alternative feasible allocation can improve the lot of one agent without worsening the conditions of some other individual.

<sup>111</sup> Mavrotas G (2005) 29.

<sup>112</sup> Eatwell J (1996) 1.

financial markets reflect the fundamentals of the real economy. Market liberalization in effect removes any market distortions that impede these free market conditions'.<sup>113</sup>

The theory that has a strong “belief in superiority and efficiency of the market mechanism suggests that government should (a) concentrate on establishing the ‘rule of the game’ in terms of a level playing field for market participants, (b) ensure obstacles to financial and private sector development are removed, and (c) avoid further interventions in the economic or financial sectors, which by definition will be sub-optimal when compared with the ‘invisible hand’ of efficient markets”.<sup>114</sup>

As it has been rightly observed, what developing countries like Nigeria in most cases ‘lack is an appropriate financial sector, which could provide incentives for individuals to save, and acts as an efficient intermediary to convert these savings into credit for borrowers’.<sup>115</sup>

This theory justifies the role of financial system in facilitating the flow of funds in terms of its allocative efficiency and the imperative for financial system reforms and development in enhancing financial sector capacity to fund and support infrastructure projects development in Nigeria.

## **2.6 Concluding remarks**

In the chapter, the three dominant theories were identified and examined as providing the logical constructs and analytical framework in support of the core thesis of this study. These theoretical constructs are to guide and provide the intellectual muscle and sinews needed to navigate through the ‘stew of many complex issues’ that are to be presented in this study and the rugged terrains of infrastructure development landscape in Nigeria.

The chapter examined the first dominant assumption which is to the effect that with appropriate legal and institutional reforms, whether in reforming the existing laws and legal institutions or enacting or creating new ones, the untapped domestic financial

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<sup>113</sup> Mavrotas (n 111 above) 30

<sup>114</sup> Spratt (n 18 above) 14

<sup>115</sup> Ibid. 29

resources can be mobilized and cross-border capital attracted for infrastructure development in Nigeria. The supportive theory is that which underscores the role of law and legal institutions in development or social change. Its main thesis is the idea of ‘legal liberalism’ that sees law as a means of social engineering and as a tool for achieving developmental objectives.

Also discussed was the perspective that emphasized on efficiency of markets and free competition and the primary role of individuals in determining optimal economic outcomes and its sub-set postulation that private sector management in a competitive environment is intrinsically more efficient than public sector management seems to be supportive of the paradigm shift from public sector to private initiative in funding and management of public infrastructure assets.

The chapter also interrogated the assumption that the development of a sound and wide-ranging financial system that is modern, diversified, well-regulated and inclusive will promote domestic savings, deepen capital market and broaden access to domestic and foreign capital for infrastructure investments in Nigeria. This was supported by the dominant financial theory on financial liberalization which postulates that ‘the market, rather than the state is the best performer of the role of intermediary between those who possess surplus funds and those who wish to borrow’ as expressed in the Efficient Market Hypothesis (EMH), which underlines many fundamental assumptions about how markets operate, financial market, in particular.<sup>116</sup>

The discussion in this chapter has therefore set the tone for the subsequent chapters and the theories will form the basis for the ‘golden thread’ that links all the chapters of this thesis together in a coherent fashion.

Having said this, the focus of this investigation shifts to interrogating the correlation between provision of infrastructure assets and socio-economic development and the sectoral-level analysis of the infrastructure assets in Nigeria.

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<sup>116</sup> Ibid.

## CHAPTER 3

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### PROCUREMENT OF PUBLIC INFRASTRUCTURE ASSETS AND THE QUEST FOR DEVELOPMENT

3.1 Introductory remarks

3.2 Defining infrastructure

3.3 Infrastructure as a critical enabler of development

3.3.1 Infrastructure and productive capacity

3.4 Overview of state of infrastructure in Nigeria

3.4.1 Facts about Nigeria

3.4.2 Sector-level analysis of state of public infrastructure

3.4.2.1 Power sector

3.4.2.2 Transport sector

i. Land transport

ii. Rail infrastructure

iii. Water transport infrastructure

(c) Coastal and inland waterways

(d) Ocean transport or shipping

iv. Air transport

3.4.2.3 Telecommunications industry

3.5 Infrastructure investment requirements

3.6 Government's efforts at addressing the infrastructure challenges

3.6.1 The power sector reforms

3.7 Concluding remarks

### **3.1 Introductory remarks**

In the previous chapter, the stage was set by examining the related theoretical constructs that underpin the fundamental assumptions that this research will be constructed on.

The question that this chapter will seek to interrogate is: what is the correlation between provision of infrastructure assets and socio-economic development in an emergent nation like Nigeria.

In answering this question, this factual chapter shall present a contextual overview through a sector-level analysis of the current state of public infrastructure in the country with the view to graphically paint the picture of the deplorable state of infrastructure and the financing gaps in Nigeria.

In accomplishing this task, there will be discussion on the idea of infrastructure; the reasons for the dilapidated state of infrastructure assets and perennial failure of service delivery in Nigeria shall be unpacked. The discussion shall also cover the various strides that have been made by the successive administrations in their quest to raise the bar in procurement of critical infrastructure and service delivery to the Nigerian public.

### **3.2 Defining infrastructure**

Defining the term ‘infrastructure’ has been quite problematic! There has not been a general consensus amongst commentators<sup>117</sup> as to the precise definition of the term.

To Grimsey and Lewis,<sup>118</sup> the items that make up ‘infrastructure’ vary from country to country and from one time to another. This they underscored by the example of steel production which was once regarded as an essential infrastructure in many countries and in the early post-war Britain where coal, iron and steel were believed as being parts of the ‘commanding heights of the economy’ but which few would describe as such in the present day Britain.

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<sup>117</sup> Grimsey D & Lewis M (n 16 1bove) 20.

<sup>118</sup> Ibid.

There have also been suggestions that public ownership should be the defining characteristic of infrastructure. However, with the global involvement of private sector in infrastructure services delivery, ownership of the infrastructure asset as a defining characteristic of asset that should be referred to as public infrastructure is not tenable. As argued by Grimsey and Lewis, while there would be a somewhat general consensus that tangible capital assets such as bridges, roads, streets and tunnels are infrastructure, other would cast a much wider net in defining the term.<sup>119</sup>

Casting the infrastructure net wider, Allen Consulting Group<sup>120</sup> defines ‘infrastructure’ as ‘those physical and social structures that support the life and interactions of a society’.

JK Gadzama,<sup>121</sup> defines the term in the following words:

infrastructure represents the minimum basic physical and organizational structure needed for operation of society or an enterprise. It is critical to efficient functioning of government and the economy. In its modern popular connotation, it typically refers to availability of technical structures such as roads, telecommunication, power supply, environmental waste management, efficient water supply and associated structures for service delivery such as schools, hospitals, administration of justice, provision of security for lives and property, etc.

However, in defining a term, tracing its ancestry may sometimes give a clue as to its original meaning. The ancestry of the term ‘infrastructure’ is traceable to the period of Second World War when the then military strategists who in their attempt to indicate wide-ranging elements of war logistics came up with the term.<sup>122</sup> Immediately

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<sup>119</sup> Ibid.

<sup>120</sup> Cited in Grimsey (n 104 above) 22.

<sup>121</sup> A board member, Infrastructure Concession Regulatory Commission of Nigeria (ICRC). He chairs the Board’s Contract Compliance Committee; a legal practitioner and the principal partner, Messrs JK Gadzama and Partners; see also Tanyi, Gerald (2009) ‘Infrastructure finance in emerging markets: lessons from recent experience’ Series published by JK Gadzama with ICRC 2 May 2009 p. ix

<sup>122</sup> Oyeranti O (2004).

thereafter, development economists began to use the term inter-changeably with ‘over-head capital’.<sup>123</sup>

In his landmark book published in 1958, Albert Hirschman also defined the term ‘infrastructure’ as:

(t)hose services without which primary, secondary and tertiary production activities cannot function. In its widest sense, it encompasses all public services from law and order through education and public health to transportation, communication, power and water supply as well as such agricultural over head capital as irrigation and drainage systems.<sup>124</sup>

Most frequently in defining infrastructure, a distinction is generally made between economic and social infrastructure and within each of these, distinction is also made between hard (physical) and soft infrastructures.<sup>125</sup>

Based on the above, four types of infrastructure are identifiable:

- hard economic infrastructure;
- soft economic infrastructure;
- hard social infrastructure; and
- soft social infrastructure.<sup>126</sup>

Economic infrastructure is the core infrastructure that is targeted at enhancing productivity and innovation in that it provides vital intermediate services to business and industry. Hard economic facilities cover infrastructure assets like ‘roads, highways, bridges, ports, railways, airports, public transport, telecommunications, electricity and gas generation, transmission and distribution’; Soft economic infrastructure assets include vocational training, capacity building, financial facilities for businesses like payments, credit, equity, derivatives, venture capital, to mention few. Also included in this sub-category are the information and communication

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<sup>123</sup> Ibid.

<sup>124</sup> Hirschman, A (1958) The strategy of economic development 83.

<sup>125</sup> Grimsey 20.

<sup>126</sup> Ibid.

technologies, other assets that are needed to facilitate research and development, technology transfer and trade.<sup>127</sup>

However, it must not be forgotten that some of these infrastructure assets are also operated and owned by private entities like individuals, institutions or organizations.<sup>128</sup>

Social infrastructure provides basic services for human survival in a society or community. It generally improves the quality of life and touches strongly on the welfare of inhabitants of the society, community or nation, especially the vulnerable groups in particular-the class in the lowest wrung of the society. Hard social facilities include hospitals, education and training buildings, water storage, dams and treatment facilities, housing, sewerage and drainage pipes, child care and aged care institutions and penitentiaries. Some of these services are also provided by private entities like private hospitals and schools.<sup>129</sup>

As for soft social infrastructure, it takes the form of the social security systems which include public health, education, law and order, to mention few.<sup>130</sup> It is however instructive to note that these distinctive categories do overlap.

At a broader level, it is the responsibility of the government to ensure the provision of a variety of infrastructure types in order to ensure the effective and efficient functioning of a society. It is important to note that these infrastructures are limited and interrelated. The effective functioning of a national economy is realisable only with the availability of a range of infrastructures-space for business, transportation, telecommunications, housing, education, health, power, waste disposal, sewerage, etc.<sup>131</sup>

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<sup>127</sup> Ibid.

<sup>128</sup> Ibid.

<sup>129</sup> Ibid. p. 21

<sup>130</sup> Ibid.

<sup>131</sup> Ibid.

Thus, from the plethora of definitions above, it could be seen that the term ‘infrastructure’ embraces two broad categories of services namely: social infrastructure and economic infrastructure.

The Central Bank of Nigeria<sup>132</sup> aligns with this broad classification of infrastructure and agrees that social infrastructure encapsulates education, health and water supply, while the economic infrastructure includes in particular, transportation and communications.

Section 36 of Infrastructure Concession Regulatory Commission (Establishment, Etc) Act,<sup>133</sup> provides a statutory insight into what infrastructure entails in the Nigerian context when it provides that:

‘infrastructure’ includes development projects which, before the commencement of this Act, were financed, constructed, operated or maintained by the Government and which, after the commencement of the Act, may be wholly or partly implemented by the private sector under an agreement pursuant to this Act including power plants, highways, seaports, airports, canals, dams, hydroelectric power projects, water supply, irrigation, telecommunications, railways, interstate transport systems, land reclamation projects, environmental remediation and clean-up projects, industrial estates or township development, housing, government buildings, tourism development projects, trade fair complexes, warehouses, solid wastes management, satellite and ground receiving stations, information technology networks and database infrastructure, education and health facilities,

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<sup>132</sup> It is the Nigeria’s apex bank. It derives its powers from the 1958 Act of Parliament, as amended in 1991, 1993, 1997, 1998, 1999 and 2007. The 2007 Act saddles the apex bank with the overall control and administration of the monetary and financial sector policies of the executive arm of the Government of Nigeria. It must however be noted that section 59 of the Central Bank of Nigeria Act 2007 has expressly repealed the Central Bank of Nigeria Act 1991 and by implication, the Central Bank of Nigeria amendment enactments of 1993, 1997, 1998, and (No. 2) of 1999.

<sup>133</sup> The Act enacted into law on the 9<sup>th</sup> day of November 2005 provides for the participation of private sector in financing the construction, development, operation, or maintenance of infrastructure or development projects of the Federal Government through concession or contractual arrangement; and the establishment of the Infrastructure Concession Regulatory Commission to regulate, monitor and supervise the contracts on infrastructure or development projects. See the Explanatory Memorandum to the ICRC Act 2005.

sewerage, drainage, dredging, and other infrastructure and development projects as may be approved, from time to time, by the Federal Executive.<sup>134</sup>

A quick look at the above statutory definition reveals that the term ‘infrastructure’ is broadly defined, covering both social and economic infrastructures and virtually every sector of the Nigerian economy.<sup>135</sup>

In recent times, the definition of infrastructure has expanded to include not only toll bridges and roads, railways, schools, hospitals, water and waste, government offices, but defence, lotteries and even stock exchange.<sup>136</sup>

It must however be noted that the statutory definition above, for the purposes of this study, shall provide the reference point throughout this thesis since the legislation remains the closest piece of law that can be referred to as infrastructure law in Nigeria.

Having discussed what infrastructure is, the focus will now shift to exploring the role of infrastructure in development process.

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<sup>134</sup> ‘Infrastructure’ is also defined under the Lagos State Roads, Bridges and Highway Infrastructure (Private Sector Participation) Development Board Law as ‘roads, bridges and highways and associated facilities’. Lagos State is the economic capital and one of the federating states in Nigeria. The newly enacted Lagos State Public Private Partnership Law 2011 defines ‘Public Infrastructure’ as ‘public facilities and amenities including roads, bridges, highways, rail lines, water transportation facility, public water works, housing, electric power stations, hospitals, recreational parks, motor parks, waste disposal facility, amusement centres, and any other infrastructure or amenities for public use’.

<sup>135</sup> So generally, ‘infrastructure’ refers to all these combined facilities that provide essential public services of transportation, utilities (water, gas, electricity), energy, telecommunications, waste disposal, park lands, sports, and recreation and housing. Infrastructure also provides the physical systems used to provide other services to the public through economic and social actions. These infrastructure facilities and services are provided by both public agencies and private enterprises.

<sup>136</sup> Delaney (n 9 above) 45.

### 3.3 Infrastructure as a critical enabler of development

It is an established fact that infrastructure is an enabler and acts as catalyst and critical to human and economic development and also the general functioning of every modern society. It defines a country's business competitiveness and also creates jobs. It provides the sub-structure upon which a given society, the super-structure in this context, is built on; it could be likened to a 'jugular vein'<sup>137</sup> of an existing society. Without it, a society cannot function! That explains why in every nation, provision of infrastructure assets has always remained in the front-burner of governments' agenda for development and policy thrust. Provision of modern and functional infrastructure plays a vital role in the socio-economic lives of the people. Therefore, raising the bar for service delivery and tackling the poverty of infrastructure have been integral components of successive governments' vision in Nigeria.

Besides, infrastructure also facilitates trade through increased productivity which is a necessity for economic growth and prosperity; it acts as a source of employment and contributes to the Gross Domestic Product (GDP). Availability of infrastructure is a major incentive to attract crucial foreign investments for development. It also acts as a growth accelerator and a 'sine qua non' for global competitiveness. In other words, the value added from a functioning infrastructure is multi-dimensional in nature. These then make for improved quality of life. Hence, the symbiotic relationship which exists between infrastructure and economic development can no longer be denied. This could be seen in the developed and industrialized West, where provision of critical infrastructures promotes economic growth, good health, rural development, agrarian culture, sound education and alleviation of scourging poverty in the society generally. This must have informed the reason why Late President J.F. Kennedy of United States said that a country cannot be rich without good infrastructure.<sup>138</sup>

Apart from being a major contributor to economic growth, infrastructure is also essential input to human development. For example, electricity powers health and education services and give boost to an enhanced productivity on the side of small business concerns; roads too provide links to domestic and international markets;

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<sup>137</sup> This is one of the veins in the neck that drain blood from the head, brain, face and neck and convey it toward the heart. See Online Medical Dictionary-<http://www.medterms.com/script/main/art.asp?articlekey=9187>.

<sup>138</sup> Obozuwa D (2010).

Information Communication and Technologies (ICTs) open up the cyber space for access to information and bring down the cost of living and transacting businesses by providing the platform for people to transact remotely.<sup>139</sup> For an instance, convenient supplies of portable water will save time and prevent a wide range of water-borne diseases including diarrhoea which is responsible for the outrageous rate of infant mortality and malnutrition in the world.<sup>140</sup> Without infrastructure, achieving the lofty millennium development goals<sup>141</sup> would also remain in the realm of dreams.

In the words of Hudson, Haas and Uddin,<sup>142</sup> the success and progress of human society depends on physical infrastructure for distributing resources and essential services to the public. The quality and efficiency of this infrastructure affect the quality of life, the health of the social system, and the continuity of economic and business activity and a nation's economic strength is reflected in its infrastructure assets.<sup>143</sup>

History is replete with many examples. The Romans built a strong empire with a tremendous impact across continents by constructing all-weather roads and viaduct throughout Europe, North Africa, and the Middle East to move people, goods, and water. In the colonial era of the 16<sup>th</sup> to 19<sup>th</sup> centuries, European nations emerged as strong shipbuilders and explorers. This was followed by the products of the industrial revolution, particularly in the use of steam engines for ships and railroad transport. In the United States and other regions of the world, historical development of the economic and social systems closely parallels phases of infrastructure development. Demands on infrastructure and related services increase as people expect a higher standard of life and public services.<sup>144</sup>

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<sup>139</sup> Foster and Briceno-Garmendia (n 21 above) 2

<sup>140</sup> Ibid.

<sup>141</sup> 'MDGs are the world's time-bound and quantified targets for addressing extreme poverty in its many dimensions-income, poverty, hunger, disease, lack of adequate shelter, and exclusion-while promoting gender equality, education, and environmental sustainability. The are also basic human rights-the rights of each person on the planet to health, education, shelter, and security as pledged in the Universal Declaration of Human Rights and the UN Millennium Declaration.'-See Investing in development A practical plan to achieve the millennium development goals Overview Report to the UN Secretary-General 2005.

<sup>142</sup> Infrastructure management (1997) 1.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

The availability of a modern, efficient and effective wide range of infrastructures provides the platform for human activity. Water and sewerage infrastructures ensure a clean and healthy environment. A strong and vibrant economic infrastructure provides oils that lubricate the wheels of manufacturing which in turn leads to creation of jobs. A well developed educational infrastructure allows the individual to extend their skills and knowledge.<sup>145</sup>

By its nature, infrastructure must be responsive to social objectives; physical infrastructure serves the social purposes of health, safety, economic, employment, and recreation.<sup>146</sup> A nation therefore requires a mixture of infrastructure services in order to ensure that development goes ahead and to ensure that development functions effectively.<sup>147</sup>

The role of infrastructure as essential building blocks of economic prosperity was further underscored by the Commission for Africa<sup>148</sup> in its landmark report<sup>149</sup> when it said:

infrastructure is a key component of the investment climate, reducing the costs of doing business and enabling people to access markets; is crucial to advances in agriculture; is a key enabler of trade and integration, important for offsetting the impact of geographical dislocation and sovereign fragmentation, and critical to enabling Africa to break into world markets; and is fundamental to human development, including the delivery of health and education services to poor people. Infrastructure investments also represent an important untapped potential for the creation of productive employment.<sup>150</sup>

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<sup>145</sup>Ennis F (2003) (ed)1.

<sup>146</sup> Rainer G (1990) xxiv.

<sup>147</sup> Renard V (1990) 75.

<sup>148</sup> The Commission was established in 2004 by the then Prime Minister of Britain, Mr. Tony Blair. At the inception, the Commission had seventeen members out of which nine were Africans who were involved in their individual and personal capacities.

<sup>149</sup> The report, *Our Common Interest*, of March 2005 was published by the Commission for Africa with the aim of creating 'a strong and prosperous Africa'. Substantial part of the recommendations of the report became a policy document and then further by G8 when they met in Greneagles in July 2005 and in other major African forums. This report has been followed up by a new report- *Still Our Common Interest*- of 2010 which calls upon African leaders to harness the great economic potentials of the continent for poverty reduction and development.

<sup>150</sup> Foster and Briceno-Garmendia 31.

Good infrastructure assets will also invigorate the private sector and promote economic growth thereby reducing poverty.

As to gender equality, improved infrastructure service delivery, for instance, long-term access to reliable electricity and transport system will have a positive impact on gender and the employment generating effect, both formal and informal.<sup>151</sup>

### **3.3.1 Infrastructure and productive capacity**

Infrastructure is also crucial to economic growth because of its ability to unlock a considerable short and long term economic gains for development. Critical infrastructure remains the backbone of production and distribution system and an efficient productive capacity is crucial to achieving sustained economic growth.<sup>152</sup>

It is through development of productive capacity that a country like Nigeria will be able to rely on domestic resource mobilization to finance her infrastructure requirements and economic growth and also attract private capital to support her development stride.<sup>153</sup> This will also provide the platform to compete in international markets in goods and services as against primary commodities that depend on concessionary special market access preferences.

‘Productive capacity’ in this context means ‘the productive resources, entrepreneurial capabilities and production linkages which together determine the capacity of a country to produce goods and services and enable it to grow and develop’.<sup>154</sup> Productive capacity is also ‘the key to reducing pervasive poverty. The existing production and trade structures offer very limited opportunities in a rapidly globalizing world driven by new knowledge-intensive production with demanding conditions of market entry’.<sup>155</sup> A developing country like Nigeria needs not just lower tariffs or improved market entry, but also enhanced supply capacities in order to

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<sup>151</sup> Project Appraisal Report African Development Fund (2010) 15.

<sup>152</sup> UNCTAD Report (2006) LDC/2006 1.

<sup>153</sup> Ibid.

<sup>154</sup> Ibid.

<sup>155</sup> Ibid. 3.

benefit from the open, global economy through producing and trading competitive goods and services.<sup>156</sup>

The report argues that productive capacities develop within a country through three closely interrelated processes: capital accumulation; technological progress and structural change.<sup>157</sup> However, without a functioning infrastructure, development of productive capacities will be impossible. Hence the reason why poverty of infrastructure has remained the major constraining factor in development of productive capacities in Nigeria.

Improving productivity will need efforts to foster improvement of the business environment and studies have shown that failing infrastructure constraints have added substantially to the cost of doing business.

In a World Bank report<sup>158</sup> which assessed the investment climate in Nigeria, three important constraints to doing business in Nigeria were identified and these are: power, access to finance and transport. In the report, the researchers came up with an illuminating insight about the state of Nigeria's infrastructure and its impact on business environment thus:

Solving the electricity crisis must remain a top priority of the government. Electricity is by far the main obstacle. Some 80 percent of firms rank it as the top constraint. Every year almost 10 percent of sales are lost due to power outages. All types of firms, irrespective of size, location, export orientation, and ownership complain about electricity shortages. All firms experience power outages and 85 percent own a generator. On average, such outages lasted some 196 hours per month, which is approximately 8 days. Large firms and firms in the manufacturing sector are more adversely affected by such outages. Large firms have lower electricity-related indirect costs although they face the most significant outages. This is explained by the fact that 97 percent of them have their own generators.<sup>159</sup>

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<sup>156</sup> Ibid.

<sup>157</sup> Ibid.

<sup>158</sup> Larossi, Mousley & Radman (2009) 4.

<sup>159</sup> Ibid.

This is higher than any of Nigeria's comparator countries.<sup>160</sup> Also to be noted about the power outages in Nigeria is the fact that power outages vary from state to state. In Kano, total outage duration averages 393 hours per month, equivalent to 16 days. In Abuja, total outage duration averages 127 hours per month, equivalent to 5 days. In comparison with other countries, the percentage of firms experiencing power outages is highest in Nigeria. As a consequence, generator ownership is also higher in Nigeria than in all other comparators.<sup>161</sup>

Transport is another important constraint accounting for 4 percent of annual sales losses. Because more than two-thirds of all Nigerian inputs are delivered by road, the quality of the network is a key issue for the whole economy. Similarly, the efficiency of customs clearance is also a critical factor in transport efficiency. In Nigeria, it takes 46 days to clear imports, the second highest among comparator countries. Of all comparator countries, Nigeria remains the most expensive location from which to ship imports or exports-it costs \$1,730 or \$2,450 to ship a 40-foot container for export or import, respectively.<sup>162</sup>

Having correlated provision of infrastructure with socio-economic development, the state of infrastructure in Nigeria comes under focus.

### **3.4 Overview of state of infrastructure in Nigeria**

The belief within the government circle in Nigeria is that power, transport and telecommunications sectors hold the aces to the overall socio-economic development in Nigeria, hence the presentation of this overview will focus on these three sectors of the economy. Power and transport sectors will serve as the 'representative platforms' for the discussions of the general problems plaguing the broader infrastructure sector in Nigeria, while discussions on telecommunications will seek to strengthen the fundamental assumptions made at the outset of this investigation and support the thesis statement stated in chapter one of this study.

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<sup>160</sup> These are: Kenya, Indonesia, India, Brazil, China and South Africa. See Giuseppe Larossi et al (n 158 above) 5 for the graph for: Indirect costs as percentage of total sales-International competition.

<sup>161</sup> Larossi (n 158 above).

<sup>162</sup> Ibid. 7.

As a preamble to the overview of the state of infrastructure in Nigeria, it is apposite to take a look at some basic facts about Nigerian state.

### 3.4.1 Facts about Nigeria

From 1861 to 1914, the British had subjugated the different nationalities in the River Niger area and later brought them together under one political umbrella called Nigeria. This political entity remained under the British influence and control until the 30<sup>th</sup> of September 1960. However, this was preceded, after the Second World War, by series of consultation-based constitutions that granted greater autonomy to the country until independence in 1960. At independence in 1960, the federation comprised of a federal government and three regional governments.<sup>163</sup> The legislatures<sup>164</sup> were bicameral and parliamentary.<sup>165</sup> Executive authority was vested in Her Majesty, the Queen of England, exercised on her behalf by a Governor-General at the Centre and Governors in the regions. In 1963, Republican Constitution was adopted, the effect of which was that the country was completely removed from under the influence of the British monarch. This democratic experience and evolution was truncated by a military mutiny in January 1966, to be followed by thirteen years of unbroken military rule. However, within these thirteen years of unbroken military rule, the first three years were used to prosecute the civil war which broke out on 6 July 1966. It was the military incursion into the political landscape of January 1966 that altered the fragile political equation and the declaration of the former Eastern region as independent state of 'Biafra' that ushered the nation into a 30-month civil war generally called 'the Biafra war'. One of the aftermaths of the war was the massive destruction of the existing public infrastructure assets in the then Eastern Region.<sup>166</sup> In 1979, the country was steered back into civilian rule with the adoption of constitution based on American-style presidential system of government. This experience too was short-lived in that the then civilian government was sacked by another military putsch which was followed by another sixteen years of military rule interrupted only by a

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<sup>163</sup> The three regions were: Northern, Western and Eastern regions. See section 2 of the Nigeria Constitution/ Order in Council 1960 enacted by the Imperial Government with all the previous consultations-based constitutions of the colonial era annexed to the Order in Council in four separate schedules.

<sup>164</sup> That is, the federal at the centre and the three regions.

<sup>165</sup> Fashioned after the British parliamentary system. See Nigeria: Country Brief The World Bank- [http://web.worldbank.org/WBSITE/EXTERNAL/CONTRACTS/AFRICA\\_EXT/NIGERIA-EXTN-](http://web.worldbank.org/WBSITE/EXTERNAL/CONTRACTS/AFRICA_EXT/NIGERIA-EXTN-) accessed last 1/07/2011

<sup>166</sup> The former eastern region now comprises of: Abia, Anambra; Ebonyi, Enugu and Imo states

failed attempt to transit back to civilian rule in 1993. In 1999, the soldier-politicians willingly returned the country to a civil rule and returned to Barracks. This marked the commencement of the fourth republic which has remained up till date.<sup>167</sup>

Nigeria has a population of about 154.7 million people,<sup>168</sup> the largest country in Africa and accounts for 47 percent of West Africa's population. A hugely diverse population which is made up of over 200 ethnic groups and 500 indigenous languages, it prides herself as the biggest oil exporter in Africa with the largest reserves of natural gas in the continent.<sup>169</sup>

With an area of 923,768 square kilometres including about 13,000 square kilometres of water, it is made up of 36 federating units called states and the Federal Capital Territory, Abuja. These federating units are in turn divided into 774 local government areas. The large reserve of natural resources including oil and gas is augmented with a favourable tropical climate coupled with an excellent geographical positioning that makes markets in Europe, Americas and Far East accessible for exportation of crude oil.<sup>170</sup>

It was the advent of oil boom in the 1970s that gave the leaders of the country a false sense of economic security that in turn led to the national neglect of the country's post-independence strong agrarian culture and somewhat reasonably high manufacturing base in favour of heavy reliance on exportation of crude oil which is basically more of a 'rentier' economic system. The implication of this is that the

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<sup>167</sup> Ibid.

<sup>168</sup> The country was last enumerated during the Population and Housing Census of March 21-27 2006, and the country's population was put about 140,431,790 (as per the final result that was published in Gazette Number 2, Volume 96 of 2<sup>nd</sup> February 2009). However, this figure generated so much of controversies in that it was disputed by some sections of the country as being skewed in favour of a particular section of the country for political and economic considerations. This allegation seems attractive in view of the fact that the size of a federating state in Nigeria could be used as a factor in determining some political and economic equations. See <http://www.cia.gov/library/publications/the-world-factbook/geos/ni.html> (last page updated last in July 5, 2011). Accessed on 22/7/2022. Another source puts the population figure about 158.26 million-<http://www.tradingeconomics-com/Nigeria/population>.

<sup>169</sup> Ibid. 2.

<sup>170</sup> Ibid.

country has a mono-cultural economy in that oil and gas exports account for over 90% of its export earnings and about 80% of the central government's revenue.<sup>171</sup>

The current oil reserves are estimated to be to the tune of 36 billion barrels and the natural gas trapped in the reserves is estimated to be over 100 trillion cubic feet. The present crude oil production is on the average of about 1.6 billion barrels per day. Unfortunately, Nigeria has not been able to take maximum advantage of this vast wealth in fossil fuels to overcome numerous development challenges confronting the nation especially the hydra-headed crushing poverty which has reduced over half of the Nigerian populace to sub-human beings.<sup>172</sup>

### **3.4.2 Sector-level analysis of the state of public infrastructure**

Analysing the state of infrastructure in Nigeria presents a spectacle of crushing poverty of infrastructure assets across the nation. This huge deficit in infrastructure is easily observed in the critical sectors of the nation's economy such as power, transportation, education, housing, water supply and health.

In every way, decades of underinvestment and general neglect in the area of maintenance have taken toll on the country's public infrastructure assets. A country's state of public infrastructure bespeaks the country's economic development and growth. An efficient and reliable infrastructure is critical to attraction of Foreign Direct Investment and expansion of international trade which are very crucial to growth.

The Global Competitiveness Report of 2010-2011,<sup>173</sup> using infrastructure as one of the twelve indicators and as a factor very fundamental to a country's ability to compete, ranked Nigeria 127<sup>th</sup> overall out of the 139 economies covered and the country receives poor assessments for its decrepit infrastructure which on its own is

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<sup>171</sup> Ibid.

<sup>172</sup> Ibid.

<sup>173</sup> The World Economic Forum's Centre for Global Competitiveness and Performance publishes Global Competitiveness Report and report series which aim to reflect 'the business operating environment and competitiveness of over 130 economies worldwide'. The report series identify advantages as well as impediments to national growth thereby offering a unique benchmarking tool to the public and private sectors as well as academia and civil society.-  
[http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport-pdf 2010-11](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport-pdf 2010-11).

ranked 135<sup>th</sup> amongst 139 economies. According to the report, Nigeria's poor stock of infrastructure is reported to be the most problematic factor that constrains doing business in Nigeria. The report underscores the poor state of Nigeria's infrastructure in that in overall quality, Nigeria's infrastructure is ranked 134<sup>th</sup>; in the quality of roads, 128<sup>th</sup>; quality of rail road infrastructure, 104<sup>th</sup>; quality of transport infrastructure, 107<sup>th</sup>; to mention few.<sup>174</sup>

According to the Central Bank of Nigeria, it costs Nigeria about US\$13 billion yearly to buy diesel/petrol to fuel generators when only about \$10 billion is required in a year in investment in power infrastructure for the next few years to develop power generation, distribution and transmission capacities. Besides, generating power from generators adds more than 40 percent to the cost of goods and services in Nigeria.<sup>175</sup> According to the Nigerian President, Goodluck Jonathan, the biggest casualty of the power outage in Nigeria is the manufacturing sector which has been robbed maximum productivity and millions of jobs that could have been created for the citizenry.<sup>176</sup>

A recent report<sup>177</sup> by the World Bank Group on assessment of the investment climate in Nigeria revealed that over 80% of companies are of the opinion that power outages and the poor transport infrastructure are the most constraining factor on their businesses in the country. The gaps in the power infrastructure seriously constrain the growth of the non-oil sector, hinder job creation, poverty reduction suffers and the country's ability to attain millennium development goals becomes a mirage.<sup>178</sup> Merely '45% of the population has access to electricity, with only about 30% of their demand for power being met. Power shortages have a disproportionate impact on low income households who cannot afford to buy and run generators'.<sup>179</sup>

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<sup>174</sup> See the Global Competitiveness Report 2010-2011, 260-261  
[http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport-pdf 2010-11](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport-pdf%2010-11)

<sup>175</sup> Jonathan G Presidential opening speech Power reform: opening Nigeria for business October 15, 2010. See website of the Office Of Public Communications, State House, Abuja-  
[http://www.nigeriafirst.org/article\\_10461.shtml](http://www.nigeriafirst.org/article_10461.shtml)

<sup>176</sup> Ibid.

<sup>177</sup> Larossi 5.

<sup>178</sup> Project Appraisal Report 14.

<sup>179</sup> Ibid.

According to the report<sup>180</sup>, resolving ‘Nigeria’s power quagmire would transform the latent SME sector which has the potential to add substantially to ordinary people’s economic and social well being, hence attainment of the MDGs targets such as ending abject poverty, gender equality and increased access to health and education’.

The report further argues that investing in infrastructure in Nigeria would prove compatible with both non-oil private sector development and the attainment of MDGs, though social indicators in country remain abysmally weak in general and are far below the average for sub-Saharan Africa (SSA).<sup>181</sup> It is believed that progress toward the attainment and achievement of MDGs and high growth rate in the non-oil sector are impeded by the decrepit power and transport infrastructure. The report also argues that urgent fixing of the infrastructure quagmire would lead to positive outcomes with quantum improvement in the business environment, exponential growth in the non-oil sector and significant reduction in poverty and reasonable progress in attainment of the MDGs.<sup>182</sup>

The deplorable state of the nation’s infrastructure has also been underscored by the Report of the Presidential Project Assessment Committee on Federal Government Projects<sup>183</sup> which reveals that: ‘Government’s attempt at providing critical infrastructure to drive industrialization, economic growth and development have been stymied by massive corruption and subversion of due process in the award and execution of projects’. Specifically, the Report states that:

There are 11,886 ongoing capital projects being executed by the Federal Government. The estimated cost of these projects is N7.78 trillion. Out of this amount, N2.69 trillion had been paid to contractors. However, there is evidence of large scale and widespread institutional mediocrity, deficiency of

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<sup>180</sup> Ibid.

<sup>181</sup> Ibid.

<sup>182</sup> Ibid.

<sup>183</sup> The Committee was in March 2010 by the then Acting President Goodluck Jonathan which by its terms of reference was, among other things ‘take inventory of all on-going projects awarded by the Federal Government; assess the level of funding of each project; undertake a physical inspection of each project to determine work done...and make appropriate recommendations to Government on how to fast-track the completion of the projects’. See Editorial Comment: ‘On presidential projects assessment committee’ The Punch Newspaper Wednesday, 10 March 2010.

vision and lack of direction in the project management. This has resulted in avoidable losses of billion of naira.<sup>184</sup>

As pointed out earlier on in this study, a nation faced with the problem of deficit in infrastructure assets remains unattractive to flow of foreign capital and it is the availability of capital that buoys the engine of the economy; a powerful catalyst for the country's development, reducing poverty and creating the fiscal space for the required investments in infrastructure development for economic growth and integration in to global economy.

To put the analysis in a proper perspective and appreciate the dire strait which the country has descended to, the analysis will be conducted on sector-level basis. As stated earlier on in this section, the analyses will be restricted to power, transport and telecommunications sectors for some reasons. First, these sub-sectors of the broader infrastructure sector are fundamental to the socio-economic life of the country and very critical to nation's march towards economic growth and development; second, the problems plaguing the first two sub-sectors characterized the other sub-sectors, hence the need to avoid needless repetitions; and lastly, while power and transport sub-sectors are representatives of the general problems plaguing the larger infrastructure sector, the telecommunications sub-sector represents a memorabilia of some of the strengths and near perfections of allocative efficiency of markets and free competition, the efficiency of private sector management in a competitive environment and what an appropriate legal reforms can achieve in a space of time. Besides, according to a report,<sup>185</sup> power and transport are two of 'the three most important constraints to doing businesses in Nigeria. Coincidentally too, the related infrastructure in these three sectors is captured by the classification of the infrastructure into economic and social groups discussed earlier on the study. Thus, the analysis starts off with the power sector.

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<sup>184</sup> The Report went on to add that: 'In addition, corruption in the handling of projects by many self-seeking and inept public officers and contractors has led to massive inflation of costs and undermined the legality of their monitoring and supervision responsibilities. There was subversion of the normal project cycle. The Committee established that almost all ongoing projects have not been subjected to, and taken through the normal project conceptualization, planning, design and procurement, contract execution and maintenance stages'. Ibid.

<sup>185</sup> Larossi 5.

### 3.4.2.1 Power sector

As mentioned above, Nigeria's huge under-investment in its power sector makes it by far the neediest of the country's infrastructure sub-sectors. Nigeria is the Sub-Saharan's and African second biggest economy-after South Africa-and an oil and gas power-house. No other infrastructure sector hinders Gross Domestic Product (GDP) growth in Nigeria more than electricity. According to the National Bureau of Statistics<sup>186</sup> Report, electricity generation, transmission and distribution account for less than one percent of Gross Domestic Products (GDP), but fifty-four per cent of the shares of utilities (that is, electricity and water supplies) in the GDP.<sup>187</sup> So, it is no longer news that Nigeria is lagging behind considerably in access, quality and availability of electricity supply to the Nigerian public. According to the report, electricity supply constitutes a very insignificant economic activity in Nigeria relatively to her geographical size and population and that if allowed operating optimally with negligible intervention from the government, it could become a major driver of the vision for economic growth in the country.<sup>188</sup>

The power sector is characterized by low generating capacity and presently, it is said to be in the region of 2,500 megawatt, while the current estimated national consumption is 4000 megawatts. The potential national demand for power is put at 10000 megawatts<sup>189</sup> with an energy deficit of some 23000 megawatts, which is costing the economy about US\$1.3 billion a year.<sup>190</sup>

The 'average per capital energy consumption stands at 129 kilowatts hours compared with 491 in India and 12,607 in the United States, according to Nigerian government's estimates'.<sup>191</sup> As a result, over US\$13 billion is spent in a year for

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<sup>186</sup> The Bureau gives 'comprehensive, timely, relevant, responsive and customer-focused statistical information relating to the social and economic activities as well as conditions of the inhabitants of Nigeria'. It enjoys collaboration with the three tiers of government and their ministries, departments and agencies to produce administrative statistics coordinate and ensure statistical orderliness and encourage the use of statistical standards. [Http://www.nigerianstat.gov.ng/](http://www.nigerianstat.gov.ng/).

<sup>187</sup> National Bureau of Statistics Electricity supply and demand statistics Bureau's website-<http://www.nigerianstat.gov.ng/>.

<sup>188</sup> Ibid.

<sup>189</sup> Yusuf M (2004).

<sup>190</sup> Infrastructure Investor Africa An intelligence report 9 February 2011-[www.infrastructureinvestor.com](http://www.infrastructureinvestor.com).

<sup>191</sup> Ibid. According to the report, the power generation capacity of 48 countries that comprise Sub-Saharan Africa (SSA) with the population of 800 million people is about the same as that of Spain with 45 million people.

‘diesel-generated power when it would only require about US\$10 billion a year investment over the next few years to fully develop its energy infrastructure’.<sup>192</sup> Quoting the Nigerian President, Goodluck Jonathan, “less than half of our citizens have access to electricity”.<sup>193</sup>

This unwholesome situation was better underscored by a statement credited to the Nigerian Nobel Laureate in Literature, Professor Wole Soyinka, when he aptly said: ‘Electricity comes in ‘periodic vengeful surges.....as if the god of lightning has....taken personal charge’.<sup>194</sup>

According to Bolanle Onagoruwa,<sup>195</sup> it is estimated that 100 million Nigerians are without access to electricity whilst the rest receives low or irregular supply. This situation is exacerbated by the fact that 30% of electricity billed is not collected and will need over US\$35 billion of investments in the next 10 years to modernize the power sector.<sup>196</sup>

She further said that ‘the power is characterized by gross inefficiencies in all segments of the value chain and failure to deliver its mandate’. This she claimed was attributable to reasons that border on poor revenue collection, inadequate metering, poor billing system and electricity theft. Others, according to her, are poor maintenance culture, ineffective regulation, inappropriate industry and market structure, cable ‘vandalization’,<sup>197</sup> unclear delineation of rules and responsibilities.<sup>198</sup> The Nigeria Vision 20:2020<sup>199</sup> puts it succinctly thus:

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<sup>192</sup> Ibid.

<sup>193</sup> Ibid. 10.

<sup>194</sup> Cited in survey striving amid chaos *The Economist* July 15<sup>th</sup> -21<sup>st</sup> 1999 10

<sup>195</sup> The Director General, Nigeria’s Bureau of Public Enterprises. The Bureau statutorily serves as the Secretariat of the National Council on Privatization in Nigeria and it’s charged with the responsibility of implementing the Privatization and Commercialization Programme of the Federal Government of Nigeria. See generally sections 9-14 of the Public Enterprises (Privatization and Commercialization) Act 1999. See also the Bureau’s Website-<http://www.bpeng.org/pages/default.aspx>-Assessed last on the 25<sup>th</sup> August 2011

<sup>196</sup> Onagoruwa B (2011)

<sup>197</sup> ‘Vandalization’ means, in the context, stealing of cables and in some case, transformers by thieves.

<sup>198</sup> Onogoruwa (n 182 above)

<sup>199</sup> Hereinafter called ‘Vision Document 2020:20’. The First National Implementation Plan (2010-2013) Volume II: Sectoral Plans and Programmes, May 2010, 8

[T]he strategic context of power in national development cannot be over-emphasized. Power is a critical infrastructure for sustainable economic growth and development...This is because most economic activities are dependent on affordable and adequate energy for effective operation. It is critical for reducing the cost of doing business, enhancing productivity and quality of life. The inadequate provision of power has a pervasive impact on socio-economic activities and consequently the living standard of citizens in Nigeria.

The Vision Document 2020:20 further alluded to the fact ‘due to lack of maintenance and expansion of the facilities, the country has suffered significantly from the impact of...limited availability of electricity supply’ and that ‘in spite of the abundant energy resources in the country and the huge Government investments in the sector over the last ten years, electricity remains a serious challenge to Nigeria’s socio-economic development’.<sup>200</sup>

According to the Document, a paltry 40 percent of the country’s ‘total population has access to....electricity supply due to inadequate transmission and distribution networks’ coupled with ‘ageing infrastructure, weak and radical network configuration and overloaded transformers, result in frequent system collapse, high transmission and distribution losses and poor voltage profile’.<sup>201</sup>

By the close of the year 2009, the peak generation supplied into the national grid by the PHCN was 3,700 megawatts for a population of 150 million people compared to comparator countries like: South Africa that generates 40, 000 megawatts for a population of 50 million people; Brazil-100,000 megawatts for a population of 192 million people; and United States-700,000 megawatts for a population of 308 million people.<sup>202</sup> The installed available generation capacity presently stands at 5,200 megawatts as against the peak generation supplies which hover between 2,000-3,700 megawatts. Given the above scenario, less than forty percent of Nigerians mostly the urban dwellers, have access to electricity.<sup>203</sup>

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<sup>200</sup> Ibid.

<sup>201</sup> Ibid.

<sup>202</sup> Ibid. 9.

<sup>203</sup> Ibid.

Regarding generation, by the year 2000, power generation capacity was 1,500 megawatts which was mainly because of ‘lack of investment in maintenance and expansion programs on existing power plants’. The Vision 2020:20 Document also noted that ‘there exists virtual independent and potential power generating facilities at various locations which are un-used and un-tapped’. Lack of synergy between the relevant supervising Ministries-Water Resources, Mines and Steel Development and Power-is responsible for this unfortunate situation.<sup>204</sup> Examples of such ‘virtual independent and potential power generating facilities’ are Dadin Kowa Dam (30MW), Oyan dam (9 MW) and ALSON (540 MW).<sup>205</sup>

However, the power generation has scaled up from 1500 MW in year 2000 to about 3700 MW by the close of the year 2009. The actual generation is often constrained to below 2100 MW as a result of inadequate gas supplies and low water levels. The Vision 2020:20 Document also observed that despite the many energy resource endowments, there are only two major resources that are presently exploited for electricity generation in Nigeria. These are: gas which contributes about 68 percent, and water which generates about 31 percent of electricity supply.<sup>206</sup>

Apart from the ones mentioned above, so many other reasons are responsible for the deplorable situation of the power sector. These have been identified in the Vision 2020:20 Document to include:

- i. inadequate power generation capacity, the predisposing factors being: cumbersome procurement; poor maintenance culture of power infrastructure; non-completion of ongoing power projects including NIPP; unfavourable enabling environment constraining private sector participation;
- ii. insufficiency of gas to power generation, the reasons being: non-implementation of gas master plan; inappropriate pricing structure; vandalization; and absence of the required synergy between relevant agencies of the Ministries of Power, Petroleum and Water Resources;

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<sup>204</sup> Ibid.

<sup>205</sup> Ibid.

<sup>206</sup> Ibid 10. Nigeria’s national electricity grid consists of three hydro and twelve thermal generating stations with a total installed capacity of about 5000 MW. However, paltry megawatts of about 2000-3000 MW of electricity are generated. There are also five Independent Power Plants contributing 486 MW to the national grid.

- iii. incomplete implementation of the reform program;
- iv. regulatory deficit;
- v. inappropriate electricity pricing;
- vi. inadequate transmission-‘the transmission network is overloaded with a wheeling capacity of less than 4,000 MW’ and ‘has a poor voltage profile, inadequate dispatch...fragile grid network, frequent system collapse, exceeding high transmission losses which is as high as 25 percent...due to low transmission grid voltages..’<sup>207</sup>
- vii. obsolete and inefficient transmission and distribution equipment;
- viii. low access to electricity supply;
- ix. billing and revenue collection-inefficiency in billing and revenue collection is one major constraint facing power sector in Nigeria. According to the Vision 2020:20 Document, it is estimated that as high as 35 percent of the electricity users in the residential areas do not pay for the electricity consumed;
- x. vandalization of equipment, transmission and distribution lines;
- xi. inadequate modern control systems like frequency governors, voltage control regulators at several power stations are obsolete and disabled hence the use of manual control methods; and lastly
- xii. electricity wastages which flow from inappropriate pricing, inefficient billing and revenue collection.<sup>208</sup>

### 3.4.2.2 Transport sector

Transportation network plays a crucial role in shaping the destiny of many nations because modern industry and commercial activities hinge on a well-developed and efficient transport system.<sup>209</sup> Nigeria’s transport infrastructure is essentially in a decrepit state owing to years of inadequate maintenance and under-investment. Nigeria presently loses about N80 billion annually to bad roads in the country.<sup>210</sup> It is also reported that additional N35billion is lost ‘annually as operating costs owing to the worsening condition of its network of roads’.<sup>211</sup> It is also estimated that over a

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<sup>207</sup> Ibid. 12-3

<sup>208</sup> Ibid.

<sup>209</sup> Central Bank Occasional Papers no. 27 104

<sup>210</sup> Nigeria loses N80 billion to bad roads annually Punch newspapers 12<sup>th</sup> July 2011

<sup>211</sup> Ibid.

period of ten years, a whopping sum of N300 billion will be needed ‘to bring national roads into a satisfactory usable condition’.<sup>212</sup>

Universally, Nigeria ranks low in the quality of its transport infrastructure<sup>213</sup> and this impacts negatively on the ease of doing business in Nigeria.<sup>214</sup> This was underscored in the introduction to the Nigeria’s National Transport Policy document of 1993 which states that:

[A]t present, the Nigerian transport system functions in a crisis situation, and one of the principal causes it identified were a major imbalance between the needs of Nigerian society and economy for adequate transport facilities and the ability of the transport sector to meet such demands.<sup>215</sup>

The assessment above still holds true almost eighteen years after the document was published. With few exceptions, transport in Nigeria is still poor resulting from many years of neglect and inadequate maintenance. It has been estimated that less than one third of federal roads are in a good condition. Accident and mortality rates on roads are high. Nigeria’s railways have been in decline since the early 1980s when it was carrying 12 million passengers and 3 million tonnes of freight each year, about. Now, only 3% of the country’s goods are carried by rail leading to acute road congestion and safety risks. Improvements in transport services delivery will alleviate such problems.<sup>216</sup>

Historically, the emergence of modern transport system in Nigeria can be classified into two phases. These are: the colonial period and the post-colonial era.

The colonial period provides the genesis of modern transport system in Nigeria. The rail, water and road networks in place then were made to meet the needs of the time for exportation of cash crops, such as groundnuts, cocoa, cotton and palm products and the importation of cheap, mass produced consumption goods. These were networked in the most economical way possible as typified in sub-standard road and

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<sup>212</sup> Ibid.

<sup>213</sup> See the Global Competitiveness Report 2010-11.

<sup>214</sup> See ‘the role of the financial system in Nigeria’s economic development’ Bankers’ Committee National Retreat December 2010 9.

<sup>215</sup> National Planning Commission (2010) Draft National Transport Policy of Nigeria 4.

<sup>216</sup> Project Appraisal Report (2010) Capacity building for ppp infrastructure in Nigeria.

rail alignments and a sub-base, which later proved inadequate to accommodate heavy vehicles.<sup>217</sup>

In the post colonial era, in response to re-orientation of goals, transport became one of the instruments of unification of the country and an important tool for social and economic development. The discovery of oil in the 1950's had a very important impact on the nation's socio-economic growth, thereby putting pressure and demands on the transport system. Goods and passengers movements were done mainly by roads, with the railway and inland waterways playing important but less significant roles. While the cross-border movement is generally done by the sea, the air transportation is the main passenger carrier.<sup>218</sup>

The investments of the governments at all levels (federal, state and local) in the country's transport system are quite substantial. The replacement value of road network at 2001 prices is put between N3,500-N4,300 billion. The fixed assets of Nigerian Ports Authority amounted to 36 billion in 1999, but this represents an addition of unadjusted historical data. The replacement value could then be much bigger. Investments in the Nigerian Railway Corporation are smaller, approximately N9.5-N10 billion.<sup>219</sup>

All transport sub-sectors suffer from the effects of past shortages of resources, and this inadequacy has consistently been reflected in the poor maintenance. In the road sub-sector, the lack of maintenance culture necessitates subsequent reconstruction. The inadequate replacement and the poor maintenance of vehicles, contribute to high social costs of atmospheric pollution, and these result in high operating costs.<sup>220</sup>

As to the railways, the lack of funding needed to keep the tracks, rolling stocks and maintenance facility in a good working condition led to a significant deterioration of the railway system. The same problems also affect the inland waterways, resulting in its inability to perform its expected roles in the economy.<sup>221</sup>

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<sup>217</sup> Ibid.

<sup>218</sup> Ibid.

<sup>219</sup> Ibid. 2.

<sup>220</sup> Ibid.

<sup>221</sup> Ibid.

Agreeing with the Draft National Transport Policy<sup>222</sup> put together by the Federal Government of Nigeria, transport plays a key role in the economic and social development of any nation, Nigeria inclusive. A well functioning and integrated transport system does many things which include: stimulating national development; enhancing the quality of life for all; allowing markets to operate by enabling the seamless movement of goods and people; providing vital links between spatially separated facilities and enabling social contact and interaction; providing access to employment, health, education and services; alleviating regional inequality and fostering national integration; increasing access to markets and links to local, regional, national and international markets and promoting economic development by increasing access to labour and physical resources thus facilitating the realization of a country's competitive and comparative advantages.<sup>223</sup>

Several reasons account for the problems facing Nigeria's transport infrastructure. First is the size of the country. With area coverage of 923,768.64 kilometres spanning the longitude 3-16 and latitude 4-14, Nigeria is comparatively a large country. This is coupled with the fact that it is inhabited by over 140 million people. This makes transportation very crucial for linking the country economically, socially and politically.<sup>224</sup>

Second are the vast natural resources. The country is endowed with diverse mineral resources coupled with the abundant agricultural and forest resources which vary by the three ecological zones of the country. The country is also blessed with a highly productive open sea with abundant and diverse marine resources within her coastline of 825 km bordering the Atlantic Ocean in the Gulf of Guinea and her maritime area of 46,000 kilometres. This variation is a factor in spatial interdependence. Transport

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<sup>222</sup> The document was put together after consultation with relevant stakeholders under the auspices of the Federal Ministry of Transport and it is about to be approved by the Federal Executive Council of Nigeria. The policy document is expected to drive the efficient development of the country's transport sector. This is coming 17 years after the first attempt at having a coherent national policy on transport in Nigeria floundered.

<sup>223</sup> Ibid.

<sup>224</sup> Ibid.

plays an important role in the exploitation and distribution of these resources and in the reduction of spatial inequality and in poverty alleviation.<sup>225</sup>

Third, the three large sectors-crop production, oil and gas, and wholesale and retail trade contributed the most to GDP. The role of manufacturing was limited while wholesale and retail trade, though a high contributor to GDP, had low linkage with domestic production due to low domestic production output and high importation. Overall, the sectors of the economy are still plagued by numerous problems notably, poor and decaying infrastructure, low power generation, institution and regulatory deficits, to mention few. The defective structure of the nation's economy makes her heavily dependent on export earnings from crude oil and on import of consumer and capital goods, thereby increasing the country's cargo and boosting the overall maritime trade. The huge volume of cargo generated by Nigeria places her at an economic advantage in South Saharan Africa.<sup>226</sup>

Fourth, the strategic location of the country is another predisposition factor. By its location, Nigeria has an extensive coast washed by the Atlantic Ocean and a geographically conducive shore which provides the opportunity of port services to landlocked countries in West Africa and particularly, Chad and Niger Republic, as well as serves a hub for transshipment for the West and Central African sub-region. Hence, the demand for transport is quite high.<sup>227</sup>

As said at the outset, the challenges facing the transport infrastructure that was identified in the introductory statement to the National Transport Policy document of 1993 remains valid today in 2011. The imbalance in supply and demand for transport capacity overall, and in the development of the different modes of transport, has indeed increased over the years since 1993.<sup>228</sup>

Though efforts were made to improve and maintain the system and make it functional which is reflected in the significant improvement, but overall, the demand for

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<sup>225</sup> Ibid.

<sup>226</sup> Ibid. 3.

<sup>227</sup> Ibid. 4.

<sup>228</sup> Ibid.

transport services in Nigeria seems to exceed the supply. The conclusion of the matter is that the Nigerian transport system is still in dire strait and needs urgent fixing. Radical changes and improvements are obviously needed.<sup>229</sup>

In furtherance of this discussion, the transport sub-sector will be classified under three categories: land, water and air transport infrastructures. Land transport infrastructure is further sub-divided into two classes: road network infrastructure and rail infrastructure. The water transport infrastructure is sub-divided into: inland water ways and shipping.

### **i. Land transport**

Land transport infrastructure makes possible the movement of persons and goods by land, from one point to the other. It is the major form of transportation and includes essentially, road and rail.<sup>230</sup>

#### *Road network*

Roads exist to enable people and goods to move from destination to destination; the extent to which a nation's landmass is covered by road network is an index of the degree of mobility of people, goods and services within the country, and the quality of the network measures the ease and cost of that mobility. Road network constitutes a vital part of the infrastructure system in Nigeria, and carries over 90% of the traffic. Nigeria has the largest road network in West Africa and the second largest, south of Sahara with a total length of 193, 200 kilometres with 28,980 kilometres paved and 164,220 kilometres unpaved. Aside the chronic and very costly-under maintenance, these roads are plagued with so many problems which include faulty designs, inadequate drainage system and poor maintenance culture, which have all conspired to a large extent in reducing the utility of the roads. The roads are pitted with crater-potholes, washed pavements, and there are collapsing bridges every where and the available drainages are clogged with rubbish.<sup>231</sup>

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<sup>229</sup> Ibid.

<sup>230</sup> National Planning Commission (n 201)12

<sup>231</sup> Road infrastructure can be characterized by spatial density which is a country's road length per land area, and road density, which is the length of the road network per capita. See generally, Hudson (n ) 4

It is believed that owing to this problem of under-maintenance, Nigeria has lost about half of her road networks over the last 40 years.<sup>232</sup>

It is also important to note that Nigeria has become increasingly dependent on the road system to meet virtually all its inland transport needs as the rail and inland waterway systems have deteriorated. Road transportation accounts for about 90% of the internal movement of goods and people in Nigeria. Except the railway is revived and the inland waterways are developed, this proportion is likely to rise even higher in the nearest future. The predominance of the road over the other modes is not only because of its inherent advantages but because government had paid greater attention to this mode, for reasons that are difficult to fathom.<sup>233</sup>

As pointed out earlier on in this study, the road network itself has suffered from the continuing lack of maintenance and investment by the three levels of government, federal, state and local.<sup>234</sup> The national road network is about 193,200 kilometres, made up of 34,123 of Federal Roads, 30,500 kilometres of state roads and 129,577 kilometres of local government roads.<sup>235</sup> More than 50% of the roads are decrepit and almost 90% of current inter-state movement are done by roads.<sup>236</sup>

The Nigerian road network is classified into four broad categories:

- the Federal Trunk ‘A’ Roads-these are under the ownership of the Federal Government and they are developed and maintained by the Federal Government;
- the Federal Trunk ‘F’ Roads-these were formally under the control of the State governments, but were taken over by the Federal Government with a view to upgrading them to federal highway standards;
- the State Trunk ‘B’ Roads-these are under the ownership and management of the federating states; and

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<sup>232</sup> See Biau, Dahou and Homma in a joint study published in 2008 by the New Partnership for Africa’s Development (NEPAD) and OECD cited in ‘Infrastructure Investor Intelligence Report, published by PEI Media p. 21-assessed 1<sup>st</sup> June 2011 at <http://www.infrastructureinvestor.com>.

<sup>233</sup> See Draft National Transport Policy et al 31.

<sup>234</sup> Ibid. 24.

<sup>235</sup> Ibid.

<sup>236</sup> See ‘The role of the financial system in Nigeria’s economic development et al 8.

- the Local Government Trunk ‘C’ Roads-are under the control and management of the Local Government Administrations which form the third-tier government under the constitution in extant.<sup>237</sup>

Under the Nigerian Constitution, each tier of government has the responsibility for planning, financing, construction and maintenance of the network of roads under its jurisdiction.<sup>238</sup>

Integrated road development in Nigeria dates back to 1925, when the Road Board was established by the then colonial administration. The Board had the responsibility to evolve blue prints for trunk road network, connecting major administrative centres in the colonial era. As at 1951, 1,782 km out of the total of 44,414 km of roads built in Nigeria were surfaced. The roads were however lacking in standard designs and were in single lane, with sharp bends and poor drainage system. The growth of economic activities prompted the need for improvement in roads. As a result of this, the quality of road construction was improved as the length and network continued to increase such that by 1952, 15,785 km of bituminous surface and 75,200 km of earth/gravel surface roads were already in place in Nigeria.<sup>239</sup>

Unfortunately, the growth of road network has not kept pace with the growth of road traffic in the wake of increasing urbanization. As the economy develops and expands, more goods need to be moved from one point to the other; more people will need to travel and more products produced will also need to be moved from the point of production to the point of sales.<sup>240</sup> Owing to this, it has become extremely difficult to move goods and services from production to consumers; farm produce from the rural agrarian areas to urban centres, which in most cases, lead to loss of man-hours and high cost of goods and services.<sup>241</sup>

Nigeria’s transport sector contributes less than 3% of real GDP, with road transport accounting for over 85% of the sector’s output. The number of vehicles plying the

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<sup>237</sup> CBN Research Dept Occasional Paper no. 27 2.

<sup>238</sup> Draft National Transport Policy (n 233 above) 24.

<sup>239</sup> CBN Research Dept Occasional Papers op. cit.

<sup>240</sup> Ibid.

<sup>241</sup> Ibid.

road has significantly increased by over 20% since the year 2000, struggling to ply a mere 193,000 km network of which 15% is paved. The implication of this is that the annual cost of the poor road networks has been estimated to be N80 billion by the OECD,<sup>242</sup> while additional vehicle operating cost resulting from the bad roads is valued at N53.8 billion bringing the total loss per annum to N133.8 billion. The man-hour losses in traffic due to bad roads and other emotional and physical trauma people go through while driving on the roads and the loss in productivity is not factored into the above estimate of annual cost of poor road networks and additional vehicle operation cost.<sup>243</sup>

As at 1985, about 23 per cent of national roads were in a bad shape and this rose to 30 per cent in 1991 and 50 percent in 2001.<sup>244</sup> One of the road studies conducted in 1998 indicated that N300 billion will be required over the next 10 years to up-grade the national road network into a reasonable level. After this, an average of N24 billion will be required each year for subsequent maintenance and N32 billion per year for road rehabilitation. Further neglect of these roads implies a loss of network value of N80 billion per year and additional operating cost of N53 billion per year.<sup>245</sup>

Quoting a World Bank Report,<sup>246</sup> Bruno Wenn<sup>247</sup> said that infrastructure assets of a typical African country need rehabilitation, but however, much of that rehabilitation could be avoided if these assets were properly maintained. According to him, for the road sector, the study found that ‘spending \$1 on road maintenance provides a saving of \$4 to the economy, meaning that an estimated US\$1.9 billion of capital spending on rehabilitation could have been avoided with some preventive maintenance’.<sup>248</sup>

As at today, ‘the road transport is characterized by: large number of small-scale operators of goods and passenger vehicles, many with a limited professional and

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<sup>242</sup> Delaney 42.

<sup>243</sup> CBN Occasional Paper op.cit.

<sup>244</sup> Draft National Transport Policy op. cit. 25

<sup>245</sup> Ibid.

<sup>246</sup> Foster & Briceno-Garmendia (2010).

<sup>247</sup> Chairman, Germany’s DEG-one of the Europe’s largest Development Finance Institutions (DFIs).

<sup>248</sup> Infrastructure investor intelligence report 13.

business capacity, uncoordinated activities, and services leading to inefficient services, non-compliance with traffic regulations and poor enforcement.<sup>249</sup>

The argument is that the overall cost implications of the bad road networks is that it impacts negatively on cost of production which explains a major trigger of cost-push inflation. Intra-state roads are the responsibility of state governments, while the local governments are required to cater for intra-urban and rural feeder roads, which account for over 60% of the existing road networks. The Federal Government is responsible for the national highways which constitute only 13% of the existing road network. In addition, the Federal Government through its agencies is also responsible for inland waterways/river ports, sea ports, railways, airports and pipelines.<sup>250</sup>

## ii. Rail infrastructure

The railways infrastructure in Nigeria is made up of approximately 3,500 kilometres of narrow gauge lines. This has been stretched further by a narrow gauge line between Onne<sup>251</sup> and Enugu-Port Harcourt<sup>252</sup> line and standard gauge of 320 kilometres linking Ajaokuta<sup>253</sup> with Warri<sup>254</sup> is yet to be completed. The railway infrastructure in

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<sup>249</sup> National Draft Transport Policy 32.

<sup>250</sup> Ibid.

<sup>251</sup> Onne hosts a major port in the Niger-Delta region of Nigeria with several quays and facilities for cargo-ships. It is also the main platform for the offshore activities in that it hosts Oil and Gas Free Zone which was officially opened in March 1997. Over 30 international oil and gas companies including the world's largest corporations use the Free Zone as platforms and the cargo throughput has increased exponentially over the years. Aside, quite a number of supply-vessels visit the Onne port every week. See <http://www.onnefreezone.com/>; <http://en.wikipedia.org/wiki/Onne>.

<sup>252</sup> Enugu city is situated in the south-central Nigeria and the capital of Enugu State. It is centre of coal and iron-ore mining and a city known for her flourishing industries which include steel, cement, vegetable oil, food processing, and motor vehicle assemblage-<http://www.mapsofworld.com/Nigeria/cities/enugu.html>. Port Harcourt is the administrative capital of Rivers State; an important port town in the Niger-Delta region and hosts corporate headquarters of many of the multi-national oil and gas companies. It serves as the nucleus of Nigeria's oil and gas industry-<http://www.portharcourt.com/>. The two cities-Enugu and Port Harcourt-are linked together by railway.

<sup>253</sup> Ajaokuta is located in Kogi State on Nigeria and is the home of the multi-billion Ajaokuta Steel Rolling Mill. Owned and operated by Ajaokuta Steel Company Limited, the Mill manufactures steel-<http://www.inveting.businessweek.com/research/stocks/private/snapshot.asp>

<sup>254</sup> Warri is a major city in Delta State of Nigeria. It has a modern seaport which serves as the cargo transit point between River Niger and the Atlantic Ocean for import and export. There is also a refinery located at Ekpan, a town very close to Warri. Most of the international and local oil and gas corporate players operating in Nigeria have their operational bases within the city of Warri.

Nigeria has the potential to provide an efficient and cost effective means of transport, particularly on long distance routes serving high density traffic flows.<sup>255</sup>

The belief is that modern rail infrastructure will provide a cost-effective, affordable, energy-saving and environmentally friendly form of transport, when traffic densities are high. When properly integrated with other modes of transport, economic levels of traffic can be consolidated to enable the railway to provide efficient services for high density flows of homogenous traffic carried over relatively long distances on a regular basis. The railways are also well suited for the movement by large numbers of inter-city passengers and high volumes of containerized cargo or bulk freight such as oil, coal, steel or agricultural produce.<sup>256</sup>

However, because of the neglect of the past successive administrations in Nigeria, railway infrastructure has not been able to meet this desirable end. There has been deterioration in every spectrum ‘and caught up in a vicious circle of declining traffic, endemic deficits, decreasing capacity to serve its customers resulting in further loss of revenue. In short, the railways have ceased to be economically viable’.<sup>257</sup>

For the current lop-sidedness in the transport infrastructure to be changed and the vision that has arisen as a result of increasing industrialization to be achieved, then it is imperative for the railways system in Nigeria to be revived.<sup>258</sup>

The Nigerian railway system has suffered long term decline as a result of competition from road transport which, due to its flexibility, has eroded the rail traffic base. Traffic volumes have been declining due to the disappearance of inter-modal nodes aggravated by the declining quality of railway assets and train services. The

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<sup>255</sup> See Draft National Transport Policy document op. cit 21. The rail infrastructure comprises of wagons, coaches, rail cars, rail buses, cranes, workshops, and station buildings, most of which are in a decrepit condition. The rail density, that is, the kilometre of rail per 100 square kilometres of land area, is 0.4. See ‘The role of the financial system in Nigeria’s economic development, at al p. 8.

<sup>256</sup> Ibid.

<sup>257</sup> Ibid.

<sup>258</sup> Ibid.

deterioration of the system has increased to such an extent that the railways are now barely operational, despite a number of rehabilitation attempt.<sup>259</sup>

The railway system has been virtually crippled by management weaknesses and the institutional arrangement and is therefore, a serious drain on the public resources without adding any economic value to the nation. It is therefore imperative for the government to urgently confront this alarming situation by putting in place ‘a functional, efficient and viable railway system in the country’.<sup>260</sup>

### **iii. Water transport infrastructure**

Water transportation is another important mode of transportation in Nigeria. It takes an average of about 1.6 per cent of the country’s gross domestic product. The obvious reason for this is that by its nature, it is slow and not ideal for movement of passengers and goods. It serves the passengers for tourism and holiday purposes where time constraint is not an issue or where other modes of transport infrastructure are not available. Water transport is made up of two components and these are: coastal and inland water transport and ocean transport or shipping.<sup>261</sup>

Specifically, water transport in Nigeria provides services which include: movement of passengers<sup>262</sup> or freight movement over water, tour operations, cruise or sight seeing boats, ferries and water taxis.<sup>263</sup>

For water transport to function effectively there must be an adequate ports infrastructure in place. So ports infrastructure presents an intricate structure in Nigeria’s transportation network in three major ways. In the first instance, it plays a number of interrelated roles ‘which include:

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<sup>259</sup> Ibid.

<sup>260</sup> Ibid. 22

<sup>261</sup> National Bureau of Statistics Transport Statistics-  
<http://www.nigerianstat.gov.ng/uploads/ministryCategory/>.

<sup>262</sup> This as said earlier on, by its nature, is slow and therefore unsuitable for transportation of passengers except those who are on holidays or on tourist trips where constraint of time does not matter. In the riverine areas of the Niger-Delta region of Nigeria where because of the peculiar terrain, and there are no roads, the inhabitants rely mostly on water transportation.

<sup>263</sup> National Bureau of Statistics Transport statistics 10.

- (i) ship-harbour interface (pilotage, dredging, provision of berths, maintenance of navigational channels, etc);
- (ii) ship-port interface (loading and unloading of cargoes); and
- (iii) port-land interface (delivering cargo to and from the hinterland).<sup>264</sup>

Second, in the area of economy, the ports play a significant role. In Nigeria, for an instance, the international trade is done through the sea ports. Consequently, how efficient the ports are determines the cost of imports and the competitiveness of exports.<sup>265</sup>

Third, directly and indirectly, ports provide quite a large number of jobs especially through insurance, customs, haulage, clearance, storage, free zone activities, sorting out the incoming and outgoing cargoes, industrial and other added activities are considered.<sup>266</sup>

As at independence, there were two major ports in Nigeria-Lagos and Port Harcourt. These two ports together with the ones at Warri and Calabar adequately serviced the maritime needs of the nation. Between the middle and the close of 1970s, the ports infrastructure in Nigeria were undoubtedly over-stretched owing to the oil boom and the concomitant improved living standard which spurred a quantum leap in importation. This dramatic increase imposed pressure on the existing port infrastructure 'leading to delays in ship handling and resulting in high demurrage'.<sup>267</sup>

In response to this unwholesome situation, the government invested massively on the ports infrastructure and the capacity of the ports rose geometrically by about 300 percent between 1975 and 1980.<sup>268</sup>

According to the Draft National Transport Policy<sup>269</sup> presently, Nigerian Ports Authority<sup>270</sup> 'has 13 major ports, 11 oil terminals and 128 private jetties within the

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<sup>264</sup> Ibid.

<sup>265</sup> Ibid.

<sup>266</sup> Ibid.

<sup>267</sup> Ibid. 11.

<sup>268</sup> Ibid.

<sup>269</sup> Ibid.

port system. There are 102 quay berths, 62 buoys and over 650 different cargo handling plants and equipment. All together, the country has a total cargo handling capacity of over 35 million tonnes’.

Though installation of this capacity could be said to be a monumental national achievement in that the present capacity of the Nigerian ports can be considered adequate, more investments in ports infrastructure may yet improve efficiency and productivity. Regarding the traffic, the ports are significantly import-dependent. In recent times, the changes in import ranged from between 31.6 percent and 6.7% for general cargo; 53.5% and 44.5% for bulk cargo; and 23.6% and -22.6 % in containerized traffic. In all, there was an increase from 20 million in 1998 to 30 million in 2000 of cargo throughput.<sup>271</sup>

As stated above, water transport in Nigeria is made up of two components which are: coastal and inland water transport and ocean transport or shipping.

#### **(a) Coastal and inland waterways**

Where the coastal and inland waterway system works, great relief will be brought to bear on the country’s rail and road transport network as bulk goods can be freighted over long distances at very low costs. The obvious reason is that the energy demand of the waterways is low. Besides, the negative impact on the environment is minimal. In other words, the inland waterways infrastructure can conveniently and potentially link major cities, commercial nerve centre and the agricultural belts in all geo-economic zones. But unfortunately, ‘much of the infrastructure is run down and not fit for use.’<sup>272</sup>

Inland waterways in Nigeria comprise of the main river system (Rivers Niger and Benue with the confluence at Lokoja), creeks, lagoons, lakes and intra-coastal waters. Early merchants, missionaries and educationists took advantage of the river system in

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<sup>270</sup> Established by an Act of 1999, it owns the entire ports infrastructure in Nigeria and part of its functions is to operate, maintain, improve and regulate the use of ports in Nigeria. See particularly section 7 of the Act.

<sup>271</sup> Ibid. The cost of doing business at these ports is prohibitive. This is as a result of multiple taxes and levies imposed on operators. The implication of this is that there is substantial diversion of cargoes to other neighbouring West African countries leading to substantial loss of income.

<sup>272</sup> ADF Project Capacity building for ppp infrastructure 14.

Nigeria to explore River Niger. In pursuit of the development of the inland waterways in Nigeria, the National Inland Waterways Authority (NIWA) was established by National Inland Waterways Act, 2004. This Act vests in NIWA the power of executive management, direction and control of the inland waterways in Nigeria.<sup>273</sup>

Nigeria has the second longest waterways in Africa. It has 8,600 kilometres of inland waterways and an extensive coast-line of about 852 kilometres. The waterways in Nigeria hinge on the country's longest rivers, Niger and Benue. These two rivers divide the country into east, west and north and merged and formed a confluence in Lokoja flowing into the Atlantic Ocean. The country's coastal waterways stretch from Badagry through Warri to Calabar. The activities in the waterways are powered by large boats and for commerce and more in the Niger Delta region along the coast from Lagos lagoon to Cross River.<sup>274</sup>

Over the last three decades, the use and effectiveness of inland waterways have reduced significantly despite its potentials and advantages. As put in the Draft National Policy document: ‘.. this transport mode has diminished particularly over the past three decades due to physical, investment and operational constraints, notably: high rate of sediment build up along the channel; physical obstruction (wreck, rock outcrop etc); poor government investment in infrastructure development; inadequate river port infrastructure; and poor communication and navigation aids’.<sup>275</sup>

The draft document also comments on the potentials of this mode of transportation in Nigeria and says:

[T]he Nigerian inland waterways are a major national resource traversing 20 out of the 36 states. The areas adjacent to the major rivers represent the nation's important agricultural wetlands. Agricultural products from the middle belt ...can be transported....(to designated-major market and port cities) through the waterways. The Ajaokuta Steel Complex which is fed with

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<sup>273</sup> See Nigerian Inland Waterways Authority's website-<http://servenigeria.com/charters/transport-niwa>.

<sup>274</sup> Ibid.

<sup>275</sup> Draft National Transport Policy document- op. cit. – <http://www.accessbankplc.com/Library/Documents/2010>. The issue is that there is a low level of penetration of inland waterways in most of the federating states in the country due to lack of infrastructure.

coal and scrap metal imported through Warri and Onitsha, a major industrial/trade centre on the Niger, will both benefit from waterways, for movement of bulk cargo.<sup>276</sup>

### **(b) Ocean transport or shipping**

It is no longer news that the Nigerian economy depends significantly on international trade. The Draft National Transport Policy says that the total cargo throughput of Nigeria ports was 14.2 million tonnes in 2000. It was projected that throughput would be 17 million for 2005; 20 million for 2010 and 24 million for 2015.<sup>277</sup>

The implication of this heavy reliance on international trade is that it portends a robust maritime industry for the country. Plethora of benefits is attached to such a robust maritime industry in a country. These include: ‘promotion of export trade, and accelerated national economic growth, acquisition of shipping technology, thereby enhancing the nation’s ability to engage in ship-building and repairs: backward linkages and creation and diversification of employment opportunities and boost in government revenue and improvement in the country’s balance of payment’.<sup>278</sup>

These benefits are far from being realized unfortunately! Statistics from the Draft National Transport Policy document indicate that ‘between 1971 and 1981, Nigeria accounted for 68% of the total trade of West and Central African sub-region but earned only 14.4% of the accruing revenue. In 1990, Nigeria was responsible for freighting only 3% of the country’s total cargo, even though it had the mandate to carry as much as 60%. The relative share of indigenous carriers in the country’s maritime trade has decreased from its very low level of 4% in 1990. To date, the shipment of cargoes depends almost entirely on foreign shipping lines. However, though modest progress has been made over the years to address the problems plaguing the industry, Nigeria continues to lose significant revenue to foreign shipping lines’.<sup>279</sup>

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<sup>276</sup> Ibid. 17.

<sup>277</sup> Ibid.

<sup>278</sup> Ibid. 19.

<sup>279</sup> Ibid.

In view of the above facts, the conclusion is that Nigeria may not participate in the carriage of her own cargo and take maximum advantage of robust maritime industry in the nearest future except adequate measures are taken to right the wrong situation.<sup>280</sup>

#### **iv. Air transport**

Air transportation constitutes another vital component of Nigeria's transport system. Looking at the transport mode from a functional perspective, it provides complementary services to other modes of transportation in terms of passengers and freight, on both domestic and international routes. Generally, it is made up of airports and air transport services.<sup>281</sup> Air transport sub-sector is important from the stand-point of its ability 'to satisfy human needs by making goods and people available not only where they are needed but also when they are needed'.<sup>282</sup>

As pointed out in the Draft Document, out of all the modes, 'air transport mode performs the "place and time utility" functions best'.<sup>283</sup>

The air transport sub-sector's infrastructure is made up airports and air navigational facilities. In the 1920s, there were three landing sites of Lagos, Kano and Maiduguri. But today, there are 19 airports and 62 airstrips spread all over the country. The airports may be classified into three categories based on their design, characteristics and level of service namely: international airports; domestic airports and local private airstrips. The international and domestic airports are the ones built and owned by governments. Owing to the challenge of high fixed cost in the operation and maintenance of the airport facilities coupled with the relatively low income, just three of all these airports operate at a commercial self-sustaining level, while the others are under the weight of crushing debt because they operate at an incredible substantial loss.<sup>284</sup>

In summary, transportation emerges as an important constraint because it generates significant indirect costs of doing business.

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<sup>280</sup> Ibid.

<sup>281</sup> Ibid. P. 39

<sup>282</sup> Ibid.

<sup>283</sup> Ibid.

<sup>284</sup> Ibid.

### 3.4.2.3 Telecommunications industry

Review of the historical evolution of telecommunications in Nigeria will start from 1886 when telecommunications facilities were established during the colonial era. On the attainment of independence in 1960, and with a population of about 40 million people, only about 18,724 phone lines were in use—a teledensity of about 0.5 telephone lines per 1000 people. Then, the telecommunications infrastructure was made of telephone networks consisting ‘of 121 exchanges of which 116 were of the manual (magneto) type and only 5 were automatic’.<sup>285</sup>

However, between 1960 and 1985, the industry had the Department of Posts and Telecommunications (P & T) superintending over the internal network and a limited liability company, the Nigerian External Telecommunication (NET) Limited, took charge of the external telecommunications services, as a window to the outside world.<sup>286</sup> As at the close of the year 1985, the installed switching capacity was about 200,000 lines, behind the projection of about 460,000. During this period under review, the entire spectrum of the telephone system was ‘unreliable, congested, expensive and customer-unfriendly’.<sup>287</sup> The exchanges were analogue and the telephone penetration remained abysmally poor at ‘one telephone line to 440 inhabitants’ which was far ‘below the target of one telephone line to 100 inhabitants’ as recommended by International Telecommunications Union for developing countries’.<sup>288</sup>

Also in 1985, the then Posts and Telecommunications Department was divided into two divisions—Postal and Telecommunications Divisions. The telecommunications division was then merged with NET to form Nigerian Telecommunications Limited (NITEL), a limited liability company which main objective was ‘to harmonize the planning and coordination of internal and external telecommunications services, rationalize investments in telecommunications development and provide accessible, efficient and affordable services’.<sup>289</sup> However in 1992, Nigeria Communications Commission (NCC) was established by the government as an independent regulator.

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<sup>285</sup> Tella S et al (2007).

<sup>286</sup> Ibid.

<sup>287</sup> Ibid.

<sup>288</sup> Ibid.

<sup>289</sup> Ibid.

Part of the NCC mandate was to ‘establish and foster an environment that will facilitate the participation of the private sector to increase and expand the extremely poor existing infrastructure’.<sup>290</sup>

By early 2000s, the telecommunications infrastructure had deteriorated to the extent that only 500,000 lines were available to over 100 million Nigerians. NITEL, as the national carrier, enjoyed many unbroken-years of monopoly over the telecommunications industry in Nigeria and was notorious for corruption and inefficiency which was as a result of bad management and this implicated in the low tele-density in Nigeria for those long inglorious years.<sup>291</sup>

As pointed out above, before 2001, Nigeria had less than 500,000 telephone lines. Nigeria was ranked as ‘the third lowest tele-density behind the war-torn Afghanistan and Mongolia. However, with the foresight of the then President Olusegun Obasanjo, the parlous situation in the telecommunications industry was reversed and Nigeria became the fastest growing telecommunications market in the world.’<sup>292</sup>

Telecommunications industry emerged on the world stage in 2001 when the deregulation of the sub-sector opened the space up for private sector investments. This emergence indeed began when the industry was opened up with the issuance of Global System for Mobile Communication (GSM) unified licence in 2001. The sweeping deregulation brought in telecommunications players like MTN, Glo Mobile, Zain (formerly Celtel), Etisalat, Visafone, Multilinks, Starcomms and Zoom (formely Reltel).<sup>293</sup>

The enabling legislation, the Nigerian Communications Act 2003, became law on the 8<sup>th</sup> of July 2003. The Act, among other things, strengthens the capacity of the regulatory agency, NCC, to properly superintend the activities of the players in the telecommunications industry in Nigeria.

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<sup>290</sup> Ibid.

<sup>291</sup> Ibid.

<sup>292</sup> ‘Killing Telecoms with Multiple Blows’ The Nation 15 May 2012.

<sup>293</sup> Ibid.

Far reaching liberalization of the telecommunications sector has led to many companies engaging in business activities in the sector and providing telecommunications services of all kinds and value-added services in a regulated market.

The upsurge witnessed in the subscribers base of the networks was as a result of combination of factors which include: the population explosion and rapid urbanization; growth in businesses; improved banking operations and the upgraded financial infrastructure; infrastructure sharing; improvements in telecommunications infrastructure; the opening up of the industry to competitiveness which forced down the cost of subscription and pricing for telecommunications services; improved interconnectivity, to mention few. For example, before the advent of the deregulation of the industry, the cost of NITEL mobile line was over N60, 000 per line; however, after the deregulation, the cost came down to N20, 000 per line, and presently, the cost has crashed down to zero, that is, lines are now given free to subscribers.<sup>294</sup>

Talking about the benefits, apart from the fact that the deregulation opened up the space for competition for enhancement of telecommunications services, the benefits are quite multi-faceted and they include: increased in accessibility and affordability of the telecommunications services to million of ordinary Nigerians; increased public sector revenue generation; and importantly, it has created many jobs, directly and indirectly, and also open up many business opportunities for many Nigerians.<sup>295</sup>

Apart from the exponential growth in voice telephony, Nigeria has also recorded considerable ‘penetration in data with the upsurge in internet services provided by the Generalized Mobile System operators and broad band internet providers’. This quantum growth is implicated in jobs creation in the economy and over 2.5 million jobs since 2001.<sup>296</sup>

From a market overview and analysis perspectives, Nigeria has over-taken South Africa to become the continent’s largest mobile market with close to 100 million

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<sup>294</sup> Ibid.

<sup>295</sup> Ibid.

<sup>296</sup> Ibid.

subscribers. In spite of the challenges besetting the telecommunications industry, Nigeria still presents ‘a goldmine’ and an environment for ‘viable business opportunity for investors into the telecommunications market’.<sup>297</sup> For an instance, the space is open for new investors in almost all the undertakings of the sector.

Another good thing about the industry is its competitiveness. For an example, the competitive landscape of the industry has made the operators to invest in new infrastructure and upgrade the existing ones all in a bid to improve the spatial coverage and quality which in turn has led to surge in subscription and usage. MTN, one of the network operators was reported to have invested over USD 1 billion in new infrastructure acquisition and upgrade.<sup>298</sup> Over the past 10 years, the four of the major telecommunications operators claimed to have invested more than 1 trillion naira in building and enhancement of mobile networks in the country.<sup>299</sup>

It important however, to point out that it is not a ‘win-win’ situation for the investors and the industry as a whole. The industry is also confronted by some challenges like power which is a crucial factor in the operating environment in the telecommunications industry. It should be noted that the operating environment for the telecommunications operators in Nigeria has been a constraint to quality service delivery to the Nigerian public. The networks operators have described the operating environment ‘as frustrating and volatile’.<sup>300</sup>

In conclusion, the lesson that can be drawn from the telecommunications industry’s experience in Nigeria is that the telecommunications sub-sector represents a memorabilia of some of the strengths and near perfections of allocative efficiency of markets and free competition, the efficiency of private sector management in a competitive environment and what an appropriate legal reforms can indeed achieve in a space of time. With an appropriate legal and financial infrastructure coupled with strong regulatory oversight and institutions, the successes recorded in the

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<sup>297</sup> See [www.nipc.gov/ng-last](http://www.nipc.gov/ng-last) accessed 19 May 2012.

<sup>298</sup> ‘Nigerian Telecom Market set for 5.9% Growth’ Leadership 21 February 2012-also at [www.leadership.ng/nga/articles/16962/2012/02/21/nigerian\\_telecom\\_market\\_set\\_59\\_growth.html](http://www.leadership.ng/nga/articles/16962/2012/02/21/nigerian_telecom_market_set_59_growth.html).

<sup>299</sup> Ibid.

<sup>300</sup> ‘We’ve invested over N1 trillion in our networks’ The Nation 19 May 2012.

telecommunications industry can be replicated in other critical infrastructure sub-sectors in Nigeria, power in particular.

### **3.5 Infrastructure investment requirements**

As pointed out in the introductory chapter, one constraining challenge that Nigeria is facing regarding infrastructure deficit is in the area of inadequate funding and lack of long-term financing.

Really, infrastructure investments are naturally lumpy with massive up front costs, long-term revenue streams and usually in fixed locations and reasonably unattractive to investors.

Though private investments in core infrastructure assets have improved over the years, it is still sub-optimal and scaled strongly in favour of few sectors. For example, the recent trend in private infrastructure investments is tilted towards the telecommunication sector.

Nigeria is presently spending around 7% of GDP on infrastructure. This includes both the public and private financing sources. This is somewhat above average in the Sub-Saharan Africa, but far below that of some countries in Africa like Mozambique with 12% of GDP, or non-African countries like China with 14% of GDP.<sup>301</sup>

Besides, the urbanization rate in Nigeria is quite rapid! According to the Document, from about 11 million in 1963, the total urban population grew to 32.2 million in 1991 and by 2000, it was estimated to be around 45 million. Averagely, Nigerian cities have witnessed growth at the rate of 8% per year, far in excess of the country's population growth of 3.2%. In Nigeria today, there are 11 cities with population above one million and 23 cities with population over 200,000.<sup>302</sup>

Problems of urban transport network could be observed in recent times in the following forms:

- poorly maintained urban road network and road complimentary facilities;
- inefficient public transport system;

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<sup>301</sup> See Project appraisal document 6.

<sup>302</sup> Draft National Transport Policy document 34.

- poor institutional framework leading to poor coordination of urban transit services; and
- poor land use-transport planning and poor and inefficient transport management.<sup>303</sup>

Based on the Document on Vision 20: 2020,<sup>304</sup> the Federal Government's proposed expenditure in road rehabilitation, upgrade and expansion between 2011 and 2013, would cost the public sector N700 billion to finance various construction and rehabilitation projects across the country within that time frame.<sup>305</sup>

Citing a report released by the Federal Ministry of Finance, it is estimated that fixing the infrastructure gap that is confronting Nigeria requires capital investments to the tune of US\$100 to US\$111 billion and this conservative estimate excludes the subsequent periodic maintenance and recurrent costs.<sup>306</sup>

According to the report, the deficit has made mockery of Nigeria's current expenditure on provision and maintenance of infrastructure assets. Transcending this, there is also the problem of effective allocation and disbursement of funds.<sup>307</sup>

Addressing this escalating infrastructure gap that obstructs Nigeria's march towards an exponential economic growth and development cannot be met by public sources of finance alone.

Therefore, to confront the poverty of infrastructure head-on in the face of shrinking fiscal space in the public sector finance in Nigeria which is as a result of poor regime of tax revenue collection, irresponsible wastages and corruption in way and manner resources are managed, dwindling overseas development assistance coupled with competing demands from other sectors of the economy, it has become imperative for

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<sup>303</sup> Ibid. 35.

<sup>304</sup> Published by the National Planning Commission-<http://www.npc.gov/ng/>-assessed on the 25<sup>th</sup> August 2011.

<sup>305</sup> Ibid.

<sup>306</sup> Project appraisal document (n 151).

<sup>307</sup> Ibid.

the government to mobilize resources from more financially robust private sector to close the yawning financing gaps in the infrastructure market in Nigeria.

### **3.6 Government's efforts at addressing the infrastructure challenges**

In addressing these challenges, since 2003 the Federal Government of Nigeria has come up with several reform agenda which include: National Economic Empowerment Development Strategy (NEEDS)<sup>308</sup> which is aimed at achieving among other things, deregulation, liberalization, privatization, transparency and accountability. As a development strategy, NEEDS focused on addressing decrepit infrastructure especially unreliable power supplies and other impediments to private-sector driven economic growth.<sup>309</sup>

The government hoped that the NEEDS would create 7 million new jobs, diversify the economy, boost non-energy sectors, increase industrial capacity utilization, and impose agricultural productivity, hence achieve growth, better service delivery, reform of government institutions and the political system, and transformation of values to overcome corruption and inefficiency.<sup>310</sup>

An initiative with similar objectives at the state level was the State Economic Empowerment and Development Strategy (SEEDS).<sup>311</sup> Though significant progress was made on these reforms, however, the daunting challenges are still far from being resolved.<sup>312</sup>

In the same vein, during the administration of Late President Yar' Adua, the Federal Government again set reform agenda called Seven-Point Agenda 2008-2011, launched in 2007. This is a development strategy which builds on the NEEDS. The

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<sup>308</sup> NEEDS is a nationally coordinated home-grown poverty reduction strategy with the vision 'to build a solid foundation aimed toward the attainment of Nigeria becoming the largest and strongest African economy and a key player in the world economy'. See CBN website-<http://www.cenbank.org/out/publications/rd/2004/needs.pdf>-assessed 15<sup>th</sup> August 2011.

<sup>309</sup> ADF Project capacity building for ppp infrastructure 111.

<sup>310</sup> Ibid.

<sup>311</sup> SEEDS is state-owned and led strategies for growth and poverty reduction within the NEEDS and MDGs framework. This is also a document stating the entire medium term development plans based on the peculiar local circumstances in the states.-<http://www.ng.undp.org/documents/SEEDS/2006-Benchmarking.pdf>.-assessed 15<sup>th</sup> August, 2011

<sup>312</sup> ADF Project capacity building (n 309 above).

NEEDS was successfully implemented during 2004-2007 and reasonably guided the government in implementing the broad reform agenda. NEEDS-II and the Seven-Point Agenda were harmonized to give birth to the fifth National Development Plan (2009-2012). The seven key areas of the Plan are:

- critical infrastructure (energy and transportation);
- Niger-Delta regional development;
- food security;
- human capital development (health, education and training);
- land tenure charges and home ownership; national security; and
- wealth creation.<sup>313</sup>

Shortly thereafter, the executive arm of the government came up with Vision 2020<sup>314</sup> as Nigeria's blue-print for transformation. The major idea behind the vision is to make "Nigeria one of the 20 largest economies in the world, able to consolidate its leadership role in Africa and establish itself as a significant player in the global economic and political arena".<sup>315</sup>

The crucial goals include: to achieve a GDP of US\$ 900 billion, GDP/Cap US\$4000; move up from 128 of 133 countries in the Global Competitiveness Index; move up from 158 of 177 countries on the UNDP Human Development Index rating (UN 2007/2008) and achieve a life expectancy of not less than 70 years.<sup>316</sup> According to the Vision, 'the key indicative parameter to achieve this is adequate infrastructure services that support the full mobilization of all economic sectors.'<sup>317</sup>

Pursuant to the above, the Federal Government has come up with the first National Implementation Plan (NIP) which has as one of its core aspirations, provision of

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<sup>313</sup> Ibid. 2.

<sup>314</sup> This is Nigeria's economic transformation blueprint of a ten year plan for stimulating Nigeria's economic growth and launching the country into a path of sustained and rapid economic growth to become one of the twenty largest economies by 2020. The vision, as said, is anchored on NEEDS and the seven point agenda of the previous administration-<http://www.centre/sd.org/index.php?>

<sup>315</sup> See Nigeria's Vision 2020 programme-Programme Plan-<http://www.npc.gov.ng/-National-Planning-Commission's-Website>.

<sup>316</sup> Ibid.

<sup>317</sup> ADF Project appraisal report et al 2.

‘adequate infrastructure services that sustain the full activation and operation of all economic sectors’.<sup>318</sup>

### 3.6.1 The power sector reforms

As at the beginning of the present democratic dispensation in 1999, the electricity power sector in Nigeria was at its lowest ebb. Out of the 79 generating units in the country, only 19 units were operational with an average daily generation of 1750 megawatts. Besides, the entire power infrastructure was decrepit. The position was that an estimated 90 million Nigerians were without access to electricity grid.<sup>319</sup>

Though an accurate and reliable statistics are hard to get, the losses incurred by the industries were put in excess of 50%<sup>320</sup>. The imperative for the reform of the sector was inspired by the poor performance of the state-run electricity industry in terms of high cost, inadequate expansion of access to electricity services for the populace, and/or unreliable supply of electricity; the inability of the state-owned sector to finance the needed investments in the sector and specifically, the need to reduce the cost of doing business in the country to facilitate new investments through the provision of uninterrupted power supply to the country for industrial, commercial and domestic uses.<sup>321</sup>

In a bold move to tackle the perennial outages in the Nigeria’s power sector, the National Council on Privatization,<sup>322</sup> in September 2000, inaugurated the Electric Power Reform Implementation Committee (EPIC) with the mandate to conduct a comprehensive study of the electric industry and make recommendations for the policy-thrust that would usher in total liberalization, competition and private sector-driven development of the sector.<sup>323</sup>

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<sup>318</sup> Ibid.

<sup>319</sup> Onogoruwa et. al.

<sup>320</sup> Ibid.

<sup>321</sup> Ibid

<sup>322</sup> Established under the Public Enterprises (Privatization and Commercialization) Act 1999, the Council is saddled with regulatory and institutional functions regarding the privatization and commercialization of public enterprises in Nigeria. Statutorily, it is chaired by the sitting Vice President and comprises of some key government functionaries including the Minister of Finance as the Vice-Chairman, Attorney General of the Federation and Minister of Justice, the Governor of Central Bank of Nigeria, Director General of Bureau of Public Enterprises (BPE), to mention few.

<sup>323</sup> Onogoruwa 2.

The main assignment of EPIC was to prepare a power policy blue-print that would define government's new direction for the electric power sector and this gave birth to the preparation of a draft National Electric Power Policy (NEPP) in March 2001 and approved by the Federal Executive Council in September of the same year.<sup>324</sup>

The outcomes of the policy recommendations were sweeping and included the complete transformation of the sector through privatization; the establishment of the Nigerian Electricity Regulatory Commission (NERC);<sup>325</sup> a market trading design and new rules, codes and processes. These recommendations were encapsulated in the Electric Power Sector Reform (EPSR) Act 2005<sup>326</sup> which provides a legal and regulatory framework for the reform of the Nigerian power sector in tandem with the new policy thrust of the government as set out in the National Electric Power Policy. The shift in paradigm as captured by the Act is the removal of operational and regulatory responsibilities of the electric power industry from the Federal Government. The kernel of the legal framework is that it establishes the regulatory body<sup>327</sup> and provides the legal platform for the unbundling of Power Holding Company of Nigeria (PHCN) and the formation of successor companies to take over the functions, assets, liabilities and staff of the PHCN.<sup>328</sup>

Electric Power Sector Reforms Act was signed into law on the 11<sup>th</sup> March 2005 and it generally provides the statutory framework for participation of private companies in electricity generation, transmission, and distribution. So, it specifically provides for the formation of companies to take over the functions, assets, liabilities and staff of the defunct National Electric Power Authority.<sup>329</sup> It also provides for development of competitive electricity markets and the establishment of the Nigerian Electricity

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<sup>324</sup> Ibid.

<sup>325</sup> Ibid.

<sup>326</sup> An Act signed into law on the 11<sup>th</sup> day of March 2005. It provides for the formation of companies to take over the functions, assets, liabilities, and staff of the National Electric Power Authority (NEPA); develop competitive electricity markets; establish the Nigeria Electricity Regulatory Commission; provide for the licensing and regulation of the generation, transmission, distribution and supply of electricity; enforce such matters as performance standards, consumer rights and obligations and to provide for the determination of tariffs, among others. See the explanatory memorandum and the schedule to the Electric Power Sector Reform Act 2005.

<sup>327</sup> Its functions, among others, include 'to create, promote, and preserve efficient industry and market structures, and to ensure the optimal utilization of resources for the provision of electricity services'. See section 32 of Electric Power Sector Reform Act 2005.

<sup>328</sup> Onogoruwa 3.

<sup>329</sup> Ibid.

Regulatory Commission. Besides, the Act also makes provision for the licensing and regulation of the generation, transmission, distribution and supply of electricity.

Regulatory issues in respect of enforcement of matters like performance standards, consumer rights and obligations and determination of tariffs are also captured by the Act.<sup>330</sup>

The legislation is also expected to create the enabling environment for the development of a competitive electricity market. This could be seen from the provisions in the Act that allow for determination of tariffs and other related issues. It also repealed the defunct Electricity Act and the National Electric Power Authority Act.<sup>331</sup>

In nutshell, the EPSR Act 2005, among others, provides for creation of Holding Company, Power Holding Company of Nigeria (PHCN), to take over the assets, liabilities and employees of the defunct NEPA; unbundling of PHCN into 18 companies and ensuring greater operational autonomy; market development; privatization of successor companies which empowers the Bureau of Public Enterprises to undertake this responsibility and establishment of the regulatory body, the Nigeria Electricity Regulatory Commission (NERC).<sup>332</sup>

The overall achievement of the two documents-Electric Power Policy 2001 and Electric Power Sector Reform Act 2005- is that they identify the private sector as the lead-driver of the future of electric power industry in Nigeria. Under the two documents, the government is to principally provide policy and independent regulation, while the private sector is expected to provide investment, managerial capacity, technology and competition.<sup>333</sup>

To this end, the government expects the private sector to acquire interest or take over existing assets in the sector and develop green field projects. The motivation really behind this move on the part of the Federal Government of Nigeria is to meet the

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<sup>330</sup> See the Explanatory Memorandum to the Electric Power Sector Reform Act 2005.

<sup>331</sup> Ibid.

<sup>332</sup> Ibid.

<sup>333</sup> Ibid.

Vision 20:2020 target of 40000 megawatts which requires investment in power sector of at least US\$ 3.5 billion per annum for the next 10 years.<sup>334</sup>

Under the First National Implementation Plan (2010-2013), it is proposed that the needed investments in the power sector during the Plan period is about N880.98 billion. This will cover investments in areas like power generation; transmission; distribution; and alternative energy. This proposition is viewed as of strategic importance to provision of power for sustainable economic growth and development. Aside the fact that most economic activities rely on regular and affordable power for productive operations, it is also imperative for reduction of the cost of doing business, enhancement of productivity and above all, quality of life in Nigeria.<sup>335</sup>

The setting up of Transmission Company of Nigeria (TCN) is seen as an integral part of the strategy which entails the adoption of five-year management contract to oversee the transmission and operations coupled with the belief that the management contract will bring about the required expertise into the transmission of electricity.<sup>336</sup>

Unfortunately, due to the slow implementation of the Electric Power Sector Reform Act, the expected change in the sector is yet to be realized.<sup>337</sup>

According to the country's Minister of Power, about 135,000 megawatts of electricity was required to effectively power the nation's economy.<sup>338</sup> He claims that presently, the baseline of power generation in the country is at 3,600 megawatts out of the 5,700 megawatts available capacity. He however, affirms the government's commitment to exploit the different methods of fuel supply for power generation such as gas, hydro, coal, and wind and solar to achieve the target.<sup>339</sup>

The Nigerian Minister of Petroleum Resources said that the current challenges in the power sector were as a result of 'gross misalignment' in gas supply to power plants.

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<sup>334</sup> Ibid. 4.

<sup>335</sup> See Nigeria Vision 20 2020 The First National Implementation Plan (2010-2013) Volume II: Sectoral Plans and Programmes May 2011.

<sup>336</sup> Ibid.

<sup>337</sup> Ibid.

<sup>338</sup> 'FG says 135,000 megawatts of electricity required to power the country' Business Day 8 May 2012.

<sup>339</sup> Ibid.

According to her, some of the power plants were sited in areas not accessible to gas to power them.<sup>340</sup>

### 3.7 Concluding remarks

In the discussion above, provision of infrastructure assets was correlated with development and the conclusion was that infrastructure acts as catalyst and critical to human and economic development and also the general functioning of every modern society; it defines a country's business competitiveness and also creates jobs. In the words of Frank Ennis,<sup>341</sup> its presence, absence, and quality affect the well-being of the people, determine the level of economic growth and assist in the effective functioning of the overall economy of any nation; and 'to fulfil these purposes, infrastructure services need to be widely and easily available'.<sup>342</sup>

The decades of sub-optimal investments in infrastructure assets and the general lack of maintenance culture are identified as some of the reasons for the parlous state of the critical infrastructure in Nigeria.

There was presentation of overview of the state of infrastructure across the entire landscape. The overview was a sector-level analysis of three sub-sectors: power, transport and telecommunications. In the discussion, it was observed that these three sub-sectors of the broader infrastructure sector were fundamental to the socio-economic life of the country and very critical to nation's match to economic growth and development. While the problems plaguing the first two sub-sectors-power and transport-characterize the other sub-sectors and are representative of the general problems plaguing the larger infrastructure sector, the telecommunications sub-sector represents a reminder of some of the strengths and near perfections of allocative efficiency of markets and free competition, the efficiency of private sector management in a competitive environment and what an appropriate legal reforms can achieve in a space of time.

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<sup>340</sup> Ibid.

<sup>341</sup> 'Infrastructure provision and the urban environment' in *Infrastructure provision and the negotiating process* (ed.) (2003) 1.

<sup>342</sup> Ibid.

Given the scale of the nation's infrastructure requirements and the ever-widening investment deficit in public assets and service delivery, it has become imperative for the Nigeria government to address the problem through the engagement of private capital to make significant investments in the development of infrastructure assets if the nation is to succeed in opening up the country's vast economic potentials and fast-track development process. This is needful because the huge infrastructure investment requirements cannot be accommodated within the available fiscal space as a result of contraction in available public resources.

As observed above, one way to do this and address this infrastructure gap in the country is through the participation of the private sector in financing of public infrastructure or a public private partnership framework which has become a world-wide revolution in the landscape of public finance and provision of infrastructure.

This takes the discussion to next topic which will examine the policy environment for private investment in public infrastructure.

## **CHAPTER 4**

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### **PUBLIC-PRIVATE PARTNERSHIP AS A FINANCING TECHNIQUE**

#### 4.1 Introductory remarks

#### 4.2 Historical overview of public private partnership (PPP) model

#### 4.3 Framework for private sector engagement

#### 4.4 Context and nature of PPP approach

##### 4.4.1 Reasons for PPP

##### 4.4.2 Specific benefits of PPP structure

##### 4.4.3 Benefits of the PPP to the private sector

##### 4.4.4 Overall benefits of PPP

##### 4.4.5 Characteristics of PPP

#### 4.5 Structures for PPP

##### 4.5.1 Privatization

##### 4.5.2 Concession

###### 4.5.2.1 Diverse faces of concession

###### i. Build-Operate-Transfer (BOT)

###### ii. Build-Own-Operate (BOO)

###### iii. Build-Lease-Transfer (BLT)

###### iv. Rehabilitate-Operate-Transfer (ROT)

###### v. Rehabilitate-Lease-Transfer (RLT)

###### vi. Build-Rehabilitate-Operate-Transfer (BROT)

###### vii. Performance-Based Variant

##### 4.5.3 Availability-based PPP

##### 4.5.4 Management and lease contracts

##### 4.5.5 Cooperative arrangements

##### 4.5.6 Merchant

##### 4.5.7 Rental

#### 4.6 Concluding remarks

#### **4.1 Introductory remarks**

In the previous chapter, the conclusion was that that infrastructure acts as catalyst and critical to human and economic development and also the general functioning of every modern society. In other words, it impacts functionality on a given society and defines a country's business competitiveness and also creates jobs. But however in Nigeria, the decades of sub-optimal investments in infrastructure assets and the general lack of maintenance culture have all taken toll on the nation's infrastructure. So, one big challenge starting the three tiers of government at the face is how to fix the yawning infrastructure gaps. But unfortunately, the magnitude of financing required to bridge the country's infrastructure deficit currently outstrips the supply of capital available from the public sector. Then the prevailing thinking of the three tiers of government in Nigeria is that one sure way to address this infrastructure gap in the country is to leverage public private partnership framework to fund critical public infrastructure. Hence, the shift in paradigm from public to private sector provision, financing and management of public infrastructure in Nigeria.

The research question in this chapter is: what does the policy environment for private investment in public infrastructure in Nigeria looks like? Thus, the chapter will seek to review the policy environment regarding private capital investment in procurement, maintenance and operation of critical public infrastructure assets in Nigeria. It will also discuss the reasons that informed the need for the public private partnerships in the infrastructure sector in Nigeria, its context and characteristics.

In setting the stage, the discussion in this chapter takes off by taking a look at the history of private sector participation in infrastructure delivery in Nigeria.

#### **4.2 Historical overview of public private partnership model**

Generally, the history of private participation in provision of public infrastructure and services shows that in many aspects, there has been some degree of cooperation between public and private sector. The stories of private contracting in the public sphere are many. Instances include: Mathew, the private tax collector in the Holy Scriptures; the private cleaning of public street lamps in 18<sup>th</sup> century England; private railways of the 19<sup>th</sup> century or the fact that 82 per cent of the 197 vessels in Drake's fleet that successfully conquered the Spanish Armada in 1588 were private

contractors to the Admiralty. In like manner, the first ship that sailed to America was a joint effort between public and private actors. These contracting arrangements may be viewed as early forms of cooperative partnerships.<sup>343</sup>

Hodge and Greve<sup>344</sup> reveal that in Denmark, a commercial company, Falek has had a partnership with the Danish public sector for nearly a hundred years. According to the duo, Falek started its business by providing an ambulance service in the capital city Copenhagen, and has since expanded its services to include fire fighting and other rescue operations. This same Falek is now the preferred partner for most of Denmark's local governments in provision of ambulance and fire fighting services.<sup>345</sup>

For many years, partnership arrangement has been espoused by government at all levels and of whatever hue. While partnership working has been endorsed as a 'good idea' for many years, it did not really start to gather momentum in the UK until during the 1980s; while continental Europe has moved at broadly the same pace as the UK, North America was, perhaps, slightly ahead. In what might be called the immediate 'pre-partnership' world, government at central or local level determined policy, decided whether or not to consult others, allocated resources, and then announced the procurement process. While occasionally this process would involve different sources of finance (including private sources) in areas such as housing or regeneration, the ultimate responsibility or control was left with the relevant central or local government body.<sup>346</sup> However, the original command and control approach under which all public services were funded and delivered by government had been gradually modified during the 1970s and 1980s by the introduction of such concepts as 'best value' and the use of the private sector to deliver some public services under contract. Advisory or monitoring partnerships were sometimes created but there was a fairly limited amount of true partnership working; in particular, government permitted little interference in policy development.<sup>347</sup>

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<sup>343</sup> Hodge and Greve (n 17 above) 2.

<sup>344</sup> Ibid.

<sup>345</sup> Ibid. 3.

<sup>346</sup> Giddes M (2005) 3.

<sup>347</sup> Ibid.

By the mid-1980s, the context had changed significantly. In general terms, the public sector was faced with eroding confidence in its ability to deliver services and was coming under increasing pressure to perform public services more effectively, efficiently and transparently. On the other side of the fence, business leaders were coming to see the community as primary stakeholders; ‘corporate social responsibility’ becomes a term which appeared more frequently in companies’ annual reports.<sup>348</sup>

Globally, since the early part of 1980s, private sector participation has witnessed a great resurgence. In some instances, this resurgence has taken the form of privatization of public enterprises. Then, the use of project finance gained currency in financing of infrastructure investments gaps. This was the main option in use for infrastructure investment like telecommunications and power generation in frontier economies. This was later expanded through Private Finance Initiative in the United Kingdom to finance public infrastructure including the construction and operation of prisons, hospitals, sub-way cars, and even the National Insurance Computer System.<sup>349</sup>

Specifically in Nigeria, the era of private sector participation was preceded by the period of economic nationalism which was in force in the 1970s up to the early part of 1980s. So for many years up to the early 1980s, Nigeria like many developing countries in consonance with the Keynesian theoretical exposition on massive involvement of public sector in economic development programmes, made a considerable use of public enterprises for resource mobilization and allocation within the matrix of social services and utilities sector, in particular. The prevalence of this economic policy significantly hindered the flow of private capital, both domestic and foreign, high technology and proven managerial skills into the nation’s economy.

However, the great successes that accompanied the lot of those countries that embraced the market approach, openness, and competition especially in the area of

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<sup>348</sup> Ibid.

<sup>349</sup> Ibid.

economic growth inspired to a very large extent the spread of liberalization and restructuring across the globe.<sup>350</sup>

The last straw that broke the Carmel's back was the economic crises of the 1980s and 1990s that forced the public and the governments then to have a re-think about public enterprises regarding their poor performances. This was also coupled with the pressures from the donors, creditors and multilateral finance institutions to deregulate and privatize as a pre-condition for debt relief that accentuated the need to embrace deregulation to open up the space for private sector participation especially in the provision of core public infrastructure and delivery of services.<sup>351</sup> Nigeria then shifted from a public sector centred economic policy to a private sector and market-driven economy that is based on competition and also export-driven.<sup>352</sup>

#### **4.3 Framework for public-private partnership in Nigeria**

Since the beginning of the fourth democratic experience in May 1999, the Federal Government has embarked on extensive liberalization and privatization program to inject private sector money and expertise in order to ensure quality infrastructure service delivery to the teeming population.<sup>353</sup> The assumption is that private sector investment in infrastructure is a key priority in moving Nigeria to the status of top 20 economies by the year 2020.<sup>354</sup>

In 2007 specifically, the Federal Government of Nigeria articulated its Seven Point Agenda which outlined the seven key drivers for Nigerian development.<sup>355</sup> Atop this list of indicative parameters, is the adequate provision of critical infrastructure<sup>356</sup> as a

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<sup>350</sup> Ibid.

<sup>351</sup> Ayodele A (1999) 12.

<sup>352</sup> Ibid.

<sup>353</sup> Report of the Nigerian Economic Summit Group International ppp and infrastructure development in Nigeria Conference on Infrastructure Development in Nigeria, 2004 1.

<sup>354</sup> Ibid.

<sup>355</sup> Project Appraisal Document 46.

<sup>356</sup> The critical infrastructure include: power, transportation, national gas distribution and telecommunications. In power-to develop an integrated, lowest cost, expansion plan for the development of the Nigerian electricity industry in the medium and long-term; upgrade and reinforce distribution network; develop appropriate gas policy to encourage production and supply of gas for electricity generation; develop gas production and supply infrastructure; and develop a policy on IPPs. In transport-provide platforms for ppp, with capacity building in ministries, departments and agencies. In roads-explore mechanisms to ensure funding for maintenance investments. In railways, revive the system and involve the private sector. In aviation-the priority is to establish the National Civil Aviation Authority as the cornerstone of reform, including a recertification project.

means to catalyze economic growth with the transport sector as a high priority for public private partnership (PPP) investment.<sup>357</sup>

Over the years, Federal Government has taken serious steps to pursue its infrastructure targets set under the Seven Point Agenda.<sup>358</sup> At the level of the states, the national infrastructure strategy has been endorsed and commitment has been pledged towards the agenda for country-wide infrastructure development.

With specific regard to PPP, the Federal Government inaugurated the Infrastructure Concession Regulatory Commission (ICRC)<sup>359</sup> in late 2008 to drive the PPP programme in Nigeria. As a first step towards establishing the proper legal and regulatory environment to attract private sector investors, the Federal Executive Council approved the National Policy on Public Private Partnership, sponsored by ICRC after stakeholder consultations and technical inputs from, inter alia, the World Bank and the UK's Department for International Development (DFID). The key PPP principles driven by the ICRC are: value for money; public interest; out-put requirements; transparency; risk allocation; competition; and capacity to deliver. This policy sets forth the ways by which private investment could be leveraged on in tackling the menace of poor infrastructure stocks and giving boost to delivery of services to the public in a manner that is sustainable. This is pursuant to sections 33 and 34 which empower the Commission to take directives from the President regarding matters of policy and power to make regulations respectively.<sup>360</sup>

Under the arrangement, the regulatory authorities is expected to come up with the guidelines, policies and most suited way to leverage on private investors' participation in infrastructure development and the best procurement procedure for public private partnership model in the country. Also the regulatory agency is required to align with the federating states to drive an orderly and harmonized framework for infrastructure procurement in Nigeria and to develop an organized market for PPP projects.

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<sup>357</sup> Project Appraisal Document (n 151 above). Others are: the Niger Delta region; food security; human capital; land tenure changes and home ownership; national security; and wealth creation.

<sup>358</sup> Ibid.

<sup>359</sup> Established by section 14 of the Infrastructure Concession Regulatory Commission (Establishment, etc) Act, 2005, to regulate, monitor and supervise the contracts for infrastructure or development projects. See particularly the Schedule to the Act.

<sup>360</sup> Project Appraisal Document (n 151 above).

Importantly, it aims to reduce infrastructure deficit in the country by leveraging private investment and capacities in delivery of infrastructure services through PPP approach. It is modelled according to international best practices and includes steps for the upstream due diligence to determine the viability of a project as a PPP transaction.<sup>361</sup>

The entire PPP framework in Nigeria is hinged on the principles of achieving better value and affordable services. As expressed in the National Policy Document, there are economic, social and environmental objectives for the adoption of PPP model as a strategy for infrastructure development.<sup>362</sup>

On the economic plane, the government intends to scale up investment in new infrastructure; improve the existing infrastructure assets to a level to meet the expectation of the public in service delivery. The government also seeks ‘to improve the availability, quality, and efficiency’ of core infrastructure and other critical services to the public in a bid to rev productivity, competitiveness, access to markets and economic growth in general.<sup>363</sup>

Another key objective is to add to the capacity and diversity of the private sector through the provision of opportunities for local as well as foreign investors including contractors in procurement of public infrastructure and service delivery thereby encouraging efficiency, innovation and flexibility at a minimal cost. It is also envisaged that PPP model will ensure that infrastructure projects are planned, prioritized, and managed to maximize economic returns and delivered in a timely, efficient, and cost effective fashion. It is also the desire of the government to leverage on PPP to utilise public assets efficiently for the benefit of users of public services.<sup>364</sup>

As to the social objectives, the government desires to deploy the PPP approach to ensure balanced regional development; scale up access to quality services for all members of the society; ensure the respect for the employment rights and

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<sup>361</sup> Ibid. 9.

<sup>362</sup> National Policy on PPP (2009) 10-12.

<sup>363</sup> Ibid.

<sup>364</sup> Ibid.

opportunities of employees and handle them transparently and fairly and enhance the health, safety, and well-being of the generality of the public.<sup>365</sup>

Lastly are the environmental objectives. The government seeks to use the PPP platform to protect and enhance the natural environment and minimize greenhouse gas emissions and other pollutants.<sup>366</sup>

In line with the commitments of Federal Government towards being transparent and accountable, it seeks to ensure that the shift in responsibility in developing infrastructure assets and delivering adequate services to the private sector followed best international practice, and this will be evidenced through an open competition.<sup>367</sup>

It is the belief of the government that private-sector led drive for infrastructure development through the public private partnership will open up the infrastructure and service delivery landscape in Nigeria to efficiency, inclusive access and overall improvement of the quality of public service delivery in a sustainable way.<sup>368</sup>

In pursuit of this lofty agenda, there came up a more investor-friendly legal and regulatory environment so that the provision of infrastructure assets and delivery of services to the public could be private-sector driven.

The ICRC Act stands as the closest legislation in Nigeria that can easily be referred to as the infrastructure law. The apparent successes that came in the way of provision of telephone services and the global system of mobile telecommunication (GSM) really heightened the expectation that the private sector participation is a sure-footed path to better service delivery and procurement of high-grade and cost-effective public infrastructure stocks.<sup>369</sup>

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<sup>365</sup> Ibid.

<sup>366</sup> Ibid.

<sup>367</sup> Ibid.

<sup>368</sup> Ibid.

<sup>369</sup> Investments in telecommunications industry grew from US\$50 million in 2000 to US\$50 billion in 2010. See Mansur Ahmed PPP for infrastructure development The Nigerian experience Angola 2011 1.

#### 4.4 Context and nature of public private partnership approach

Just like the term ‘infrastructure’, defining ‘PPP’ too lacks precision. There is an intense debate as to the exact definition or what constitutes a PPP. While some see it as new governance tool that will replace the traditional method of contracting out for public services through competitive tendering, others see it as a new language in public management; designed to cover older established procedures involving private organizations in the delivery of public services.<sup>370</sup> Yet, others conceive it as a new way to handle infrastructure projects such as building tunnels and renewing harbours.<sup>371</sup> There are also some that tend to use the terms ‘contracting’ and ‘PPP’ interchangeably.<sup>372</sup>

The term does not have a legal meaning and can be used to describe a wide variety of arrangements involving the public and private sectors working together in some way and though the precise boundary surrounding PPP is still evolving, the concept has gained so much currency worldwide and there is divergence of views as to determining how PPP should be thought about. It has been loosely defined as ‘cooperative institutional arrangements between public and private sector actors’.<sup>373</sup> In a broadest sense however, it also pertains to privatization.<sup>374</sup>

PPP is still fundamentally about applying the private sector’s skills in technical and financial risk management in ways that represent real value for public sector. In the infrastructure projects landscape, PPPs are seen as financial models that enable the public sector to make use of private finance capital in a way that enhances the possibilities of both the government and the private company.<sup>375</sup>

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<sup>370</sup> Linder 1999 cited in ‘The challenge of public private partnership learning from international experience Hodge and Greve (2005) 1.

<sup>371</sup> Savas 2000 cited in ‘The challenge of public private partnership et. al. *ibid.*

<sup>372</sup> *Ibid.*

<sup>373</sup> *Ibid.*

<sup>374</sup> Grimsey and Lewis 2004 cited in N Hrovatin Public private partnership in Slovenia Reverse financial innovations enhancing the public role Innovations in financing public services Case studies Bailey, Valkama and Antiroiko 2010 87. This has been disputed by some writers as a misconception since the private actor does not buy an asset, but rather ‘purchase a stream of services under specified conditions’. This writer argues that in the context of privatization in Nigeria, the private investors do not only buy a stream of services under some specified conditions but also purchase an asset.

<sup>375</sup> Hodge and Greve (2005) 4.

The term only really came into common usage in the UK in the late 1990s. Prior to then, as part of the national agenda to improve the delivery of public services, there had been a great deal of discussion centring around the need for public bodies to involve other organizations in the delivery of public services; and this concept of ‘partnering’ was encapsulated in the following definition published by the Department for the Environment, Transport and the Regions (DETR) in 1998:<sup>376</sup>

Partnering involves two or more organizations working together to improve performance through mutual objectives, devising a way of resolving disputes and committing to continuous improvement, measuring progress and sharing gains.<sup>377</sup>

The partnering process thus encouraged by central government led to the creation of formal public private partnerships, the first major study of which was undertaken by the Institute of Public Policy Research (IPPR); they established a Commission on Public Private Partnerships which put forward the following working definition of a PPP in their Report *Building Better Partnerships* published in June 2001:

A risk sharing relationship based upon a shared aspiration between the public sector and one or more partners from the private and/or voluntary sectors to deliver a publicly agreed outcome and / or public service.<sup>378</sup>

A similar definition was put forward by a Working Group set up by the Northern Ireland Executive to review public private partnerships in 2003:

A public private partnership is generally a medium to long term relationship between the public and private sectors (including the voluntary and community sector), involving the sharing of risks and rewards and the utilisation of much-sectoral skills, expertise and finance to deliver desired policy outcomes that are in the public interest.<sup>379</sup>

These definitions highlight a number of characteristics of a PPP. First, it is a medium-to-long-term relationship; it is not a ‘quick fix’. Second, it is a relationship based on shared aspirations which aim to deliver outcomes and services in the public interest

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<sup>376</sup> See section 2 of the Executive Summary

<sup>377</sup> Geddes (2005) 1

<sup>378</sup> Ibid.

<sup>379</sup> Ibid.

on a continuously improving basis. Third, it can involve a range of partners. Fourth, it involves the sharing of risks, rewards and resources on the part of all the partners.<sup>380</sup>

As pointed out by a commentator,<sup>381</sup> PPP typically enables public sector to do more with less resources, in that, under the model, the public sector pays for the delivery of a service or facility as against bearing the costs of building with the associated risks, operating the facility in its own account. It indeed helps ‘both the public and private sectors by easing the burden on the former and stimulating the growth of the latter’.<sup>382</sup> Moreover, all the risks are allocated to the party best in the position to bear them. More importantly, the public sector gains from the standpoints of certainty, outsourcing the hassles of securing different services and the efficiencies and innovations that are available with private sector involvement.<sup>383</sup>

#### **4.4.1 Reasons for PPP**

The development of infrastructure in Nigeria has primarily been through the traditional form of contract award by federal and state governments through budgetary allocations. In this regard, the federal, state and local governments fund infrastructure within the respective jurisdictions; contracts are awarded directly to contractors who bear little or no risk. The public sector would determine what kind of facilities it needs, solicits tenders, negotiate and enter into a contract with a builder, supervise the construction contract, employ and pay the personnel to run the facility.<sup>384</sup>

The growth of the economy, among other reasons, has now necessitated a continuous investment in infrastructure facilities. However, limited resources in the public domain have led the government to seek to utilize private capital investment in infrastructure facilities. Hence the government now seeks to grow a diversified funding by attracting private sector funding.

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<sup>380</sup> Ibid. 2.

<sup>381</sup> Oranafu, C (2011).

<sup>382</sup> Ibid.

<sup>383</sup> Ibid.

<sup>384</sup> Ibid.

As for the PPP model, the public sector entity decides the particular services the public needs and then calls for tenders from the private entities to finance, build, operate and manage a facility for service delivery to the public. This entails a contract between a public sector authority and a private party in which the private party provides a public service or project and assumes substantial financial, technical and operational risk in the infrastructure project. A fee is payable by the public sector on delivery of the infrastructure asset and service and in some instances, the private entity will be entitled to stream of revenue through the users' fees charged to recoup its investment for a specified period. A rider to this is that fee is paid not before but after delivery and payment can be withheld if the agreed project specification is not met and the agreed level of service is not attained.<sup>385</sup> In some cases, after the expiration of a specified time frame, the facility is returned to the public sector as the owner.<sup>386</sup> As said earlier on in the study, the private sector participation in infrastructure came up as an innovation to tackle the problem of huge demand for the provision of basic infrastructure.<sup>387</sup>

An Investment Climate Assessment Report sponsored by the World Bank revealed that over 60% of respondents to the survey reported that power and transport infrastructures are the most binding constraints on doing business in Nigeria.<sup>388</sup> The emphasis on infrastructure development particularly the development of the power and transport sectors is reinforced in the Federal Government of Nigeria's development agenda for 2005-2011. In addition, infrastructure development is a key area of the NEEDS, which focus on addressing decaying infrastructure, especially in the area of power supplies, and other impediments to private enterprises. A similar initiative at state level is the SEEDS.<sup>389</sup>

Participation of a private party in the project design, construction and management of project delivery and the collection of financial streams (including risk bearing) is a

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<sup>385</sup> Ibid.

<sup>386</sup> Ibid.

<sup>387</sup> See Project Appraisal Report Capacity building for ppp infrastructure (2010) iii

<sup>388</sup> Larossi et al 23-29.

<sup>389</sup> Project Appraisal Report (n 151 above).

distinctive feature of PPP as against the traditional procurement type of contractual agreements.<sup>390</sup>

The implication of this is that government has moved from being the infrastructure developer and operator to facilitator and governing. It is the belief of the government that the choice of PPP will actualize the attainment of the goal of “adequate infrastructure services that support the full mobilization of all economic sectors” and will make a thing of the past the problems associated with ‘traditional procurement such as inefficiency, unreliability and poor fiscal management and will address other factors such as short political tenures (government risk) and rent seeking behaviours from various interest groups.’<sup>391</sup>

Added to the above is also the strong belief that the infrastructure deficit menace could be tackled taking advantage of private sector strengths such as: management efficiency; newer technologies; work place efficiencies; cash flow management; personnel development; shared resources and platforms; and access to diverse sources of capital.<sup>392</sup>

It is worthy to note that Nigeria has a long list of good and potentially viable infrastructure projects which can be optimized through PPP. It is therefore logical for the government to engage in PPP for effective and efficient delivery of quality infrastructure services. This is hinged on the government’s desire to increase investment and job creation in the private sector by creating an enabling policy framework, improve access to finance and skills for enterprises through the greater use of PPP.<sup>393</sup>

Besides, there are other more general reasons for the PPP model. These are enumerated below.

First, PPP is a new option for the effective provision of infrastructure and service delivery. The role of private investment in infrastructure facilities is expected to grow

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<sup>390</sup> Ibid.

<sup>391</sup> Ibid. 2.

<sup>392</sup> Ibid.

<sup>393</sup> Ibid. 3.

as government revenue is limited and expenditure in sectors such as welfare is increasing. A PPP programme enables the public sector to break the short-term constraints in infrastructure investment imposed by insufficient tax revenues and limited public sector borrowing.<sup>394</sup>

As a complement to public investment, PPP may provide critical economic infrastructure such as roads and railways, as well as social infrastructure such as schools and cultural facilities.<sup>395</sup>

Timely provision of various social infrastructure facilities is becoming a social issue. Delays in the initiation of public facilities projects will ultimately raise construction and land acquisition costs. Relying on the government budget alone may not provide public services in a timely fashion. For instance, where it would take at least 20 years to renovate old elementary and middle school buildings across a nation that is more than 30 years old, introducing the build-transfer-lease (BLT) scheme, could allow renovation of about 70 percent of them within two to three years.<sup>396</sup>

PPP is an efficient and effective method for the delivery of public services. By combining such responsibilities as design, building, financing and operating (DBFO) in a single contract and transferring part of the risks and responsibilities to the private sector, PPP projects may realise value for money (VFM) with lower project costs and improve service quality compared to conventional public procurement. PPP also encourages the private sector to utilize its professional skills, creativity and ability to innovate, which can be extended to the public sector.<sup>397</sup>

It is often claimed that PPP projects have a lower likelihood of construction delays or cost overruns since the contract terms and conditions are fixed before work begins and the private company in the project bears most of the risks of construction delays and additional costs. The private company maintains and operates the newly

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<sup>394</sup> Surk-Tae Kim (2010) 38-9.

<sup>395</sup> Ibid.

<sup>396</sup> Ibid.

<sup>397</sup> Ibid.

constructed facilities for 10-30 years. Therefore, it undertakes construction with a long-term perspective, starting with the design state.<sup>398</sup>

PPP also provides a stable and long-term investment opportunity for the private sector. The PPP system can mobilize more capital than that the government can do alone by attracting extra capital to invest in PPP projects from pension funds as well as the private sector. PPP will not only help the circular flow of the money in the economy by inviting private capital which is working for investment opportunities into public projects, but will also enhance economic growth and competitiveness.<sup>399</sup>

By its nature, PPP is highly incentive-compatible contracting arrangement; its cost-effectiveness relative to traditional procurement is as a result of upfront engineering of the design solution and the financing structure combined with downstream management of project delivery and the revenues. According to Grimsey and Lewis, all of this is a consequence of the incentives built in to the services payment system and the risk transfer in the PPP model.<sup>400</sup>

Specifically on the other hand, the advantages of the PPP may also be looked at from the perspective of the government, by extension, the tax payer and its benefits to the private sector.

#### **4.4.2 Specific benefits of PPP structure**

First, PPP provides an opportunity to improve delivery of services by allowing both the public and private sector to concentrate on what they can do best. The traditional responsibility of government is to set policies with the interest of the public at heart. This, the government is well positioned to do while the private sector takes the responsibility for ancillary functions such as operating and maintaining infrastructure assets.<sup>401</sup>

Second is the improved cost effectiveness. By taking advantage of private sector innovation, experience and flexibility, PPP can often deliver cost-effective services

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<sup>398</sup> Ibid.

<sup>399</sup> Ibid.

<sup>400</sup> Grimsey and Lewis 6-7.

<sup>401</sup> Obozuwa 1

than the traditional method of procurement of infrastructure assets. PPP definitely relieves the pressure on the public purse and create fiscal space for other needed services.<sup>402</sup>

Another benefit is that PPP increases investments in development of public infrastructure assets. The government has traditionally been financing provision of wide range of infrastructure like hospitals, schools, highways and other public assets and this in many instances, has deepened the debt-crises in some of these countries. PPP has the capability to reduce government's capital costs, helping to close the yawning gaps between the need for infrastructure and the government's financial ability.<sup>403</sup>

PPP also helps to reduce the public sector risk by transferring to the private sector those risks that can be better managed by the private sector. An instance is: a company that specializes in operating buildings may be better positioned than the government to manage risks associated with the changing demands of commercial real estate.<sup>404</sup>

PPP delivers projects faster than the traditional method of procurement because of the use of private partner's flexibility and access to resources in procuring the infrastructure asset. An example is the MMA 2, the terminal building and facilities for the domestic airport in Lagos, Nigeria that was procured through the PPP model.<sup>405</sup>

There is also the benefit of an improvement in budget certainty. The transfer of risk to the private entity in procurement of public asset can reduce the potential for government cost overruns from unforeseen circumstances during project development or service delivery. Services are provided at a predictable cost as set out in contract document.<sup>406</sup>

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<sup>402</sup> Ibid.

<sup>403</sup> Ibid.

<sup>404</sup> Ibid.

<sup>405</sup> Ibid.

<sup>406</sup> Ibid.

Also there is better use of assets. Private sector partners tend to use facilities fully, and to make the most of commercial opportunities to maximize returns on their investments. This, it is argued, can result in higher levels of service, greater accessibility, and reduced occupancy costs for the public sector.<sup>407</sup>

The PPP also adopts a ‘life cycle’ approach to planning and budgeting through the use of long-term contracts. For example, a company that agrees to operate and maintain an infrastructure asset for a term of 50 years will have to ensure that the asset remains in a certain condition and, therefore, must include maintenance costs in its budget for the life of the agreement. By contrast, public sector maintenance costs can sometimes be deferred in response to budget constraints which can reduce the value of an asset over time.<sup>408</sup>

#### **4.4.3 Benefits of PPP to the private sector**

PPP gives the private sector access to secure long-term investment opportunities. Private entities can generate business with the relative certainty and security of a government contract. Payment is provided through a contracted fee for service or through the collection of the user fee and the revenue streams may be secure for as long as 50 years or more.<sup>409</sup>

Second, private entities can profit from PPP model by achieving effectiveness, based on their managerial, technical, and financial innovation capabilities. They can also expand their PPP capacity and expertise or their expertise in a particular sector which can be leveraged to create additional business opportunities. For an instance, a particular company can market its experience and expertise in other jurisdictions, once it has established a track record of successful partnership with the public sector in a particular country or jurisdiction.<sup>410</sup>

#### **4.4.4 Overall benefits of PPP**

The longer term beneficiary of an efficient private sector involvement in provision of infrastructure assets is the Nigerian population. In the longer term, it will impact on

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<sup>407</sup> Ibid.

<sup>408</sup> Ibid.

<sup>409</sup> Ibid.

<sup>410</sup> Ibid.

job creation and poverty reduction through the growth of industry as a result of increased competitiveness, longer production cycles and greater access to markets, through an improved transport network. The general well being and quality of life of all Nigerians will also improve as a result of greater access to electricity and cheaper, reliable and improved quality electricity. The improved transport network will increase population mobility and greater access to leisure and social and welfare services.<sup>411</sup> Besides, PPP drives the mobilization of private investment for infrastructural development and socio-economic growth.

It should be noted that typically, the public sector regulates the service delivery, the private sector designs, manage and finance; end-users provide streams of revenue by paying for the services.

#### **4.4.5 Characteristics of PPP**

PPP approach captures a wide-range of private sector participation options in public infrastructure procurement and service delivery. Usually, the infrastructure landscape is characterized by lumpy investment coupled with long pay back periods. Lumpy investments and national monopoly are the normal characters of PPP thereby making the PPP arrangement vulnerable to many contract-related problems. Besides, the perennial mismatch between currency revenue and cross-border borrowing usually creates foreign exchange risks.<sup>412</sup>

Under the PPP, the private sector brings skills and core competencies, while donors and private entities take care of the funding.<sup>413</sup>

However, there are three basic features which are peculiar to the PPP option. First, PPP covers the design, construction or rehabilitation of public infrastructure stocks including their maintenance and in some cases with the delivery of service directly to the users. Second, the contract requirements are part of the outputs and the required standards of service to be met as against the inputs which entail how the particular

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<sup>411</sup> Project Appraisal Report 10.

<sup>412</sup> Grimsey and Lewis 6.

<sup>413</sup> Ibid.

infrastructure asset is designed and constructed.<sup>414</sup> Third, payments made to the private contractor or as the case may be, stream of revenue from the user charges where a concession is involved, are the consideration for meeting the specified standards of performance. Where the specified standards of performance are not met by the private contractor, then there will be reduction in the payment. Both ways, it gives the procuring entity the required leverage to enforce the contract and the private contractor an incentive for performance.<sup>415</sup>

Under the PPP arrangement, payments are not made until the service has been provided, and that design and construction of the infrastructure asset is financed privately by the contractor. The cost of the construction is recouped from service charges and/or user charges which are usually for a specified period of time as stated in the contract. The method of payment, usually in tranches, provides an incentive to the private contractor to complete the construction and expeditiously provide the services so that payments can begin. What this also means is that the private contractor would need to continue the service delivery throughout the period of the contract in order to recoup all the financing costs of the infrastructure asset and services provided for the public.<sup>416</sup>

In nutshell, what this translates into is that the procuring entity leases the infrastructure asset (or grants the right to exploit it where the PPP option is concession), and ‘transfers the responsibilities and the risks of ownership to the private contractor’.<sup>417</sup>

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<sup>414</sup> Typical example of this is in road construction where though the contract makes specification for the quality of the road surface, its traffic capacity, environmental and safety standards and others, but does not make specification with exactitude as to how the construction will be done. In this instance, the contractor proposes his own designs and methods to be used in the construction of the road. However, the procuring entity in this instance must be satisfied that such proposals made by the contractor align with the procuring entity’s standards. Though the private contractor could be creative in its approach to the road construction, it still needs to factor into the contract the aspect of maintenance to ensure that the infrastructure asset continues to give value for money as specified and required through the life span of the contract.

<sup>415</sup> National Policy on Public Private Partnership (2009)18-19

<sup>416</sup> Ibid.

<sup>417</sup> Ibid.

Other features peculiar to a typical PPP model are:

- the public sector defines the services it requires over a long-term period, between 15 and 30 years, by reference to an output specification and closely specified performance criteria, without being too prescriptive about the means of delivery;
- design risk, in terms of the decision on the type of assets needed to deliver the services to the required standard, is left to the private sector entity and the assets are effectively owned and operated by the private sector;
- the public sector provides no funding during the construction phase, and the risk of cost overruns, delays, etc. rests with the private sector; and
- the public sector has to develop control on the private sector over the assets and resources needed to deliver the service to such an extent that the private sector bears the risks and receives the rewards of effective ownership.<sup>418</sup>
- PPP arrangement may manifest in different forms and may embrace some or all of the following features:<sup>419</sup>
  - the public sector entity transfers land, property and facilities controlled by it to the private sector entity (with or without payment in return) usually for the term of the arrangement;
  - the private sector entity builds, extends or renovates a facility;
  - the public sector entity specifies the operating services of the facility;
  - services are provided by the private sector entity using the facility for a defined period of time (usually with restrictions on operations standards and pricing); and
  - the private sector entity agrees to transfer the facility to the public sector (with or without payment) at the end of the arrangement.<sup>420</sup>

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<sup>418</sup> Grimsey and Lewis 6 & 7.

<sup>419</sup> See Pierson and McBride 1996 cited in Grimsey and Lewis et. al. 2.

<sup>420</sup> Grimsey and Lewis 2.

## 4.5 Structures for PPP

Private participation in public infrastructure procurement and service delivery can manifest in many ways using different but somewhat overlapping platforms under different nomenclatures. Broadly, there are those that arrange for a private party to provide public infrastructure under a long-term contract with a public sector body. Under such an arrangement, the private sector party usually agrees to undertake the following-

- design and build or upgrade the public sector infrastructure;
- assume substantial financial, technical, and operational risks;
- receive a financial return through payments over the life of the contract from users, from the public sector, or from a combination of the two; and
- return the infrastructure to public sector ownership at the end of the contract (in some cases, the private party may retain ownership of the asset).<sup>421</sup>

Terms such as BOT (build, operate and transfer) or DBFO (design, build, finance and operate) are often used to describe such schemes. When the infrastructure is not returned to the public sector, it is sometimes referred to as a BOO (build, own, and operate) contract. While different sectors will have their own particular issues, these arrangements can apply across a wide range of infrastructure provision. Whether in power generation, roads, or the provision of schools or hospitals, the broad nature of the PPP is determined by what rights, obligations, and risks are assumed by the public or private parties within the partnership.<sup>422</sup>

However, the attention will now be shifted to the different platforms by which private sector may participate in the public infrastructure development and delivery of critical services in Nigeria.

### 4.5.1 Privatization

Various writers have defined privatization in different ways. Privatization is one essential aspect of price and market reforms which entails unshackling of private

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<sup>421</sup> World Bank (2009) 7.

<sup>422</sup> Ibid. 8.

sector development through removal of government restrictions on private economic activities and divestiture of state assets particularly, public infrastructure assets and public enterprises, into private hands.

In the context of the discussion in this research, the term ‘privatization’ is defined ‘as the transfer of operational control of an enterprise (or public utility or infrastructure asset) from the government to the private sector’.<sup>423</sup> Though ‘operational control can be placed in private hands through leases, concessions, or management contracts, control is most often secured by majority ownership’.<sup>424</sup>

In other words, ‘privatization’ then includes any transaction which ends up in the government giving up ownership and control through a decrease in its equity interest from 50 percent or more to less than 50 percent.<sup>425</sup>

The common usage of the term ‘privatization’ means transfer of ownership, management and/or control of business enterprises from the public sector to the private sector. Essentially, privatization describes a variety of policies which encourage competition and emphasize the role of market forces in place of statutory restrictions and monopoly powers. More importantly also, the concept encompasses the broad idea of the economy being totally private sector-led with the government offering complementary and legal support for economic growth and development.<sup>426</sup>

For many years, up to the early 1980s, many developing countries (including Nigeria) in consonance with the Keynesian theoretical exposition on large-scale involvement of the public sector in economic development programmes, made fairly use of public enterprises for resource mobilization and allocation, particularly, within the social services and utilities sector.<sup>427</sup> However, the tremendous economic growth experienced by those countries that have adopted market approach, openness and competition influenced the worldwide adoption of liberalization and restructuring.

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<sup>423</sup> White and Bhatia (1998) 10.

<sup>424</sup> Ibid.

<sup>425</sup> Ibid.

<sup>426</sup> Adinuba C (1995) 1.

<sup>427</sup> Ayodele A (1999) 8.

Besides, the economic crisis of the 1980s and the 1990s shifted the attention of the public to public enterprises in relation to their abysmal performance.<sup>428</sup>

#### 4.5.2 Concession

Generally, concession provides a platform for private financing of infrastructure project. It was first in use in the United States and Mexico in the 19th century. However, in the recent times, concession is deployed as a platform for a wide and varied uses which include power generation and distribution; telecommunications; desalination plants; water treatment and distribution facilities; waste collection and disposal; hospitals and public transportation (for example, urban and inter-railways, underground trains, bus lines, roads, bridges, tunnels, ports including airlines and airports).<sup>429</sup>

Section 36 of the infrastructure law in Nigeria, the Infrastructure Concession Regulatory Commission (Establishment, etc.) Act interprets ‘concession’ to mean:

A contractual arrangement whereby the project proponent or contractor undertakes the construction, including financing of any infrastructure, facility and the operation and maintenance thereof and shall include the supply of any equipment and machinery for any infrastructure.

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<sup>428</sup> Ibid. While some writers have argued that PPP lies on a continuum between privatization (maximum involvement of the private sector) and short-term service contracts (minimum involvement of the private sector), others are of the opinion that this can be misleading if it gives the impression that privatization, for example, is a form of PPP. They argued further that there is a very clear difference between these two forms of private sector engagement. According to them, under a PPP model, the public sector retains ultimate accountability to the citizen for the provision of a public service, whereas under privatization, accountability for delivery is transferred to the private party. They stressed further that this can be an important issue when governments seek to engage public understanding of and support for PPP and begin to identify the skills and processes needed. They also argued that the distinction between PPP and privatization is also reflected in the fact that privatized industries may be subject to general legal regulations (for, regarding standards for services or returns on capital), whereas PPP are usually subject to controls within the specific contract. See *Attracting investors to African public private partnerships et. al.* 7.

<sup>429</sup> Tanyi 3.

Typically, in a concession, a public authority grants a private party the right to design, build, finance, and operate an infrastructure asset owned by the public sector. The concession contract is for a fixed period, say 25-30 years, after which responsibility for operation reverts to the public authority or agency. The private party recoups its investment, operating, and financing costs and its profit by charging members of the public a user fee.<sup>430</sup>

Thus, a key feature of a concession is that the private party usually assumes the risk of demand for use of the asset, in addition to the risks of design, finance, construction, and operation. However, demand risk may be allocated in various ways: for example, the public authority may share the risk by underwriting a maximum level of usage. User charges may be either prescribed in the concession contract or set by the concessionaire. Typical examples of this type of PPP include toll roads, railways, urban transport schemes, ports, and airports.<sup>431</sup>

Franchises are a subset of concession in which the private sector takes over existing public infrastructure, operating and maintaining it under a fixed-term contract, often with an obligation to upgrade it.<sup>432</sup> They are common, for example, in the rail sector. The private party often pays an initial lump sum of money to the public authority to acquire the franchise. Clearly, the dividing line between franchises and concessions is not precise. If a project involves a high level of initial investment in new or upgraded infrastructure, it may be called a concession, whereas if it involves a limited level of initial (even if there are long-term maintenance requirements), it may be called a franchise.<sup>433</sup>

### ***i. Diverse faces of concession***

Seven faces of concession are identified and discussed hereunder and they are as follows:

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<sup>430</sup> For example, a toll.

<sup>431</sup> World Bank (2009) Attracting investors to African public private partnerships 8

<sup>432</sup> Ibid.

<sup>433</sup> Ibid.

(a) **Build-Operate-Transfer (BOT)**

BOT allows for private sector to invest directly in large-scale public infrastructure project development. Under this approach, the private sector takes primary responsibility for financing, designing, building and operating the project at its own risk. Control and formal ownership of the project is then transferred back to the public sector at the end of the contract period. Under this contract, the private entity recoups its investments by charging user fees for a specified period after which ownership is transferred back to the public sector. The government provides revenue guarantees through long-term take-or-pay contracts for bulk supply facilities or provides minimum traffic revenue guarantees.<sup>434</sup>

Generally, BOT is hinged on a theoretical construct which goes like this:

- Build-a private company agrees with a government to make investments in a public infrastructure asset with the company sourcing for the funds to build the said infrastructure asset.
- Operate-the private investor company then becomes the owner and maintains and operate the facility for an agreed period of time called the concession period and the private investor recovers its investments through user-charges or what is sometime called the ‘tolls’.
- Transfer-after the expiration of the concession period, the private investor then transfers ownership and operation of the facility to the government through the procuring entity or agency/authority.

This type of procuring option has some benefits. First, it confers on the public procuring entity the benefit of leveraging on the private sector finances and the use of the best skills in the building, operation and maintenance of the project. Second, it impacts on the project the advantage of efficiency and quality through the use of the best equipment. Then, in the run up to the project, because it is usually conducted in a competitive bidding atmosphere, it allows for use of best hands and at the lowest possible cost available.<sup>435</sup>

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<sup>434</sup> Ibid. 83

<sup>435</sup> Ibid.

**(b) Build-Own-Operate (BOO)**

Here, the control and the ownership of the projects remain in private hands. The private entity finances, builds, owns and operates an infrastructure facility in perpetuity, at its own risk. The government usually provides revenue guarantees through long-term take-or-pay contracts for bulk supply facilities or minimum-traffic revenue guarantees.<sup>436</sup>

**(c) Build-Lease-Transfer (BLT)**

Under BLT, a private sponsor builds a new facility largely at its own risk, transfers ownership to the government, leases the facility from the government, and operates it at its own risk up to the expiry of the lease. The government usually provides revenue guarantees through long-term take or pay contracts for bulk supply facilities or minimum-traffic revenue guarantees.<sup>437</sup>

**(d) Rehabilitate-Operate-Transfer (ROT)**

A private sponsor rehabilitates an existing facility and then operates and maintains the facility at its own risk for the contract period.

**(e) Rehabilitate-Lease-Transfer (RLT)**

A private sponsor rehabilitates an existing facility at its own risk, leases or rents the facility from the government owner, and then operates and maintains the facility at its own risk for the contract period.

**(f) Build-Rehabilitate-Operate-Transfer (BROT)**

A private developer builds and add-on to an existing facility or completes a particularly built facility and rehabilitates existing assets and then operates and maintains the facility at its own risk for the contract period.<sup>438</sup>

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<sup>436</sup> Ibid.

<sup>437</sup> Ibid.

<sup>438</sup> Ibid.

### **(g) Performance-Based Variant**

In a performance-based variant of concession contract, the assets need rehabilitation and maintenance only, such as an existing road, and the cost may be minimal and sometime privately –finance by the contractor.

Between concessions and other types of PPP, the concessions transfer some or all of the demand and revenue risks of the public service to the concessionaire, while these risks are usually borne by the public sector in other genre of PPP.

It is also needful to appreciate the main difference between concession and privatization. Like concession, privatization gives the private sector the full responsibility for operations, maintenance and investment. However, unlike concession, privatization transfers ownership of assets to the private sector. In privatization, existing assets are taken over by private entities. Here, law determines how services are provided to the public and quite often, with an independent regulator put in place to monitor, and in some instances, to control prices and prevent market abuse. Whereas in a concession, the government retains the responsibility for the service delivery to the public but delegates the operational tasks to private service providers under a contract. The contract provides for how public policy issues are to be handled especially if the contract involves user charges.<sup>439</sup>

Also in some instances, the responsibility to set up user charges lies with the private contractor and involves being remunerated through user payments from the public. In other words, the government through the regulatory agency may put user charges in place and pay the private contractor for the services provided. This also extends to a situation where the contractor collects user charges rather than the government. A typical instance is where a light rail scheme involves the private contractor operating in the PPP contract and collecting the fares but being paid by the relevant authority according to the quality of the service. Here, the public authority would set the fares and determine any subsidy for specific classes of users. In this instance, it could be

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<sup>439</sup> ICRC National Policy on Public Private Partnership (2009) 19.

said that the private contractor risk was performance risk, while the public sector was taking demand and revenue risk.<sup>440</sup>

### 4.5.3 Availability-based PPP

This is another form of PPP which is similar to concession in that it also involves the private party designing, financing, building or rebuilding, and subsequently operating and maintaining the necessary infrastructure. However, in this case, the public authority (as opposed to the user) makes payments to the private party, as, when, and to the extent that a public service (not an asset) is made available. Hence, the demand or usage risk remains with the public authority.<sup>441</sup>

The original form of availability-based PPP is the power purchase agreement (PPA) used in power generation projects. In this case, private investors build a power generation plant and contract to sell the electricity generated to a publicly-owned power utility.<sup>442</sup>

The public authority assumes the demand risk and makes a minimum payment for availability (or capacity) of the power plant, whether or not its output is required.<sup>443</sup>

The PPA structure can be used for any kind of “process plant” project—that is, cases where something goes in one and comes out the other end, such as gas converted to electricity or transported in a pipeline. The same principle can be used for waste treatment plants. A further development of the PPA structure is also used in social infrastructure projects, such as schools, hospitals, prisons, or government buildings, as well as in other non-‘self-funding’ projects such as rural roads. Such are used where accommodation is provided or where equipment or a system is made available. In all

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<sup>440</sup> Ibid. 20.

<sup>441</sup> A hybrid of the concession (user paid, demand risk) and availability-based (public sector paid) PPP is the use of “shadow tolls” in PPP road projects. Here, payment is made by the public sector based on usage by drivers. See ‘Attracting investors to African public-private partnerships et al p. 9

<sup>442</sup> In this case, the off-taker does not have to be a public authority; in countries where the electricity sector has been privatized a private sector power distributor can sign the power purchase agreement in lieu of a public authority. This is clearly not a PPP, as only private sector parties are involved.

<sup>443</sup> A further payment is made for usage, to cover the cost of fuel for the plant.

these cases, payments are again generally based on the availability of the accommodation facility, equipment, or system and not on the volume of usage.<sup>444</sup>

#### **4.5.4 Management and lease contracts**

In management and lease contracts, a private entity takes over the management of a state-owned enterprise for a fixed period, while ownership and investment decisions remain with the state. There are two subclasses of management and lease contracts:

- Management contract-the government pays a private operator to manage the facility while the operational risk remains with the government,
- Lease contract-the government leases the assets to a private operator for a fee, while the private operator takes on the operational risk. The private operator assumes the operation of a public infrastructure and associated services. This may include further investment in the public assets and is usually for a fixed term.<sup>445</sup>

These kinds of contracts range from 5 to 10 years tenor and they share same, but not all the characteristics of PPP.<sup>446</sup>

#### **4.5.5 Cooperative arrangements**

These arrangements occur between the government and private entities where the government gives fiscal incentives or guarantees to attract private capital into social infrastructure development like investing into low-cost housing associations for social housing projects. Another example is in the power sector where independent power producers and self-generators sell power into the national grid.<sup>447</sup>

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<sup>444</sup> Attracting investors to African public-private partnerships ( 2009) 9. It should be noted that availability-based options such as power purchase agreements have indirect user payments that are collected by an electricity distribution authority and fed back to make payments under the agreement; however, as it has been noted, the private investor who is a party to the agreement does not take any risk regarding either the demand for electricity or the adequacy of payments received by the distribution authority.

<sup>445</sup> Ibid. 82

<sup>446</sup> Ibid.

<sup>447</sup> Grimsey (2004) 12

#### 4.5.6 Merchant

A private sponsor builds a new facility in a liberalized market in which the government provides no revenue guarantees. The private developer assumes construction, operating, and market risk for the project (for example, a merchant power plant).<sup>448</sup>

#### 4.5.8 Rental

Electricity utilities or governments rent mobile power plants from private sponsors for period ranging from 1 to 15 years. A private sponsor places a new facility at its own risk and owns and operates the facility at its own risk during contract period. The government usually provides revenue guarantees through short-term purchase agreements such as a power purchase agreement for bulk supply facilities.<sup>449</sup>

These types of PPP have been found to be very effective in ensuring that public facilities are delivered on time and on budget; are properly maintained, and are able to deliver public services in the context of constrained resources. The United Kingdom pioneered this form of PPP as part of its private finance initiative (PFI) provision of social infrastructure and many other countries such as South Africa are increasingly using this approach. These types of PPP are sometimes called PFI-model PPPs. In some countries, these forms of PPP are referred to as annuity schemes. However, if an annuity is paid irrespective of performance, these schemes are just another form of government borrowing and fall outside the scope of PPPs.<sup>450</sup>

Whether to use a concession or an availability-based PPP are both a policy decision and a reflection of who is best placed to pay for the service. The affordability of PFI-model PPPs is likely to be an issue in Africa because each project does not involve user payment mechanisms.<sup>451</sup>

However, concession PPPs presents their own challenges with regard to demand risk and user affordability. It is important to establish the appropriate level and scope of services, looking at the opportunities to blend concession and PFI-model approaches

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<sup>448</sup> Attracting investors to African public private partnerships (2009) 83.

<sup>449</sup> Ibid.

<sup>450</sup> Ibid.

<sup>451</sup> Ibid. 10.

and to tailor overseas development assistance into longer-term, performance-based contracting support or capital grants blended with the private financing requirements.<sup>452</sup>

#### **4.6 Concluding remarks**

In the chapter, in reviewing the policy environment of private capital investment in procurement, maintenance and operation of critical public infrastructure assets in Nigeria as indicated at the outset, the discussion started with historical overview of the public private partnership and went on to describe in Nigeria, how the era of private sector participation was preceded by the period of economic nationalism which was in force in the 1970s up to the early part of 1980s and the how the prevalence of this economic policy significantly hindered the flow of private capital, both domestic and foreign, high technology and proven managerial skills into the nation's economy. It was also pointed out that it was the economic crises of the 1980s and 1990s that forced the public and the governments then to have a re-think about public enterprises regarding their poor performances coupled with the pressures from the donors, creditors and multilateral finance institutions to deregulate and privatize as a pre-condition for debt relief that accentuated the need to embrace deregulation to open up the space for private sector participation especially in the provision of core public infrastructure and delivery of services. Given the above, Nigeria then shifted from a public sector centred economic policy to a private sector and market-driven economy that is based on competition and also export-driven.

In examining the policy framework for the public private partnership, there was discussion on how since the beginning of the democratic experience in May 1999, the Federal Government had embarked on extensive liberalization and privatization program to inject private sector money and expertise in order to ensure quality infrastructure service delivery to Nigerians based on the assumption that private sector investment in infrastructure was a key priority in moving Nigeria to the status of top 20 economies by the year 2020. It was this that informed the enactment of ICPC Act and the inauguration by the Federal Government inaugurated the Infrastructure Concession Regulatory Commission (ICRC) in late 2008 to drive the

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<sup>452</sup> Ibid.

PPP programme in Nigeria. The ICRC Act stands as the closest legislation in Nigeria that could easily be referred to as the infrastructure law. The apparent successes that came in the way of provision of telephone services and the global system of mobile telecommunication (GSM) is a reminder of the benefits of engagement of private sector capital and expertise in provision, maintenance of infrastructure and quality service delivery.

Besides, the reasons for the adoption of PPP model were unpacked and it was indicated in the chapter that the growth of the economy, among other reasons, has now necessitated a continuous investment in infrastructure facilities. However, limited resources in the public domain have led the government to seek to utilize private capital investment in infrastructure facilities. Hence the government now seeks to grow a diversified funding by attracting private sector funding.

It was further pointed out that the summary of the reasons for PPP policy was the strong belief that the infrastructure deficit menace could be tackled taking advantage of private sector strengths such as: management efficiency; newer technologies; work place efficiencies; cash flow management; personnel development; shared resources and platforms; and access to diverse sources of capital.

The different manifestations of private participation in public infrastructure development and service delivery were also discussed, starting with privatization, concessions with all its variants and other ways by which the capital and expertise of private entrepreneurs are engaged.

The conclusion therefore is that PPP typically enables public sector to do more with less resources, in that, under the model, the public sector pays for the delivery of a service or facility as against bearing the costs of building with the associated risks, operating the facility in its own account and helps 'both the public and private sectors by easing the burden on the former and stimulating the growth of the latter'.

However, critical to the entrenchment of the PPP model as a policy thrust is the existence of an appropriate legal framework which is a necessary prerequisite to an enabling legal environment that encourages private sector participation in provision, management and maintenance of critical infrastructure assets and service delivery to

the public. This leads to the discussion on the legal framework for private investments in public infrastructure.

## CHAPTER 5

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### LEGAL FRAMEWORK FOR PRIVATE SECTOR PARTICIPATION IN INFRASTRUCTURE FINANCING

- 5.1 Introductory remarks
- 5.2 Legislative framework
- 5.3 Regulatory environment
- 5.4 Regulatory and industry specific laws
  - 5.4.1 Highways Act 1971
  - 5.4.2 Utilities Charges Commission Act 1992
  - 5.4.3 Bureau of Public Enterprises (Privatization and Commercialization) Act 1999
  - 5.4.4 Debt Management Office Act 2003
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- 5.5 Institutional landscape
  - 5.5.1 Line ministries and their agencies
    - 5.5.1.1 The Federal Ministry of Finance (TFMF)
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    - 5.5.1.4 Contract compliance centre
- 5.6 At sub-national level
  - 5.6.1 PPP legal framework in Lagos State
  - 5.6.2 Regulatory system
- 5.7 Concluding remarks

## 5.1 Introductory remarks

Generally in administrative law, law is based on policy and policy comes into existence through a policy-making process. Usually, this process starts when political leaders decide to respond to the needs, problems, ideals and aspirations of the citizens of a particular country. Particular issues and problems are identified by way of research inquiries and a consultation process in response to which a general discussion document is drafted. Then, official policy is translated into written laws and policy becomes law through a law-making process.<sup>453</sup> So, laws outline and define principles, procedures, mechanisms and action to be taken in order to achieve a predetermined policy goal. This process too applies to the introduction of policy shift from public sector funding to engagement of private capital in infrastructure provisioning and financing in Nigeria.

Having discussed in the previous chapter the policy environment for private sector engagement in financing, procurement, maintenance and operation of infrastructure service delivery in Nigeria, it is logical at this point to examine the legal framework that translated this policy thrust-the private participation in infrastructure financing, procurement, maintenance and operation-into law and made it a financing technique in Nigeria's infrastructure landscape.

So, the question is what are the related laws governing the private sector participation in the provision of infrastructure and service delivery in Nigeria?

Essentially this chapter will present an overview of the entire legal framework, that is, all the laws that make up the legal landscape for infrastructure provision, maintenance and financing in Nigeria. By necessary implications, legal framework in the context of this chapter, includes all the infrastructure-related statutes or legislation including the ones that regulate private investments in public infrastructure in Nigeria, the regulatory system which itself is a subset of the legal framework and the institutional framework.

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<sup>453</sup> Scheepers 18

## 5.2 Legislative framework

As observed above, critical to the entrenchment of the PPP models is an enabling legal framework. This is rightly underscored in the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects,<sup>454</sup> which states that the existence ‘of an appropriate legal framework is a prerequisite to creating an environment that fosters private investment in infrastructure’ and where it is in place, then, ‘it is important to ensure that the law is sufficiently flexible and responsive to keep pace with the developments in various infrastructure sectors’<sup>455</sup> in the economy.

Generally, the legislative framework provides the platform by which the governments regulate and ensure the provision of public services to the public and offers protection of rights for public service providers and the customers. That explains why the legislation needs not only to be transparent must also be fair. A fair legislative framework will incorporate the wide and varied interests of all parties-the government, the private investor who provide services for the public and the public at large and seeks to achieve an equitable balance between all these wide and varied interest. Aside the character of transparency and fairness, an appropriate law on infrastructure development must also have the objective of ensuring the long-term provision of the services to the public and pays attention to ‘environmental sustainability’.<sup>456</sup>

It is also needful to appreciate the fact that lack of a clear, predictable, transparent and fair legal framework would lead to legal fluidity, hinders the bankability of projects and the flow of the required domestic resources and cross-border capital into the infrastructure development landscape.<sup>457</sup>

For an instance, in the granting of concession rights on public infrastructure asset to a private investor, a legislation would be required to vest in the private investor the exclusive legal right to operate, maintain and earn stream of revenue through the collection of end-user fees during the period of the concession in order to recoup its

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<sup>454</sup> United Nations Commission on International Trade Law, United Nations, New York, 2011

<sup>455</sup> UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects United Nations Commission on International Trade Law, United Nations, 2001 A/CN.9/SER.B/4 P. 23

<sup>456</sup> Ibid.

<sup>457</sup> Ibid.

investments in the public infrastructure asset. Aside, legislation would also be needed to protect the public end-users from exploitation ‘by setting limits on adjustments of end-user fees and other contingent charges which the private sector entity may charge’.<sup>458</sup>

As Tanyi further argues:

...the legislative framework may also include the scope of the authority to award concessions; the agencies vested with authority and the relevant fields of activity; the purpose and scope of concessions, any particular conditions to be satisfied by the concessionaire; a description of the tender process (open tender, pre-qualified tender, limited public tender, direct contract) and the rules and selection criteria; the maximum period of any concession, payment of fees/royalty to the host government; toll/tariff and collection policy; source of financing and availability of host government financing; the basic terms of the concession contract, termination provisions and compensation for early termination, sectoral competence and mandate or regulatory agencies, institutional mechanisms, powers of regulatory agencies, the regulatory process and procedures, and rules governing recourse against decisions of the regulatory agency.<sup>459</sup>

Rules are therefore very significant in defining the terms and the templates upon which financial capital flows. It is the legal framework that breathes the ‘breath of life’ into the entire gamut of the policy framework for private participation in procurement of public infrastructure.

### **5.3 Regulatory environment**

Regulatory system is a sub-set of the legislative framework. The critical imperative of putting in place a regulatory and institutional environment that inspires confidence through ‘open and transparent processes and procedures and a level playing’ is not misplaced. This will promote competition and enables the investors to earn fair returns for the risks take.<sup>460</sup>

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<sup>458</sup> Ibid. 6-7.

<sup>459</sup> Ibid.

<sup>460</sup> Shonekan E National Policy on Public Private Partnership 1.

Typically, the regulatory environment embraces the rules of procedure governing the way and manner institutions saddled with regulatory functions exercise their powers. For a regulatory process to be credible it must be transparent and objective. Rules and procedures must be lucid and objective for the purposes of fairness, impartiality and prompt action from the regulatory body concerned.<sup>461</sup>

A typically conducive regulatory environment will create a level-playing field for all players on the PPP terrain. At minimum, there should be guarantee as to the protection of consumers through regulations that touch on minimum service requirements, coverage, pricing, etc, and generally to seek to prevent abuses of the rights of the consumers.<sup>462</sup>

Pursuant to the signing into law the enabling Act, the Federal Government of Nigeria inaugurated the Infrastructure Concession Regulatory Commission (hereafter ‘the Commission’) on the 27<sup>th</sup> November, 2008, to provide the requisite regulatory and institutional framework within which all Ministries, Departments and Agencies (MDAs) of the Federal Government can effectively enter into partnership with the private sector in the financing, construction, operation and maintenance of infrastructure projects as provided for in the Act.<sup>463</sup>

At this juncture, the review will now shift to related regulatory bodies or agencies of the Federal Government of Nigeria.

#### **5.4 Regulatory and industry specific laws**

At this point, the study moves on to embark on the analysis of all the relevant laws touching on private sector involvement in procurement of public infrastructure and service delivery in Nigeria, starting with the oldest law-Highways Act of 1971.

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<sup>461</sup> See UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects 35

<sup>462</sup> Tanyi 3

<sup>463</sup> See the National Policy on Public Private Partnership 10.

### **5.4.1 Highways Act 1971**

The Highways Act<sup>464</sup> empowers the Minister of Transport to construct and operate toll gates and collect tolls on the Federal Highways. What this means is that in concessions of federal roads that require tolling, the authority lies with the Minister in charge.

### **5.4.2 Utilities Charges Commission Act 1992**

Utilities Charges Commission Act establishes the Utilities Charges Commission that regulates tariff charged by public utilities in Nigeria. The implication of this is that the approval of the Commission may be required in fixing the tariffs between the private investor (concessionaire) and the Government.

### **5.4.3 Bureau of Public Enterprises (Privatization and Commercialization) Act 1999**

This Act provides the legal framework for the privatization programme in Nigeria and establishes the National Council on Privatization (NCP) and the Bureau of Public Enterprises (BPE) as the supervisory and implementing agencies respectively for privatization transactions. It however, repeals the Bureau of Public Enterprises Decree No. 78 of 1993.

Under the Privatization and Commercialization Act, 1999, the National Council on Privatization is saddled with the responsibility for determining which public assets the government should divest from. Under the provisions of this Act, concessions have been used severally as a means of commercialization of existing government-owned enterprises.

**Section 9 (1)** of the Act establishes the National Council on Privatization (hereinafter referred to as the “the Council”).

The Council is made up of the following members-

- the Vice President, as Chairman;
- the Minister of Finance as Vice Chairman;

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<sup>464</sup> See section 2

- the Attorney – General of the Federation and Minister of Justice;
- the Minister of Industry;
- the Secretary of the Government of the Federation;
- the Governor of the Central Bank of Nigeria;
- the Special Adviser to the President on Economic Affairs;
- four other members to be appointed by the President; and
- the Director-General of the Bureau of Public Enterprises.<sup>465</sup>

Notwithstanding the provisions of subsection (2) of Section 9, the Council may co-opt the supervisory Minister of an affected public enterprise to attend relevant meetings of the Council.<sup>466</sup>

**Section 11** however provides for the functions and powers to include the following-

- determine the political, economic and social objectives of privatization and commercialization of public enterprises;
- approve policies on privatization and commercialization;
- approve guidelines and criteria for valuation of public enterprises for privatization and choice of strategic investors;
- approve public enterprises to be privatized or commercialized;
- approve the legal and regulatory framework for the public enterprises to be privatized;
- determine whether the shares of a listed public enterprise should be by public or private issue or otherwise and advise the Government of the Federation, accordingly;
- determine the time and when a public enterprise is to be privatized;
- approve the prices for shares or assets of the public enterprise to be offered for sale;
- review, from time to time, the socio-economic effect of the programme of privatization and commercialization and decide on appropriate remedies;

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<sup>465</sup> See section 9 (2) of the Public Enterprises Act 1999.

<sup>466</sup> Ibid. See section 9 (3).

- approve the appointment of privatization advisers and consultants and their remuneration;
- appoint as and when necessary, committees comprising persons from private and public sectors with requisite technical competence to advise on the privatization or commercialization of specific public enterprises;
- approve the budget of the Council;
- approve the budget of the Bureau;
- supervise the activities of the Bureau and issue directions on the implementation of the privatization and commercialization programme;
- receive and consider, for approval, the audited accounts of the Bureau;
- submit to the Head of State, Commander – in – Chief of the Armed Forces in each year a report on the activities of the Council and the Bureau;
- receive regular and periodic reports from the Bureau on programme implementation and give appropriate directions; and
- perform such other functions as may, from time to time be necessary to achieve its objectives.

In the same vein, Section 12 (1) establishes the Bureau of Public Enterprises.<sup>467</sup>

The functions of the Bureau with respect to privatization are-

- implement the Council's policy on privatization;
- prepare public enterprises approved by the Council for privatization;
- advise the Council on further public enterprises that may be privatized;
- advise Council on the capital restructuring needs of the public enterprises to be privatized;
- carry out all activities required for the successful issue of shares and sale of assets of the public enterprises to be privatized;
- make recommendations to the Council on the appointment of consultants, advisers, investment bankers, issuing houses, stock brokers, solicitors,

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<sup>467</sup> Hereinafter referred to as 'the Bureau'.

trustees, accountants and other professionals required for the purposes of privatization;

- advise the Council on the allotment pattern for the sale of the shares of the public enterprises set out for privatization;
- oversee the actual sale of shares of the public enterprises to be privatized by the issuing houses, in accordance with the guidelines approved, from time to time, by the Council;
- ensure the success of the privatization exercise taking into account the need for balance and meaningful participation by Nigerians and foreigners in accordance with the relevant laws of Nigeria; and
- perform such function with respect to privatization as the Council may, from time to time, assign to it.<sup>468</sup>

The first enabling legislation for privatization in Nigeria was the Privatization Decree No. 25 of 1988 that established the Technical Committee on Privatization and Commercialization (TCPC), an agency charged with responsibility for implementing the provisions of the Act and carrying out the privatization and commercialization process.

Later the Bureau of Public Enterprises Act 1993 was enacted to replace the Privatization Act of 1988 and reorganized the TCPC which metamorphosed into Bureau of Public Enterprises. In 1999, Public Enterprises Act was enacted by the Federal Military Government of Abdulsalam Abubakar and it repealed the previous Bureau of Public Enterprises Decree 1993 and provides for the establishment of a restructured Bureau of Public Enterprises.

The Act only applies to the privatization and commercialization of the list of public enterprises set out in the Act. The Act does not apply to the primarily ‘greenfield’ kinds of PPP transactions. The agreement between the two regulatory agencies-ICRC and BPE- is that all assets mentioned in the Privatization Act that are to be developed

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<sup>468</sup> Ibid. See section 13.

into PPP will be led by the MDAs with ICRC coordinating and BPE providing technical advice.<sup>469</sup>

The BPE as an agency drives the privatisation process of so many state-owned business enterprises in Nigeria since 1999. It holds the public assets in trust for Ministry of Finance until successfully sold or commercialized. Over the years, the BPE has garnered experience, skills and capacity through the concession method used during the privatization of state-owned business enterprises. This institutional expertise and experience could be made available in implementing the PPP projects under the new PPP policy, while the ICRC drives the process. The synergy could be well deployed without conflict between the two institutions. For an instance, BPE may serve as advisors to the MDAs PPP project teams in conjunction with external transaction advisors whose services may be secured by the ICRC. They could work together to expand the space and opportunities for private sector participation in the procurement of infrastructure and service delivery.<sup>470</sup>

#### **5.4.4 Debt Management Office (DMO) Act 2003**

Debt Management Office (Establishment, Etc.) Act, No. 18 of 2003 was enacted to establish the debt management office<sup>471</sup> which is responsible, among other things, for the preparation and implementation of a plan for the efficient management of Nigeria's external and domestic debt obligations at sustainable levels compatible with desired activities for growth, development and participation in negotiations aimed at realising the objectives.<sup>472</sup>

It has specific responsibilities with respect to all loans and borrowings of the Federal Government and empowers the Minister of Finance to give guarantees for such borrowings and to approve loans from financial institutions to the Federal, State or Local Governments or any of their agencies. Since all PPP processes may involve

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<sup>469</sup> Project appraisal document 56.

<sup>470</sup> See the National Policy on Public Private Partnership op. cit. 74. See also Project appraisal document 55.

<sup>471</sup> See section 4 of Debt Management Office Act 2003.

<sup>472</sup> See the Explanatory Memorandum to the Debt Management Office Act. See also sections 1 and 8 of the Act.

Federal Government borrowings and guarantees and other long-term contingent liabilities, by virtue of section 6 of the Act, the DMO's approval will be required.<sup>473</sup>

The DMO supervises the money and capital markets by ensuring that the two segments of the financial sector work perfectly and develop the range of appropriate instruments that are needed to hedge financial risks in the PPP projects. Example is developing the secondary market for government bonds in both liquidity and depth and this will ultimately provide a reference interest rate for PPP financing.<sup>474</sup>

Part of the DMO's mandate is to be satisfied that any contingent liabilities are manageable within the government's economic and fiscal forecast.<sup>475</sup> To this end, the DMO advises the FEC as part of the approval process for individual projects. The project teams consult the DMO for approvals before involving the multilateral agencies such as International Finance Corporation (IFC), Multilateral Investments Guaranty Agency (MIGA) or International Development Agency (IDA) for provision of guarantees or other financial instruments.<sup>476</sup>

#### **5.4.5 Electric Power Sector Reforms Act, 2005**

Electric Power Sector Reforms Act was signed into law on the 11<sup>th</sup> March 2005. Generally, it provides the statutory framework for participation of private companies in electricity generation, transmission, and distribution. Specifically, the Act provides for the formation of companies to take over the functions, assets, liabilities and staff of the defunct National Electric Power Authority.<sup>477</sup> It also provides for development of competitive electricity markets and the establishment of the Nigerian Electricity Regulatory Commission. Besides, the Act also makes provision for the licensing and regulation of the generation, transmission, distribution and supply of electricity. Regulatory issues in respect of enforcement of matters like performance standards, consumer rights and obligations and determination of tariffs are also captured by the Act.<sup>478</sup>

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<sup>473</sup> Project appraisal document 56.

<sup>474</sup> Ibid. 75.

<sup>475</sup> Ibid.

<sup>476</sup> Ibid.

<sup>477</sup> Onogoruwa (2009)-[www.sec.gov.ng/files-Last](http://www.sec.gov.ng/files-Last) assessed on the 28 July 2011.

<sup>478</sup> See the Explanatory Memorandum to the Electric Power Sector Reform Act 2005.

Section 1 of the Act provides for the transformation of the defunct National Electric Power Authority (NEPA) to the Power Holding Company of Nigeria (PHCN) which was then unbundled into autonomous companies comprising of: one Transmission Company; seven generation companies and eleven distribution companies. Part of the reforms which was provided for in the Act was the establishment of the Nigerian Electricity Regulatory Commission (NERC), the Rural Electrification Agency (REA) and the National Electricity Liability Management Company (NELCO)-a special purpose vehicle expected to take over and manage the residual assets and liabilities of the defunct NEPA, after privatization of the unbundled companies. Section 83 empowers the Commission to set up and administer a fund under the name: ‘Power Consumer Assistance Fund’ to be used to subsidize under-privileged power consumers as may be specified by the appropriate minister.<sup>479</sup>

#### **5.4.6 Infrastructure Concession Regulatory Commission Act 2005**

The Infrastructure Concession Regulatory Commission Act 2005 was signed into law by former President Olusegun Obasanjo on the 10<sup>th</sup> of November, 2005. The Act provides for the participation of private sector in financing the construction, development, operation, or maintenance of infrastructure or development projects of the Federal Government through concession or contractual arrangements; and the establishment of the Infrastructure Concession Regulatory Commission (ICRC) to regulate, monitor and supervise the contracts on infrastructure or development projects.<sup>480</sup>

The Act has two distinct subject matters set out in Part I and Part II. Part I provides that Federal Government entities can enter into agreements with the private sector for the provision of infrastructure. Part II establishes the ICRC Commission and provides that its functions are to:

- take custody of every concession agreement made under the ICRC Act and monitor compliance with the terms and conditions of such agreement;
- ensure efficient execution of any concession agreement or contract entered into by the government;

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<sup>479</sup> See the Transmission Company of Nigeria’s Website @ <http://www.tcng.or/org/StatusOfPower.aspx-Assessed> last on the 28 July 2011.

<sup>480</sup> See the Explanatory Memorandum and the Schedule to the ICRC Act.

- ensure compliance with the Act; and
- perform such other duties as may be directed by the President.<sup>481</sup>

The Act provides for the granting of the PPP contracts or concessions by the government or any of its ministries, agencies, corporations, or bodies. Under the Act, the term ‘concession’ does not imply that the rights to any revenue stream from user charges are also transferred to the private sector entity involved in its operation, but include an obligation to finance the infrastructure. In the schedule to the Act, there is a list of infrastructure assets to which the provisions of the Act apply but requires the Federal Executive Council (FEC) to approve any other form of infrastructure and development project.<sup>482</sup>

Under the Act, however, there is an obligation on the part of each Federal Ministry to prioritize its infrastructure projects and secure the formal approval of the investment decision from the FEC as required in the National Policy Statement. The Act also makes it mandatory that the approved projects should follow a transparent competitive procurement process which is openly advertised. It also requires that any subsequent guarantees, letter of comfort or undertaking given by the ministry may only be given with the prior consent of the FEC. Hence, the Act provides the legislative basis for the procedures set out in the National Policy for PPP.<sup>483</sup>

The ICRC is the statutory regulatory body established by the ICRC Act, 2005 with a mandate to evolve and issue guidelines on PPP policies, processes and procedures (including those for concessions), and to act as a national centre of expertise in PPP. It is expected to, in conjunction with the relevant MDAs, identify potentially ‘bankable’ PPP projects, ‘and will act as the interface with the private sector to promote communication on national policies and programmes’.<sup>484</sup> The communication envisaged ‘will be continuous, clear, timely, and accurate’.<sup>485</sup>

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<sup>481</sup> See sections 1, 14, 19 and 20 of the ICRC Act, 2005. See also Project appraisal document 53.

<sup>482</sup> Project appraisal document 53

<sup>483</sup> Ibid.

<sup>484</sup> Ibid. 15.

<sup>485</sup> Ibid.

The ICRC is empowered to grant PPP type contracts or concessions by any of the Federal Government ministries, agencies, corporations or bodies.<sup>486</sup> The Commission is expected to incorporate PPP Resource Centre which is to play an important aspect in the institutional framework.<sup>487</sup>

As part of the regulatory functions, ICRC will see to the smooth implementation of the Government's policies and processes and give advice to the Federal Executive Council (FEC) on the thrust and evolving national policy on PPP. This will include giving opinion to 'FEC on whether projects submitted to it for approval meet the requirements of the regulations'.<sup>488</sup> The Contract Monitoring Unit within the ICRC framework will be responsible for monitoring of compliance with the terms and conditions of the contracts between the contracting parties arising from the PPP processes.<sup>489</sup>

However, there are some of the provisions of the ICRC Act which still need more details and clarifications.<sup>490</sup> Besides, there are some observed lacunae in the legal framework that would need to be plugged to make significant stride in the implementation of the infrastructure law and the PPP policies.<sup>491</sup>

First, the Act empowers the ministries, departments and agencies of the Federal Government of Nigeria to enter into PPP related agreements after the approvals of the Federal Executive Council without mentioning or considering the other government establishments that may be affected by such agreements or other relevant laws. Besides, no mention is made of the need to take into account the effect of the proposed PPP transactions on finances of the Federal Government.<sup>492</sup>

The Act made no mention of the ownership of infrastructure assets by the private sector, nor does it provide for the stream of income through users' fees to be collected

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<sup>486</sup> Ibid.

<sup>487</sup> Ibid.

<sup>488</sup> Ibid.

<sup>489</sup> Ibid.

<sup>490</sup> See Project appraisal document 53

<sup>491</sup> Ibid.

<sup>492</sup> Ibid.

by private sector operators from the general public for the use of infrastructure assets, nor does the Act provide for the possible acquisition land.<sup>493</sup>

It should also be noted that the provisions of the Act are cloudy concerning the approval process for PPP projects and, in particular, the granting of a concession.<sup>494</sup>

In the same vein, the powers conferred on the Commission are minimal and restricted to taking custody of already signed agreements and monitoring them. No specific responsibilities are given the Commission in the evaluation and tendering process for PPP projects and no provisions as to the relationship and coordination between the Commission and other ministries, departments and agencies of the Federal Government regarding the monitoring of the PPP contracts.<sup>495</sup>

Similarly, the Act makes no reference to the scale of projects to be considered for private sector participation and does not provide a mechanism for dealing with unsolicited proposal.<sup>496</sup> Also, no provision is made for a fair, efficient appeal process for illegal amends or aggrieved parties.<sup>497</sup>

The Act provides not for a proper audit/review of processes and outcomes or for the need for proper public financial management.<sup>498</sup>

Gravely too, no provisions were made in the Act for alternative dispute resolution mechanisms.<sup>499</sup> Misunderstanding and disputes are inevitable between parties involved in PPP transactions and alternative dispute resolution mechanisms would have offered several ways of settling such misunderstanding and disputes in business in a less painful and more accommodating manner than the adversarial way of settling issues through the judicial process or litigation in a court of law.<sup>500</sup>

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<sup>493</sup> Ibid.

<sup>494</sup> Ibid.

<sup>495</sup> Ibid.

<sup>496</sup> Ibid.

<sup>497</sup> Ibid.

<sup>498</sup> Ibid. See also the National Policy on Public Private Partnership et. al.

<sup>499</sup> Ahmed M 'Infrastructure development for Nigeria-the PPP imperative' ICRC website-<http://www.icrc.gov.ng/>-assessed last on the 30<sup>th</sup> July 2011.

<sup>500</sup> Ibid. ADR is an acronym for 'Alternative Dispute Resolution' a generic name for resolution of disputes outside the judicial process or litigation in a court of law and include the following

In order to make the regulatory functions of the Commission more effective, the Act needed to have included in its provisions that any PPP transactions done without compliance to the Act would be unlawful.<sup>501</sup>

In relation to the functions, the piece of legislation lacks the regulatory and enforcement provisions that are vital in delivering the Commission's mandate.<sup>502</sup> The statutory functions are somewhat restricted in scope in a number of instances.

One instance relates to the role of the Commission which is restricted to monitoring and ensuring compliance of post-transaction's activities. Ordinarily, the Commission should be allowed to have oversight functions over the pre-financial close arrangements so as to ensure that the contractual arrangements are grounded on a very solid legal footing.

The Act does not provide for the role of the Commission as it relates to evaluating or approving proposals, and says nothing in reference to processes for preparing or analyzing projects or for deciding which projects should be privatized by federal agencies. The inclusion of the word 'regulatory' in the title of the Act and in the Commission is not reflective in the statutory powers conferred on the Commission in the Act as regard powers of industry regulation and it seems it is not intended to have such powers.

No specific link to other related laws<sup>503</sup> that touch on infrastructure procurement processes<sup>504</sup> and no provision in the Act shield the Commission from all forms of

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methods: negotiation, mediation, conciliation, arbitration and what is sometimes called the multi-door approach. Out of these options, arbitration seems to be the most developed and the commonest. Generally, one of the reasons for ADR is the undue delay suffered by litigants in the normal courts. Justice Adam (Alternative Dispute Resolution and Canadian Courts: a time for change, 1989, p. 14), identified the following reasons as the basis for the adoption of ADR: lower caseloads and related public expenses; more accessible for a to people with disputes; reduced expenditure of time and more for parties; speedy and informal settlement of disputes otherwise disruptive of the community or lives of the parties to the disputes and their families; tailored resolution to the parties' needs; increased satisfaction and compliance with resolutions in which the parties have directly participated; restoration of neighbourhood and community values which are more cohesive; enhanced public satisfaction with the justice system, among others.

<sup>501</sup> Ibid.

<sup>502</sup> Project appraisal document 53.

interference given the prevailing and peculiarity of the political environment in Nigeria. To this end, the Commission needs to be insulated from executive and political interference and given the needed tools for delivery its functions.<sup>505</sup>

The ICRC ought to be given primacy on issues regarding the PPP processes touching on the Federal Government-sponsored infrastructure projects. Typical example is the conflicts between ICRC and BPE in relation to the PPP processes. Reasonably and carefully looking at the enabling laws for these two agencies, it is obvious that while the BPE is mainly saddled with the mandate for the privatisation of public enterprises, the ICRC is concerned with superintending and moving the PPP processes forward, importantly, the concession transactions. The Act ought to have empowered the Commission to impose sanctions on those who contravened the provisions of the Act. There is also the need to include the provision that MDAs may receive and consider unsolicited bids subject to guidelines issued by the Commission from time to time.<sup>506</sup>

Section 20 of the ICRC Act, however, empowers the Commission to “perform such other duties as may be directed by the President from time to time, as are necessary or expedient to ensure the efficient performance of the functions of the Commission....”<sup>507</sup> However, pursuant to the provisions of section 34, the Commission may, with the approval of the President, “make such regulations as in its opinion are necessary or expedient for giving full effect to the provisions of this Act and for the due administration of its provisions”.

The relevant stakeholders have agreed to the fact that there are many lacunae and cloudy areas in the ICRC Act and the urgent need for a modern, comprehensive PPP law that would provide answers to so many questions in the Act and also create a platform for consistency across all infrastructure sectors and clarity of the decision-making processes. However, the ICRC has articulated the argument that quite a number of the observed lacunae “can be resolved or mitigated through the issuance of

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<sup>503</sup> For example: the Privatization and Commercialization Act 1999; the Fiscal Responsibility Act 2007 and the Public Procurement Act 2007. These legal instruments especially the Public Procurement Act might impact on the PPP procurement processes in the country.

<sup>504</sup> Project appraisal document 53.

<sup>505</sup> Ibid.

<sup>506</sup> Ahmed Infrastructure development for Nigeria 4.

<sup>507</sup> See subsection (d).

detailed regulations under the ICRC Act, developed in consultation with the MDAs and other interested agencies, and through operational guidelines, PPP Regulations and, where necessary, amendments to other applicable legislation”.<sup>508</sup>

This argument, this writer is of the view that it will not be in the interest of the private sector players in the PPP processes given the successive Nigerian governments’ penchant for policy reversal or ‘summersaults’. The writer is of the view that the Act should be amended to capture all these perceived lacunae for the sake of predictability and protection of private investments in procurement of public infrastructure and delivery of services to the public. Leaving all these observed legal gaps to be corrected through the operational guidelines and regulations will tantamount to leaving it to the whims and caprices of public officers and the political class and it will surely not be in the interest of private investors. As a matter of priority and urgency, the Act must be amended to address all these gaps and controversies pointed out above if the purpose for its enactment is intended to be accomplished.

The transitional arrangements apply to PPP projects which started the procurement process before June 2007<sup>509</sup> but where FEC approval is required under the ICRC Act. They apply to projects based on unsolicited proposals by a private sector party as well as projects which are financially free-standing (that is, which do not require funding from the Federal budget) but which involve the transfer of rights to exploit public assets and/or to charge users of an unregulated service through a concession.<sup>510</sup>

The Operational Guidelines address procedures which will apply to all new infrastructure facilities selected for implementation as PPP projects. Specifically, the Guidelines spell out the roles of the different MDAs with Federal Government with regard to the identification, selection, appraisal, procurement, negotiation and monitoring of PPP projects. The authority of these Arrangements and Guidelines needs to be reinforced by issuing them in the form of regulations approved by the President.<sup>511</sup>

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<sup>508</sup> Project appraisal document 54.

<sup>509</sup> The date of enactment of the Public Procurement Act 2007.

<sup>510</sup> Project appraisal document 56

<sup>511</sup> Ibid.

The proposed ICRC Regulations will strengthen the role of the Commission and seek to provide clarity and consistency for all aspects of a PPP transaction. A preliminary review of the Arrangements and Guidelines indicates, however, that there are areas of overlap with Procurement Regulations. To avoid uncertainty and inconsistency, the proposed ICRC Regulations will be limited to those matters that are outside the present Procurement Regulations and these Regulations will be incorporated by reference or appropriately cross-referenced.<sup>512</sup>

In agreement with the Document,<sup>513</sup> many variances could be seen between the provisions of the Procurement Act and the Procurement Regulations on the one hand and the PPP Policy on the other hand. Typical example is ‘the conduct of due diligence by third party investors, the potential renegotiation of terms over the life of a project, financing by third party investors, the use of variant bids and the right of the Federal Government to step-in in the event that the contractor fails to perform, are all matters that are specific to PPP projects and not contemplated by the Procurement Act or the Regulations’. This goes to reinforce the conclusion that the Act does not apply in all fours to privately financed infrastructure development.

The argument is that there is a compelling need for the appropriate authorities to rapidly move to enact a new legislation that will address all these grey areas concerning procurement of infrastructure assets through the private sector. Pursuant to broad-based consultations amongst the top government functionaries and the stakeholders, a comprehensive set of regulations for infrastructure procurement through the PPP should be drafted to move the PPP process in the country forward. Clarity of rules will, without doubt, enhance the confidence of prospective investors and attract the right kind of capital needed to fix the infrastructure financing gaps.

#### **5.4.7 Fiscal Responsibility Act 2007**

The objectives of the Fiscal Responsibility Act<sup>514</sup> are to:

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<sup>512</sup> Ibid.

<sup>513</sup> Ibid.

<sup>514</sup> Among other things, the Act establishes the Fiscal Responsibility Commission charged with the responsibility of monitoring and enforcing the provisions of the Act to ensure greater accountability, transparency and prudence in the management of the nation’s resources by the Federal Government, government-owned corporations or companies and agencies as provided for under sections 13, 16(1) and (2) and item 60 of the Exclusive Legislative List as set out in Part 1 of

- provide for the prudent management of the nation’s resources;
- ensure long-term macro-economic stability of the national economy;
- secure greater accountability and transparency in fiscal operations within a medium term fiscal policy framework; and
- establish the Fiscal Responsibility Commission (FRC) so as to ensure the provision and enforcement of the nation’s economic objectives and for related matters.<sup>515</sup>

The major statutory function of the Commission is to prepare the Medium Term Economic Framework and the requirements of the Annual Budget. The Act secures fiscal responsibility through imposing limits on spending and borrowing. Section 55 of the Act provides that the President may make regulations generally for the purpose of carrying into effect the provisions of the Act. As rightly pointed out in the Project Document, the power contained in section 55 of the Act might become a useful tool to introduce requirements, procedures, practices and guidelines for PPPs in the short-run given the absence of a comprehensive PPP legal framework.<sup>516</sup>

#### **5.4.8 Public Procurement Act, 2007**

The Public Procurement Act of 2007 (hereinafter referred to as ‘Procurement Act’)<sup>517</sup> established the National Council on Public Procurement and the Bureau Public Procurement (BPP) as the regulatory authorities responsible for the monitoring and oversight of public procurement, harmonizing the existing government policies and practices by regulating, setting standards and developing the legal framework and professional capacity for public procurement in Nigeria, and other related matters’.<sup>518</sup>

It is applicable to all forms of procurement of goods, works and services carried out by-

- the Federal Government of Nigeria and all “procuring agencies” and

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the second schedule to the 1999 Constitution of the Federal Republic of Nigeria and provides incentives to encourage states and local governments pass similar fiscal responsibility legislation.

<sup>515</sup> See the Explanatory Memorandum to the Fiscal Responsibility Act.

<sup>516</sup> See Project appraisal document 57.

<sup>517</sup> No.14. Signed into law on the 4<sup>th</sup> day of June, 2007.

<sup>518</sup> See the Explanatory Memorandum and the Schedule to the Public Procurement Act 2007.

- all other entities which derive at least 35% of the funds appropriated, or proposed to be appropriated, for any type of procurement from the Federation share of the budget.<sup>519</sup>

Section 60 of the Act defines a procuring entity as any public body engaged in procurement and includes a ministry, extra-ministerial office, government agencies, parastatal and corporation, while the term ‘procurement’ is defined tersely as “acquisition”. The Procurement Act does not apply to procurement by the states except to the extent that such procurement falls within (b) above.<sup>520</sup>

A careful perusal of the Act reveals that the Procurement Act applies to traditional public procurement of goods, works and services. No exact reference is made to infrastructure procurement or to public private partnerships. However, where the procurement of goods, works and services necessary for infrastructure projects is involved, the Act will apply but it is silent on the non-tender or concession aspects of PPP transactions;<sup>521</sup> and there is no reference to unsolicited bids or to the interaction between procurement under the Procurement Act and multilateral donor procurement rules.<sup>522</sup>

The Bureau of Public Procurement (hereinafter called ‘BPP’) was established by the Public Procurement Act of 2007 (hereinafter referred to as ‘Procurement Act’) which also established the National Council on Public Procurement. The BPP serves as the regulatory body responsible for the monitoring and oversight of public procurement, harmonizing the existing government policies and practices by regulating, setting standards and developing the legal framework and professional capacity for public procurement in Nigeria, and other related matters’. It drives the process of entrenchment of due process in the procurement of public works and services. In discharge of this function, it puts into use the techniques such as benchmarking in ensuring that the prices paid for goods and services are fair and reasonable. Part of its functions is the constituting of Tender Boards in each procuring entity in the Federal Government’s bureaucracy and it is also statutorily empowered to issue a certificate

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<sup>519</sup> See section 15.

<sup>520</sup> Project appraisal document 55.

<sup>521</sup> In other words, the Act does not apply directly to privately financed infrastructure assets.

<sup>522</sup> Project appraisal document (n 520 above).

of no objection before a procurement process can be concluded and the required funds disbursed by the Accountant General of the Federation. This procedure is subsumed into the procedure of Government approval of a Final Business Case through the FEC.<sup>523</sup>

In furtherance of its objectives, the Government is putting up a Procurement Department in each of the MDAs, to ensure the observation and deepening of due process in all procurements. There has also been suggestion to the effect that a member of the MDA's Procurement Department should be included on the Project Steering Committee set up with the MDA to superintend each PPP project. The BPP is also expected to work with the ICRC Resource Centre to evolve appropriate procurement processes for the PPP projects.<sup>524</sup>

The whole idea of the Bureau of Public Procurement is to entrench best practices in public procurement in the overall interest of national development. Unfortunately, that vision is far from being realised in that there is currently an increasing wave of corruption moving through the procurement process by the ministries, departments and agencies of government at the three levels-local, state and federal. This has in no small measure compounded the infrastructure and service delivery woes in the nation.<sup>525</sup>

The Procurement Act also provides for the establishment of National Council on Public Procurement (hereinafter referred to as "the Council").<sup>526</sup> The Council is empowered, among others, to approve and amend the monetary and prior review thresholds for the application of the provisions of the Act by procuring entities and

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<sup>523</sup> Ibid.

<sup>524</sup> Ibid.

<sup>525</sup> See 'BPP laments rising corruption in public procurement process' The Punch Wednesday, 20 July 2011. Recently, the Bureau uncovered and stopped the payment of an astonishing N216, being the inflation from a contract resulting from the implementation of 2010 federal budget. The uncovered amount was as a result of over-invoicing by the contractors for jobs claimed to have been done. This underscores 'the revolving doors of corruption and collusion that exist between contractors and government Ministries, Departments and Agencies'. Ibid.

<sup>526</sup> Section 1 of Procurement Act; the Council under the Act is the governing body on issues relating to public procurement in Nigeria and should have approval powers on the administration and management of public procurement.

consider and approve policies on public procurement.<sup>527</sup> The dark side of the story of the Procurement Act is that the Federal Government of Nigeria has not formally constituted and inaugurated the Council as part of the overall anti-corruption strategy and in compliance with the Procurement Act. This is a fall-out of the government's propensity to always honour laws in the breach than in the observance! The non-inauguration of the Council as provided for in the Act is not only illegal and a fundamental breach of the provisions of the Procurement Act, but has also opened the entire procurement process to abuse and undermine the anti-corruption crusade within the Nigerian public sector.<sup>528</sup>

### **5.5 Institutional framework**

Rightly, a sound institutional mechanism is crucial to facilitating an evolution of effective framework for the PPP market in Nigeria. The government as part of the policy thrust intends to create an institutional framework to implement its policy for PPP and make the ministries, departments and agencies of the Federal Government of Nigeria accountable in the delivery of quality public infrastructure and services within their jurisdictions by allocating specific roles and responsibilities to them in project identification, planning, approval and procurement. In addition, the government seeks to ensure that the MDAs have unrestricted access to adequate funding, required direction, quality training and expertise in planning, procurement and management of infrastructure projects and public services within the areas of their responsibility, effectively and efficiently taking into cognisance the value for money and long term affordability of the particular projects and services.<sup>529</sup>

To this end, the Federal Government of Nigeria has issued a Policy statement with the Supplementary Note which provides further details on its proposed allocation of roles and responsibilities within the institutional framework.<sup>530</sup>

As part of the institutional framework, guidance will be issued for the benefit of states that intend to come up with their own version of PPP policies and strategies and put

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<sup>527</sup> Ibid., section 2.

<sup>528</sup> "Constitute National Council on Public Procurement Now...New Procurement Anti-Corruption Group tells FG" News Diary Online Saturday, February 26, 2011-[newsdiaryonline.com/council\\_now.htm](http://newsdiaryonline.com/council_now.htm)-last accessed, 19 November, 2012.

<sup>529</sup> Project appraisal document 15.

<sup>530</sup> Ibid.

up the institutional mechanisms to coordinate these and encourage the development of PPP manuals where it becomes needful. These institutions will also coordinate communications between the public authorities and private entities. The MDAs are also expected to ensure that the Federal Government's sponsored projects under-go due diligence before going through a competitive and transparent procurement process and getting the required approval by the relevant authorities and the Federal Executive Council which formally approves all the PPP contracts before the award of a contract.<sup>531</sup>

Under the institutional framework, ICRC will issue regulations that will specify a value threshold below which these requirements will not apply. The representatives of civil society organizations, investors and contracting associates will also contribute to the effectiveness of the government's investment strategy and institutional framework in managing the PPP programme.<sup>532</sup>

The institutional framework is to see to the implementation of the PPP policies, assign specific roles and responsibilities to various MDAs of the Federal Government for the PPP project identification, planning, approval, procurement, and implementation.<sup>533</sup>

### **5.5.1 Line ministries and their agencies**

All the line ministries and their agencies responsible for service delivery will be accountable through their ministers for the provision of quality service delivery to the public and the good management of the public resources. Where necessary, the responsibility for the planning and coordination will be transferred to new bodies as in the case of power and transport. It is also figured out that establishment of new agencies will improve the threshold of responsibility.<sup>534</sup>

In view of the complex nature of PPP as a form of procurement, it has been argued that there is the need to integrate them into the overall investment strategy for the relevant sector, as well as cross-sectoral plans such as the Medium Term Expenditure. In this regard, MDAs are now required to prepare long-term plans for infrastructure

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<sup>531</sup> Ibid.

<sup>532</sup> Ibid.

<sup>533</sup> Ibid.

<sup>534</sup> Ibid. 73.

investment and maintenance which has been incorporated into the government's fifteen-year Development Plan by the National Planning Commission. As integral part of this process, the MDAs in conjunction with ICRC will identify where PPP is likely to offer more value over and above other procurement options and it will then be factored into the budgetary estimates in the plan. Nigerian Planning Commission (NPC) jointly with ICRC shall provide direction on the criteria that MDAs will use to measure value for money and provide the budgetary estimates of costs and risk.<sup>535</sup>

Part of the arrangement is that decisions on procurement options will be reviewed as projects are fine-tuned and enter the three-year Medium Term Expenditure Framework (MTEF). The framework is designed to define the forward programme of projects and allocate resources for their planning and preparation.<sup>536</sup>

It is also proposed that on entering the forward programme, the relevant MDAs will appoint an Accountable Officer at the level of a Director who will be saddled with the responsibility for oversight of the preparation and procurement phases and will also chair a Project Steering Committee. Pursuant to this, a Project Director and Project Team will be put in place along with external advisors, where necessary, who will be responsible for preparing all of the project business cases, the procurement documents, and the bidding process up to the award of the contract. This team will then handover the project management to the manager who will be responsible for its implementation, supervision, and management. From this point, a minimum of two approvals are needed from the Federal Executive Council (or the Economic Management Team or other relevant authorities) before the project can scale to subsequent stages. These approvals will be based on Outline and Full Business Cases which will be completed before the procurement can proceed or before a PPP contract can be awarded. Guidance on each of these approvals and other aspects of the PPP contract is expected to be provided by the proposed PPP Resource Centre. In a matter of time, a PPP Unit under the supervision of the MDAs will be put in place to provide further direction specific to PPP in the relevant sector.<sup>537</sup>

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<sup>535</sup> Ibid.

<sup>536</sup> Ibid.

<sup>537</sup> Ibid.

### **5.5.1.1 The Federal Ministry of Finance**

The Federal Ministry of Finance (TFMF) plays a vital role in the public financial management of PPP projects, and in the evaluation and management of fiscal risks arising from the contract terms. Part of the functions of the TFMF is to ensure that the forecast costs for the government are affordable within the Medium Term Expenditure Framework.<sup>538</sup> The budgets will need to capture the provision for any subsidies that may be required to make a project ‘bankable’ or for indigent Nigerians. The review of costs and contingent liabilities is usually on-going as the project designs and risk valuations are refined during the project preparation and procurement phases. It has been suggested that the government should consider setting up a Risk Management Unit in TFMF to serve as centre for expertise for all forms of PPP project related risks.<sup>539</sup>

### **5.5.1.2 Office of the Accountant General of the Federation (OAGF)**

As part of the safety valves, the government is expected to come up with measures through the Office of the Accountant General of the Federation (OAGF) to ensure that funding for payment obligations incurred through Federal Government-sponsored PPP contracts are protected to ensure prompt release of funds, but of course, subject to appropriate approvals. Thus, the States are expected to follow suit by devising strategy to make sure that all payment obligations arising from the PPP contracts are met. However, ‘where the financial standing of the public sector contracting party is not clear then special arrangements , such as escrow account, may need to be set up to reduce the reliance on financial guarantees from the Government’.<sup>540</sup>

The idea of creation of PPP Guarantee Fund has also been mooted. That would entail the Federal Government carrying the state governments along. The idea is hinged on the need for provision of additional security to would-be investors to hedge them against both actual and contingent liabilities where this becomes necessary. So also is the push for instituting an Infrastructure Fund to provide equity or debt to contracting companies under PPP arrangements.<sup>541</sup>

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<sup>538</sup> Ibid. 74.

<sup>539</sup> Ibid. 75.

<sup>540</sup> Ibid. 17.

<sup>541</sup> Ibid. 75.

### 5.5.1.3 The ICRC PPP resource centre

In tandem with global practice, the government has proposed the establishment of a PPP Resource Centre within the institutional framework of ICRC, to enhance and fast-track the development of the PPP in the country. This is expected to be an important integral part of the institutional framework that is being created to support the government PPP policy. The Centre will generally provide technical assistance to MDAs in the development and procurement of PPP projects.

As proposed, the Resource Centre will enjoy independence from the ministries, departments and agencies and will be enabled to recruit staff from the private sector. The Centre will also provide supporting assistance to similar units within the states and it is also believed that it will act as an interface between the public and private sectors in relation to PPP policy and practice. It has also been suggested that the proposed Resource Centre may have a role in managing government equity in projects when the government decides that it is appropriate. By this role, it would ensure that its investment decisions were made on commercial rather than political basis.<sup>542</sup>

One important role proposed for the Resource Centre is capacity building to drive the PPP process in the private sector through publicity, conferences and other meetings. It is also expected to act as a bridge between the public and the private sectors and to ensure that the PPP programme across the country has sufficient scale and ambition to attract global players into the Nigerian infrastructure market and probably build synergies with small and medium sized local players. The Centre will also be responsible for ensuring that the PPP programme is effectively and aggressively marketed and that both investors and potential bidders have confidence in the ability of the procuring authorities working together to manage a procurement process efficiently.<sup>543</sup>

The Resource Centre will be made up of a combination of public and private sector persons with wide and varied legal, financial and public sector background, to provide the wide range of skills that a programme of PPP projects across a number of different sectors needs. The Board of the ICRC will exercise oversight functions and give

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<sup>542</sup> Ibid. 71.

<sup>543</sup> Ibid.

‘strategic direction to the Resource Centre and the Contract Monitoring Unit through its governance structures’.<sup>544</sup>

The role of the proposed Resource Centre, among others will be:

- to provide advice to the Federal Government on the development of policy for PPP;
- to issue guidance in conjunction with the NPC, on the identification of PPP projects and programmes within the Government’s investment strategy;
- to provide advice on the value for money assessment and affordability analysis of the infrastructure projects that are being considered for PPP;
- to develop a communications strategy for PPP across the Federation and with all private sector stakeholders;
- assist MDAs with project appraisal, the appointment of external advisers where required, and the preparation of Outline and Final Business Cases;
- to provide technical assistance to MDAs in the procurement of PPP projects including defining appropriate output requirements, a payment mechanism, risk allocation, evaluation criteria, and draft contractual terms;
- to provide through the ICRC Board, advice to the Federal Executive Council on the approval of all significant infrastructure projects;
- to support MDAs during the operational phase of projects when required, for example in contract change or refinancing;
- to coordinate the PPP policies and programmes of the State and Federal Governments, working with similar units in the States or ministries to ensure consistency of approach and a steady flow of projects to the market.<sup>545</sup>

The Centre will be financed through a dedicated Project Development Fund to support the cost of external project and policy advisors for the PPP projects.<sup>546</sup>

#### **5.5.1.4 Contract compliance centre**

In an a bid to reassure the investors of the importance attached to legality and enforceability of concession contracts entered into in line with the provisions of the

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<sup>544</sup> Ibid.

<sup>545</sup> Ibid.

<sup>546</sup> Ibid.

ICPC Act, the Compliance Centre has been established and integrated into the ICRC framework. This Centre, among other functions, keeps on evolving and takes custody of every concession agreement and monitors compliance with the terms and conditions of such agreement; ensures efficient execution of any concession agreement or contract entered into by the government; develops guidance and procedures for monitoring of such agreement and maintains a database on concessions and other PPP contract entered into by the government.<sup>547</sup>

## **5.6 At sub-national level**

Out of all the federating states in Nigeria, only Lagos State<sup>548</sup> has shown flashes of seriousness as a result of its pro-active approach to infrastructure development which has been quite commendable.

### **5.6.1 PPP legal framework in Lagos State**

Due to the ever-increasing influx of people from the rural areas and the fact of life that the Lagos State is the commercial and financial capital of Nigeria and almost becoming a city state, there has been a tremendous pressure on the existing infrastructure assets and this has translated into an urgent and compelling need to upgrade, expand and build new infrastructure. It is in an attempt to address this deficit that the Lagos State Government decided to leverage on the PPP approach to generate power, manage waste disposal, maintain the highways and streets, to mention a few. It has also been used to develop, upgrade, rehabilitate, operate and manage state roads, bridges and highways within its geographical and constitutional jurisdiction.

The main infrastructure law in Lagos State is Lagos State Public Private Partnership Law (LSPPP Law) which was enacted and signed into law on the 24<sup>th</sup> of June, 2011. The LSPPP Law, in the main, encompasses in one document the framework for PPPs capturing the entire infrastructure spectrum in all facets of the economy as against its predecessor which was limited to roads, bridges and highways as suggested by the title of the law.

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<sup>547</sup> Ibid.

<sup>548</sup> It is one of the smallest federating states but has a population that is put in the region of 17 million with an annual growth rate of 8 percent per annum.

Other infrastructure-related laws in extant in Lagos State are:

- Lagos State Roads, Bridges and Highway Infrastructure (Private Sector Participation) Development Board Law;
- Lagos State Water Sector Law 2004;
- Lagos State Metropolitan Area Transport Authority Law 2007; and
- Lagos State Waterways Authority Law 2008.

The Lagos State Roads (PSP) Law, 2007 has been expressly repealed by the new and main Infrastructure Law in Lagos State.<sup>549</sup>

### **5.6.2 Regulatory system**

The new Infrastructure Law establishes the Office of Public Private Partnership (Office) and prescribes a Governing Board for it. Under the Law, the Office is statutorily responsible for development of public infrastructure or public assets and provision of social amenities and other facilities through the PPP framework.

However, the Lagos State Roads, Bridges and Highway Infrastructure (Private Sector Participation) Development Board Law which was enacted into law in 2004 by the Lagos State House of Assembly also makes provision for a legislative and regulatory framework for private sector participation in the development, rehabilitation, upgrading and construction of roads, bridges and highway infrastructure within the state. It also established the State Roads, Bridges and Highway Infrastructure (Private Sector Participation) Development Board which is saddled with the responsibility of coordinating all policies and programmes of the state regarding private sector participation in the development and provision of infrastructure in the state.<sup>550</sup>

The functions of the Board include: to verify and monitor compliance with the terms and conditions of concession agreements by concessionaires; and to advise the state government on matters relating to financing, construction and maintenance of roads, bridges and highways within the state and in particular, to identify and make

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<sup>549</sup> See 'Lagos State, Nigeria's PPP gateway' Business Day, Thursday, 11 August, 2011.

<sup>550</sup> See section 1 (1) of the Law.

recommendations to the state government with respect to the acquisition of land required for such purposes.<sup>551</sup>

In furtherance of its functions under the Law, the Board is empowered to: grant concessions to, or engage the services of and enter concession agreements with, private investors on behalf of the State Government, for the design, construction, operation, management, control, maintenance, rehabilitation and financing of roads, bridges and highways and the collection of tolls and other charges under such concession agreement; and to enter into ancillary agreements including agreements for the purpose of facilitating any related financing required in respect of any concession granted pursuant to the Law, or any other form of agreements it may deem necessary to carry out its functions under the Law.<sup>552</sup>

### **5.7 Concluding remarks**

This chapter is descriptive in nature in that it reviews the applicable laws in Nigeria regarding infrastructure procurement and the private sector engagement in provision, maintenance and operations of public infrastructure assets and service delivery.

In the chapter, it is observed that law is based on policy and policy comes into existence through a policy-making process; the process usually starts when political leaders decide to respond to the needs, problems, ideals and aspirations of the citizens of a particular country and particular issues and problems are identified by way of research inquiries and a consultation process in response to which a general discussion document would be drafted. By implications, the official policy would be translated into written laws and policy would become law through a law-making process. In other words, laws usually outline and define principles, procedures, mechanisms and action to be taken in order to achieve a predetermined policy goal.

The conclusion then was that this same process applies to the introduction of policy shift from public sector funding to engagement of private capital in infrastructure provisioning and financing in Nigeria.

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<sup>551</sup> Ibid. See section 2

<sup>552</sup> Ibid.

Aside the substantive law that enables private investment in public infrastructure in Nigeria, the regulatory system which is a sub-set of the legal framework, also came under review. It was argued in the chapter that the critical imperative of putting in place a regulatory and institutional environment that inspires confidence through ‘open and transparent processes and procedures and a level playing field’. This is not misplaced in that it would promote competition and enable the investors to earn fair returns for the risks taken. The enquiry also observed that typically, the regulatory environment would embrace the rules of procedure governing the way and manner institutions saddled with regulatory functions exercise their powers and that a positive regulatory environment would create a level-playing field for all players on the PPP terrain.

Lastly on the institutional landscape front, the conclusion is that a sound institutional mechanism is crucial to facilitating an evolution of effective framework for the PPP market in Nigeria and that the government on her part should endeavour to put in places an institutional framework that would inspire the confidence of all players in the infrastructure market.

Despite all the potentials, appreciable progress has not been made through leveraging on PPP technique due to non-availability of long term fund for infrastructure financing in the environment of economic recession has remained the major challenge confronting infrastructure financing in Nigeria. This study however argues that the inadequacy of appropriate laws and inefficient financial system are partly responsible for the huge financing gaps in the Nigeria’s infrastructure market and with the legal and financial reforms, an enabling legal and financial environment that would create space for resource mobilization through innovative financing techniques and sources to widen access to long-term financing and increase the appetite for private investment in the nation’s public infrastructure assets and services.

So, the next chapter will seek to prove that the present regimes of laws are inhibiting financial resource mobilization and that an appropriate and effective legal infrastructure is a critical imperative to creating an environment that will enhance mobilization of financial resources and promote private investment in infrastructure.

## CHAPTER 6

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### IMPERATIVES FOR REVIEW OF THE LEGAL INFRASTRUCTURE TO UNLOCK DOMESTIC FINANCIAL RESOURCES

#### 6.1 Introductory remarks

#### 6.2 Review of sector and industry-specific legislation

##### 6.2.1 Investments and securities Act 2007

##### 6.2.2 Infrastructure Concession regulatory Commission Act 2005

##### 6.2.3 Contractual savings institutions/investment laws

###### 6.2.3.1 Pension Reform Act 2004

###### 6.2.3.2 Insurance Act 2003

###### 6.2.3.3 Nigerian Cooperative Society Act 1993

#### 6.3 The need for reforms of other related bodies of law and legal regimes

##### 6.3.1 Foreign investment protection law

##### 6.3.2 Foreign exchange regime

##### 6.3.3 Property law

##### 6.3.4 Secured credit transactions law

##### 6.3.5 Insolvency law, practice and creditor rights

##### 6.3.6 Contract law

#### 6.4 Re-inventing regulatory environment

#### 6.5 Judicial system reforms

##### 6.5.1 Non-judicial institutions

#### 6.6 Concluding remarks

## 6.1 Introductory remarks

In the previous chapter, there was an analysis of the entire legal framework that underpins procurement of infrastructure and the engagement of private sector capital in infrastructure provision, maintenance and financing in Nigeria which captured the related regulatory and industry specific legislation, the regulatory mechanism and the institutional landscape. In the concluding segment, it was argued that the infrastructure-related laws in extant are inadequate and this inadequacy is partly responsible for the huge financing gaps in the Nigeria's infrastructure market and that with appropriate legal reforms, the immediate outcome would lead to creation of right legal environment for resource mobilization through innovative financing techniques and sources which would widen access to long-term financing and increase the appetite for private investment in the nation's public infrastructure assets and services.

Hence, the chief objective of this chapter is to interrogate how the country's legal infrastructure can be transformed to unleash innovative financing solutions to fund the critical infrastructure in Nigeria.

So, this chapter takes a critical look at the entire legal infrastructure for engagement of private sector in procurement, maintenance and operation of public infrastructure assets in Nigeria and argues that there are gaps in the related laws and that the inadequacy and ineffectiveness of laws and legal institutions are significantly responsible for the huge financing gaps in the Nigeria's infrastructure market and that with appropriate reforms of the legal infrastructure, the untapped domestic resources will be mobilized and adequate foreign capital attracted for procurement of public infrastructure and service delivery.

The starting point is to remark that appropriate and effective legal infrastructure is a critical imperative to creating an environment that promotes private investment in infrastructure.<sup>553</sup> Therefore, reviewing the existing infrastructure-related laws and establishing an enabling framework are critical to deepening private sector

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<sup>553</sup> UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects 23.

involvement in procurement and delivery of public infrastructure and services in Nigeria.

It is however important to note at the outset that for the purposes of this study, ‘legal infrastructure’ refers to ‘entire system of rules, procedures and institutions that undergirds’<sup>554</sup> the infrastructure spectrum in Nigeria. In this context, it means the laws and legal institutions relevant to infrastructure landscape in Nigeria. ‘Laws’ herein include written<sup>555</sup> and unwritten laws,<sup>556</sup> substantive<sup>557</sup> and procedural laws.<sup>558</sup> Then ‘legal institutions’ here refers to judicial<sup>559</sup> and non-judicial<sup>560</sup> institutions.

Generally, the law provides the platform by which the governments regulate and ensure the provision of public services to the public and offers protection of rights for public service providers and the customers alike. That explains why the legal framework needs not only to be transparent but must also be fair. A fair legal framework will incorporate the wide and varied interests of all parties-the government, the private investors who provide services for the public and the public at large and seeks to achieve an equitable balance between all these wide and varied interest. Aside the character of transparency and fairness, an appropriate law on private infrastructure procurement development must also have the objective of

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<sup>554</sup> Knight, Edward (2000) ‘Legal Infrastructure for the New Global Market Place, 34 Int’L Law 211, 212 cited in Keith Rosten (2008) “Scaffolding for legal infrastructure: developing sustainable approaches” Tulane J. of Int’L and Comparative Law, Vol. 16:395 at 397-Last accessed online on 29<sup>th</sup> March 2012 at:<http://work.bepress.com/cgi/>.

<sup>555</sup> ‘Written laws’ or ‘leges scripta’ are those laws that are enacted in some written forms by the Legislature including the rules and regulations made by the executive under the framework of delegated legislation. Legislation is very crucial to fostering private investment in public infrastructure projects. It ‘typically embodies a political commitment, provides specific legal rights and may represent an important guarantee of stability of the legal and regulatory regime’. See the UNCITRAL Legislative Guide on Privately financed Infrastructure Projects, p. 24. Generally, appropriate relevant laws will set forth the rules under which projects will be awarded and executed.

<sup>556</sup> ‘Unwritten laws’ or ‘leges non scripta’ such as the common law doctrines which still remain one of the sources of Nigerian jurisprudence.

<sup>557</sup> ‘Substantive laws’ lay down the rights, duties, liberties and powers of all the interested parties in the infrastructure sector.

<sup>558</sup> ‘Procedural or adjectival laws’ relate to the enforcement of rights and duties under an infrastructure project contract.

<sup>559</sup> ‘Judicial institutions’ are the courts which include the various shades of courts within the Nigerian legal system.

<sup>560</sup> ‘Non-judicial institutions’ refer specifically to alternative dispute settlement mechanisms.

ensuring the long-term provision of the services to the public and pays attention to ‘environmental sustainability’.<sup>561</sup>

Thus, a strong and reliable legal infrastructure entails enactment of appropriate laws and availability of a well-functioning court system. Reasonably, a country with better legal infrastructure will be able to attract investment into the infrastructure landscape. Related to this is the capacity to enforce contracts. The problem of enforceability raises the risk of capital loss and hinders flow of capital into infrastructure development.<sup>562</sup>

## **6.2 Review of sector and industry-specific legislation**

As noted earlier on in the chapter, by reviewing and improving the related laws touching on private investment in public infrastructure, the government would have made a critical impact in securing a positive legal environment for attracting private capital in infrastructure development and the engagement of private capital and expertise in financing and operation entail a need for a wholesale reform of the country’s legal landscape which may also require amendment of the existing relevant laws and enactment of the new ones.

In this segment, the study will seek to critically review some of the sector and industry-specific laws of immediate relevance to private infrastructure finance and establish the need to either review the existing ones or enact the new ones.

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<sup>561</sup> UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (2011) 23.

<sup>562</sup> Ibid.

### 6.2.1 Investments and Securities Act, 2007

Part XIII of the Investments and Securities Act, 2007<sup>563</sup> provides for Collective Investment Schemes.

A collective investment scheme is a scheme in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which-(a) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; (b) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio or a scheme or on any other basis determined in the deed, but not a collective investment scheme authorized by any other Act.<sup>564</sup>

Under the law, collective investment schemes can happen in three ways or mechanisms: unit trust scheme; open-ended investment company; or Real Estate Investment Company or trust.<sup>565</sup>

The ISA provides the legal framework for unit trust scheme. Section 315 of Act defines ‘Unit Trust Scheme’ as-

any arrangement made for the purpose, or having the effect, of providing facilities for the participation by persons as beneficiaries under a unit trust, in profits or income arising from acquisition, holding, management or disposal of securities or any other property.

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<sup>563</sup> Hereinafter referred to as the ‘ISA’ was signed into law on the 25<sup>th</sup> day of June, 2007 and amongst other things, provides for: the establishment of Securities and Exchange Commission; the enlarged powers and functions of the Securities and Exchange Commission over the capital market; and a set of new market infrastructures and wide-ranging system of regulation of investment and securities business in Nigeria, especially in the area of mergers, acquisitions and take-overs, and collective investment schemes, where new provisions were made. See the explanatory memorandum to the Act.

<sup>564</sup> See sections 153 and 315 of ISA 2007.

<sup>565</sup> See section 154 of the ISA.

Unit trust is a vehicle established to enable many small investors to pool their funds together to enjoy the benefit of diversification and professional management at low cost without impairing the liquidity and safety of their investment. A unit trust scheme is not a limited company but the liability of each member is limited to their financial interest. It is best described as an investment club similar to the traditional co-operative savings schemes called ‘esusu’ in South Western area of Nigerian state.

Unlike an investment trust company which is closed –ended, a unit trust can have an unlimited number; that is, it is open-ended. In a unit trust, property is held on trust for a large number of investors. Those who invest their savings in units are in law the beneficiaries in whose interest the trust must be administered. When individual contributions are “pooled” into fund, they are invested either generally or in specific sectors in accordance with each fund’s objective. The decisions on which shares to buy and when to make changes are made by investment experts known as fund managers.<sup>566</sup>

One major benefit of the unit trust scheme is that by investing in unit trust, the smaller investor gains the advantage of a spread of shares that would have been to the exclusive preserve of the larger investor. Though the value of unit fluctuates according to the market value of the underlying investments, the unit holders gain from the professional guidance of specialist fund manager since they hardly have time, and the expertise to study stock market closely.<sup>567</sup>

The unit trust scheme clearly illustrates the collective investment function of trust whereby under close statutory regulation and scrutiny, a corporate custodian trustee holds a fund gathered from the public in return for the issue of units of the fund and a corporate managing trustee invests this fund in whatever stock market securities seem best at any given time, dividends and capital gains earned from the investment accrue for the benefit of current unit holders.<sup>568</sup>

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<sup>566</sup> Guobadia D (1992) 307

<sup>567</sup> Ibid.

<sup>568</sup> Ibid.

A unit trust is constituted by a trust deed made between managers who are responsible for the selection within limits prescribed by the trust deed ( and the statute) of the portfolio of securities comprised in the trust fund and trustees who are responsible for the safe custody of those securities and the collection and distribution of income from them.

The ISA also defines ‘trust deed’ as-

the agreement drawn up between the trustees and the managers or between such persons approved by the Commission and in relation to the provisions of the Act for regulating the operations of a collective investment scheme or other approved schemes, funds, debentures, bonds or market operations.<sup>569</sup>

On the issue of the investment of collective investment schemes funds, section 171 provides that:

a scheme fund shall be invested by a manager in accordance with the provisions of the trust deed or custodial agreement with the objectives of safety and maintenance of fair returns on amount invested and subject to guidelines issued by the Commission, from time to time, the funds and assets of a scheme shall be invested in any of the following-

- bonds, bills and other securities issued or guaranteed by the Federal Government and the Central Bank of Nigeria;
- bonds, debentures, redeemable preference shares and other debt instruments issued by corporate entities listed on a securities exchange and registered under the Act;
- ordinary shares of public limited companies listed on a securities exchange and registered under the Act with good track records having declared and paid dividends in the preceding five years;

- bank deposits and bank securities of which the banks shall be rated by rating agencies registered by the Commission;
- investment certificates of closed-end investment fund or hybrid investment funds listed on a securities exchange and registered under the Act with a good track records of earning;
- units sold by open-end investment funds or specialist open-end investment funds listed on the securities exchange recognized by the Commission;
- real estate investment; and
- such other instruments as the Commission may, from time to time, prescribe.

The argument here is that the provisions of the section above could be amended to allow fund managers to invest a sizeable percentage of these funds in infrastructure assets development through a Special Purpose Vehicle. By its nature, the investment of a collective investment scheme like unit trust is for long term and this perfectly fits into the mould for infrastructure investment.

Apart from the unit trust scheme, there is also an open-ended investment company which is another mould of collective investment scheme which funds can be channelled into infrastructure to bridge the financing requirements in the infrastructure landscape in Nigeria.

Section 152 of ISA defines ‘open-ended investment company’ an ‘a company with an authorized share capital whose articles of association authorizes the acquisition of its own shares structured in such a manner that it provides for the issuing of different classes of shares to investors’.<sup>570</sup>

This platform could also be used to meet the investment requirements in infrastructure by statutorily making it mandatory for the custodians or trustees of such collective investment club to invest a reasonable percentage of their portfolio in infrastructure bonds and also contribute percentage of their profit to an infrastructure fund.

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<sup>570</sup> Section 152 gives general definitions of certain words used in Part XIII of the ISA

Then there are also a real estate investment companies or trusts as the third platform for collective investment scheme. A real estate company or trust is a body corporate incorporated for the sole purpose of acquiring intermediate or long-term interests in real estate or property development and may raise funds from the capital market through the issuance of securities which shall have the following characteristics-

- an income certificate giving the investor a right to a share of the income of any property or property development; and
- an ordinary share in the body corporate giving the investor voting rights in the management of that body corporate.<sup>571</sup>

It is suggested here in this investigation that the ‘Infrastructure Investment Company’ could be substituted for ‘Real Estate Investment Company’ specifically designed for investment in core infrastructure assets or the ISA is amended to create ‘Infrastructure Investment Company/Trust’ as the fourth platform to administer the collective investment schemes.

As provided for under the Act, a trust may be constituted for the sole purpose of acquiring a property on a “trust for sale” for the investors.<sup>572</sup>

The trust referred to, as stated in ISA, shall have the following characteristics-

- the investors shall acquire units in the trust through which they shall be entitled to receive periodic distribution of income and participate in any capital appreciation of the property concerned; and
- the investors shall also be entitled to retain control over their investments by investing directly in a particular property rather than in a portfolio of investments.<sup>573</sup>

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<sup>571</sup> Section 193 (1).

<sup>572</sup> Section 193 (2).

<sup>573</sup> Section 193 (3).

### 6.2.2 Collective investment companies

By way of introduction, collective investment companies are strategic to the development and sustenance of the financial system and mobilization of domestic resources for infrastructure investment of a given nation.<sup>574</sup> They include pension funds, insurance and in Nigeria, cooperative societies. They operate by pooling and investing ‘the savings of their members to generate sufficient funds to meet their liabilities’.<sup>575</sup>

These classes of assets are strategic to mobilization of domestic resources for infrastructure investment for many reasons.

First, by the nature of their liabilities which are generally very long-term, they expectedly look for investments with a similar maturity which matches their assets and liabilities. Sensibly, they are more inclined to have strong demand for shares and long term bonds. This provides a source of longer term investment funds, which has a positive impact on capital market development and, ultimately, economic growth in the longer term. Second, when these factors are combined with the scale of these institutions, this also affords them the opportunity to exert significant leverage over corporate behaviour, which again may have a positive impact upon growth.<sup>576</sup>

Collective investment companies remain relatively under-developed in Nigeria and hence, it would be argued here that the legislative reforms of the three related legislation below would open up the idle funds and assets of these institutions to the infrastructure investments and unlock the required resources for infrastructure development. This argument is hinged on the fact that generally, collective investment companies are heavily regulated in Nigeria and as such, compulsory investments in infrastructure assets by these savings institutions will end up in freeing the huge funds that are lying idly in the banks’ vaults for infrastructure financing and development.

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<sup>574</sup> Spratt 99.

<sup>575</sup> Ibid.

<sup>576</sup> Ibid.

### 6.2.2.1 Pension Reform Act 2004

One of the collective investment companies is the pension funds and the Pension Reform Act of 2004 provides the legal framework for pension funds administration in Nigeria.

Specifically, the contributory pension scheme came into existence as a result of the enactment of the Pension Reform Act of 2004.<sup>577</sup> The Pension Act repeals the Pensions Act 1990 and established a uniform contributory pension scheme for both the public and private sectors in Nigeria.<sup>578</sup>

Naturally, pension funds are sticky and long-term. These two attributes make the funds ideal for infrastructure investments and development. According to the Nigerian Pension Commission's 2010 annual report, pension assets as at the end of 2010 stood at N2.029 trillion.<sup>579</sup> This implies that the amount of idle funds available for investments in infrastructure assets is in excess of N3.5 trillion. This amount is expected to grow as pension assets grow by an estimated 20-30 percent per annum in the next few years.<sup>580</sup>

This development has brought to the fore the need to expand the investment space for pension funds,<sup>581</sup> and one of the outlets is the investment in infrastructure. Part of the pension funds may be put in the banks especially the Development Financing Institutions (DFIs) to make them more liquid and promote savings to be directed to infrastructure projects financing.<sup>582</sup>

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<sup>577</sup> Hereinafter referred to as 'Pension Act'.

<sup>578</sup> The uniform contributory pension scheme has the features of: contributions of funds by both the employer and the employee to fund retirements benefits; crediting the employee's retirement savings accounts with pension fund administrators with any funds so contributed; pension fund assets are to be privately managed and invested by professional pension fund managers; strict regulation of the activities of pension fund administrators and custodians of pension fund assets under uniform laws and regulations for both public and private sectors; and lastly, the establishment of the National Pension Commission charged with the responsibility for matters relating to the regulation, supervision and effective administration of the Scheme, and for matters connected herewith. See the Explanatory Memorandum to the Act.

<sup>579</sup> Developing private equity and venture capacity-Thisday-30 August, 2011.

<sup>580</sup> Ibid.

<sup>581</sup> Ibid.

<sup>582</sup> Ibid.

Thus, it is argued here in this study that the infrastructure financing techniques need to be opened up to the pensions industry. Pension law and regulations need to be reformed to allow up to a certain percent of the pensions assets to be invested in infrastructure projects through special purpose vehicle or infrastructure bond in the capital market. Funds from this source may also be dedicated to debt financing of infrastructure projects through some selected banks under a very strict supervision.

### **6.2.2.2 Insurance Act 2003**

Generally, the insurance industry remains a key sector within the broader financial system. In most of the advanced economies, the insurance sector accounts for a considerable portion of the overall economy. By taking those insignificant premiums from the people in an economy, insurance companies could gather a large pool of ‘investible’ funds for short, medium or long term periods.<sup>583</sup>

Thus, the development of the insurance industry is critical for the deepening of the domestic financial sector as a whole and the mobilization of savings for investment into productive sectors for economic growth and development. As noted in the World Bank Report, the insurance industry ‘is critical to ability of emerging and transitional economies like Nigeria to grow and develop’ and besides, it ‘provides stability by allowing large and small businesses operate with a lesser risk of volatility or failure’.<sup>584</sup>

Insurance Act 2003<sup>585</sup> provides the legal framework for the insurance industry in Nigeria and applies to all insurance businesses and insurers. The Act provides, among other things, for better supervision and control of the insurance industry in Nigeria<sup>586</sup> and applies to all insurance business and insurers in Nigeria.<sup>587</sup>

Sub-section 1 of section 25 of the Act states that an insurer shall at all times in respect of the insurance transacted by it in Nigeria, invest and hold invested in Nigeria, assets

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<sup>583</sup> World Bank (2009) Making finance work for Nigeria 83.

<sup>584</sup> Ibid.

<sup>585</sup> Hereinafter referred to as ‘Insurance Act’.

<sup>586</sup> See the Explanatory Memorandum to the Act and Schedule to the Insurance Act, 2003.

<sup>587</sup> See section 1 of the Insurance Act.

equivalent to not less than the amount of policy holder's funds in such accounts of the insurer.

Sub-section 2, however, prohibits the investment of the policy holders' funds in property and securities except: shares of limited liability companies; shares in other securities of a cooperative society registered under a law relating to cooperative societies; loans to building societies approved by the Insurance Commission; loans on real property, machinery and plant; loans on life policies within their surrender values; cash deposit in or bills of exchange accepted by licensed banks; and such investments as may be prescribed by the Commission.

The insurance assets could be channelled into infrastructure financing because the funds from insurance portfolio match the long term nature of infrastructure investment. This can be achieved through the amendment and inclusion of mandatory clause in the Insurance Act making the investment of reasonable insurance assets under the management of the insurance companies invested in infrastructure assets.

### **6.2.2.3 Nigerian Cooperative Society Act 1993**

Nigerian Cooperative Society Act (formerly Decree No. 90 of 1993)<sup>588</sup> came on stream in 1993. The crux of the legislation is that it makes provision for the registration and operation of cooperative societies throughout the Federation to foster the achievement of the national objective of socio-economic development at grassroots level in whole Federation.

In discussing the legislative aspect of cooperative societies in Nigeria, the Cooperative Development Act, 1990 and Nigerian Cooperative Societies Decree 90 of 1993 are the reference points. While Cooperative Development Act provides, in the main, for the institutional framework for regulation and supervision of cooperative

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<sup>588</sup> Note that under the Constitution of Federal Republic of Nigeria, 1999, Cooperative Society falls under the Concurrent List, the implication of which is that both the federal and federating states may legislate on the matter and hence, some states in the Federation have their various laws which regulate Cooperative Societies within their jurisdictions.

societies in Nigeria, the Nigerian Cooperative Societies Act provides the legal framework for cooperative schemes in Nigeria.

Section 57 of Nigerian Societies Cooperative Act, 1993<sup>589</sup> defines ‘cooperative society’ as:

a voluntary association of individuals united by common bond, who have come together to pursue their economic goals for their own benefit.

Section 33 of Cooperative Act states that a registered society may invest or deposit its funds:

- in a Cooperative Bank, or any other bank approved for the purpose by the Committee of that society;
- in any securities issued and guaranteed by the Federal Government; and
- in any other manner approved by the Committee of the society.

This study argues for the amendment of the provisions of the enumerated section above to specifically require a reasonable percentage of the cooperative funds be invested in infrastructure-related securities or instruments in a bid to bridge the yawning gaps in infrastructure financing in Nigeria. This amendment becomes important in view of the fact that the use of the cooperative funds is regulated by the Act and the executives of the cooperative do not have the latitude to invest in the infrastructure-related instruments or investments unless given the approval to do so under the Act by the appropriate authorities.

In the same vein, sub-sections (2) and (3) of section 34 of the same legislation also provides that ‘at least one-fourth of the net profits of a registered society... shall be paid into a fund to be called “reserve fund” which shall be applied as specified in the Act’ and that the cooperative societies ‘may contribute an amount not exceeding ten percent of the remainder of the net surplus to an education fund’.

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<sup>589</sup> Hereinafter referred to as ‘Cooperative Act’.

It is suggested here that the phrases ‘infrastructure fund’ should be substituted for ‘reserve fund’ and ‘education fund’ in the provisions of the Cooperative Act to alleviate the problem of lack of finance which genuine investors are facing in infrastructure development and financing in Nigeria. The ‘reserve fund

### **6.3 The need for reforms of other related bodies of law and legal regimes**

Aside the laws of immediate relevance to privately financed infrastructure projects, a typical sound and effective legal framework will require supportive aspects of other areas of law. Privately financed infrastructure would be deepened if there is legislation that generally promotes and protects private investment especially, the foreign investment.<sup>590</sup> This is further underscored in the UNCITRAL Legislative Guide when it remarked that: ‘the existence of adequate legal provisions in these other fields may facilitate a number of transactions necessary to carry out infrastructure projects and help to reduce the perceived legal risk of investment in the host country’.<sup>591</sup>

#### **6.3.1 Foreign investment protection law**

The issue of investment protection in the host nation is very pertinent to would-be investors. Foreign investors will always request for assurances or guarantees that in the event of investing capital in the host country, their investment will be legally protected from ‘nationalization or dispossession without recourse to judicial review and payment of appropriate compensation’ in tandem with the rules in extant in the particular host nation and the established rules of International Law. In this regard, the laws relating to promotion and protection of foreign investment may be crucial to the decision making of foreign investors as to whether to invest into the public infrastructure sector or not.<sup>592</sup>

Also of importance to the investors are issues like: bringing in to the host country the required skilled manpower to work on the project without unreasonable restriction; the latitude to also bring in the needed goods and machineries; unrestricted access to

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<sup>590</sup> UNCITRAL Legislative Guide 190

<sup>591</sup> Ibid.

<sup>592</sup> Ibid.

foreign exchange needed to facilitate the execution of the project; and the issue of transfer abroad or repatriation of the investors' profit or the amount required to meet financial obligations related to the infrastructure project.<sup>593</sup>

In Nigeria, the enactment into law of Nigerian Investment Promotion Commission Act of 1995 marked the watershed in the annals of investment legislation in Nigeria. Particularly, the Act introduced measures targeted at making Nigeria business landscape investment-friendly and far-reaching changes were made in 'freeing up foreign investments in Nigeria by allowing for alien participation in virtually all enterprises. Importantly, the Act makes provision for investment protection assurances.<sup>594</sup>

Section 25 of the Act specifically provides for guarantees against expropriation. It states that:

Subject to subsections (2) and (3) of this section-

- no enterprise shall be nationalized or expropriated by any Government of the Federation; and
- no person who owns, whether wholly or in part, the capital of any enterprise shall be compelled by law to surrender his interest in the capital to any other person.

Section 24 states that there shall be no acquisition of an enterprise to which the Act applies by the Federal Government, unless the acquisition is in the national interest or for a public purpose and under a law which makes provision for-

- payment of fair and adequate compensation; and
- a right of access to the courts for the determination of the investor's interest or right and the amount of compensation to which he is entitled.

Any compensation payable shall be paid without undue delay, and authorisation for its repatriation in convertible currency shall where applicable, be issued.<sup>595</sup>

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<sup>593</sup> Ibid.

<sup>594</sup> See: [www.nipc.gov.ng/about.html-last](http://www.nipc.gov.ng/about.html-last) visited: April 16, 2012.

<sup>595</sup> See the Nigerian Investment Promotion Commission Act, 1995.

The Act also gives guarantees for transfer of capital, profits and dividends by providing that ‘a foreign investor in an enterprise to which this Act applies, shall be guaranteed unconditional transferability of funds through an authorised dealer, in freely convertible currency, of—

- dividends or profits (net of taxes) attributable to the investment;
- payments in respect of loan servicing where a foreign loan has been obtained; and
- the remittance of proceeds (net of all taxes), and other obligations in the event of a sale or liquidation of the enterprise or any interest attributable to the investment.<sup>596</sup>

### **6.3.2 Foreign exchange regime**

In addition to the provision guaranteeing transfer of capital, profits and dividends by foreign investors under the Nigerian Investment Promotion Act, there also exist the Foreign Exchange (Monitoring & Miscellaneous Provisions) Act No. 17 of 1995 (“Forex Act”),<sup>597</sup> which was enacted to further deregulate and liberalize Nigeria’s foreign exchange regime which was one main hindrance to inflow of foreign investment into Nigeria.

Under the provisions of the Act, the Nigerian Naira may be freely exchanged with foreign currencies provided that such transaction is properly documented and does not relate to illegal activities.<sup>598</sup>

By these legislation, the issues of having unrestricted access to foreign exchange needed to facilitate the execution of the project and the transfer abroad or repatriation of the investors’ profit or the amount required to meet financial obligations related to the infrastructure projects seem settled under the Nigeria’s investment legal infrastructure.

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<sup>596</sup> Ibid., section 24.

<sup>597</sup> Now Cap F. 34 Laws of the Federation of Nigeria 2004; it was initially enacted as No.17 of 1995 but now included in the revised laws of 2004 under Chapter F34.

<sup>598</sup> Forex Act, Section 10.

### 6.3.3 Property law

The desirability for the property law of the host country to be reflective of acceptable global standards cannot be over-emphasized. Measuring up to the international standards will entail ‘adequate provisions for the ownership and the use of land and buildings, as well as movable and intangible property’ and ensuring that the private investor has the power to buy, sell, transfer and licence the use of property whenever he deem fit and appropriate.<sup>599</sup>

Thus, the provisions in the host state’s constitution which protect property rights are crucial factors which encourage the flow of private capital into many nations of the world. In other words, the necessity for a secured land tenure system is very critical.<sup>600</sup> A private investor in infrastructure sector or a concessionaire expects that the ownership of the land can be clearly and unequivocally established through proper registration procedures which confer legal title on him and the ownership of the land will never be in dispute.<sup>601</sup> Where this is not so, a private investor will be reluctant in investing in such projects if the laws of the particular host state are unclear and the means of ascertaining rightful ownership is not adequate.<sup>602</sup>

As a necessary corollary, it is also important to make provisions for effective mechanism for the enforcement of the property and ‘possessory’ rights granted to a private investor or concessionaire against third parties’ violations.<sup>603</sup>

Under the Nigerian the Land Use Act of 1978, ownership of all land in a federating state vests in the Governor of the federating who is empowered to allocate land for development for a lease of 99 years. The implication of this is that ownership of land is in reality a “right of occupancy” which is recognized through a certificate of occupancy. This right of occupancy is transferable, with the Governor's consent. By this, all transactions touching on the property, including sales, leases, mortgages and other charges, are subject to complex requirements and processes including the

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<sup>599</sup> UNCITRAL Legislative Guide 190.

<sup>600</sup> Ibid.

<sup>601</sup> Ibid.

<sup>602</sup> Ibid.

<sup>603</sup> Ibid.

consent of the State Governor, which adds a significant amount of time to the registration process.<sup>604</sup>

#### **6.3.4 Secured credit transactions law**

A sound framework for secured lending is a critical pre-requisite for a modern economy that is highly leveraged. Similarly, a sound collateral system provides information for lenders about prospective debtors regarding the existence of prior interests in collateral and gives creditors who register an assurance of priority in the collateral, thereby mitigating ‘risk to lenders and facilitating access to credit’.<sup>605</sup>

Typically by design, information asymmetries about collateral are eliminated by collateral registries which implicates in reduction of the risk of secured lending by movables of all classes<sup>606</sup> including those not available in traditional systems. Collateral registries therefore, promote financial deepening by making effective uses of classes of collateral in existence and creating new classes of collateral to be used by lenders.<sup>607</sup>

Generally, and as pointed out by the Guide, in some jurisdictions, security interests can be created in almost all kinds of assets including intellectual property, while in others, security interests can only be created in a limited category of assets like immovable assets such as land and buildings.<sup>608</sup> Again, in some nations, security interests can also be created over future assets<sup>609</sup> and security may also be taken over all of a company’s assets, while allowing the company to continue to deal with those assets in the ordinary course of business. Similarly, some legal systems may provide for a non-possessory security interest, the implication of which is that the security can be taken over assets without taking actual possession of the assets and in some, regarding those assets which are not subject to a title registration, security may be taken by physical possession or constructive possession.<sup>610</sup>

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<sup>604</sup> Ibid. 27-8.

<sup>605</sup> Djankov S, McLiesh C & Shleifer A (2007) 9.

<sup>606</sup> The use by lenders of movable collateral as security for a loan depends on the country. In Nigeria, the use of movable as a collateral is not allowed.

<sup>607</sup> Djankov et al (n 605 above).

<sup>608</sup> Ibid.

<sup>609</sup> That is, assets that do not yet exist.

<sup>610</sup> UNCITRAL Legislative Guide 191-2.

In Nigeria, the collateral infrastructure for secured lending only consists of the mortgage registry. Loans are often guaranteed by real estate, either the home of the owners, or the company's warehouse or offices. Mortgage financing is therefore normally an important component of financial infrastructure and a critical element of the lending infrastructure.<sup>611</sup>

As mentioned under the property law caption above, in Nigeria, by the provisions of the Land Use Act, ownership of all land in a federating state vests in the Governor of the federating state who is empowered to allocate land for development for a lease of 99 years. The implication of this is that ownership of land is in reality a “right of occupancy” which is recognized through a certificate of occupancy. This right of occupancy is transferable, with the Governor's consent. The reality is the fact that in all transactions regarding the property in Nigeria, including sales, leases, mortgages and other charges, such dealings are subject to complex requirements and processes including the consent of the State Governor, which adds a significant amount of time to the registration process.<sup>612</sup>

Additionally, the Nigerian collateral system is characterized by a complex and expensive system of registration charges, which cumulatively are among the highest in the world. This is also further complicated by the existence of an equally complex system of waivers, derogations and special deals so that the full impact of the charges may be mitigated for the privileged few.<sup>613</sup>

Nigeria is believed to be one of the most expensive nations for property registration globally and this is underscored by a World Bank survey<sup>614</sup> in which Nigeria is ranked number 180<sup>615</sup> for property registration with ‘13 procedures, duration of 82 days and costs of 21.9 percent of property value. The total fees are estimated at 20–30 percent of the mortgage, although developers and others can negotiate waivers for particular developments or even defer payments’.<sup>616</sup>

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<sup>611</sup> Ibid. 27.

<sup>612</sup> Ibid. 27-8.

<sup>613</sup> Ibid. 28.

<sup>614</sup> The 2012 World Bank Doing Business Report.

<sup>615</sup> Out of 181 comparator countries.

<sup>616</sup> World Bank Making finance work for Nigeria (2009) 28.

As earlier on pointed out, in line with the prevailing Nigeria's secured credit transactions law, mortgages must be registered at the lands registry of the state where the property is registered and, in the case of a corporate borrower, also at the Corporate Affairs Commission's registry.<sup>617</sup> Unfortunately, the land registries are not interconnected with the registry at the Corporate Affairs Commission, and conducting searches for details of security given is unreliable for many reasons. Consequently, there is a widespread practice of taking but not registering security over land (mortgages), especially for short-term borrowing. This practice leaves lenders completely unprotected from a legal viewpoint, but it has some "moral" value as the borrower has in fact agreed to give the real estate as security. As further argued by a group of researchers,<sup>618</sup> one reason for this common practice is that the cost of registration can easily negate any potential profit on the loan, or alternatively, if the cost is passed to the borrower, the cost of the loan would then be prohibitive (even exceeding informal market rates). Typically, mortgages are only registered prior to legal action being required. Consequently, information held by land registries is often inaccurate and of little use to credit providers seeking to establish the credit-worthiness of potential borrowers. Given these complications, access to finance for infrastructure development is further contracted even if infrastructure development investors have real estate to offer as collateral.<sup>619</sup> Thus, in most cases, the information held by the land registries is inaccurate and serves no useful purposes.<sup>620</sup>

Given the above scenario, mortgage registration in Nigeria makes it difficult for investors to secure loans.<sup>621</sup> Thus, the collateral requirements coupled with the costs of property poses a serious hindrance to access to finance in Nigeria especially finance for infrastructure development in Nigeria.<sup>622</sup>

As noted earlier on in the study, in Nigeria, industry-specific regulations require that loans should be collateralized while also limiting the kinds of collateral acceptable.

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<sup>617</sup> Corporate Affairs Commission is the agency in charge of registering and regulating the formation and management of companies in Nigeria.

<sup>618</sup> World Bank Making finance work for Nigeria op.cit.

<sup>619</sup> Ibid. 29.

<sup>620</sup> Ibid. 59.

<sup>621</sup> Ibid. 60.

<sup>622</sup> Ibid. 61.

Hence, there is urgent need for the collateral legal framework and the registries (especially for movables such as equipment) be modernize to promote their use in raising capital.<sup>623</sup>

Thus, to modernize the credit and collateral system and widen access to finance in Nigeria, the laws should be reviewed and where appropriate, reform the legislation and regulations on collateral and registries in the medium term. The related legislation and regulations should be reformed to embrace the recent developments in the global credit information system and market, widen ‘the definition of acceptable guarantees, and improve use of debtor credit history’.<sup>624</sup>

Reforming the collateral infrastructure entails putting in place ‘a sound legal and regulatory framework’ to support the collateral system and the establishment ‘of a unified collateral registry system’ in Nigeria. The legal framework which is part of the collateral infrastructure should necessarily make provision ‘for the creation, perfection, and enforcement of security interests.’ Particular ‘these entail:

- creation of a security interest by simple agreement of the parties (‘creation’);
- establishment of priority of a security interest against third parties (commonly known as ‘perfection’);
- use of notice registration (also known as ‘filing’) and creation of a notice registration system; and
- simple and expeditious enforcement of a security interest upon default by the debtor (‘enforcement’).<sup>625</sup>

In the area of enforcement, in some countries, enforcement of the security interests can be done without involving the court, while in some, it may only be enforced through the judicial institutions.<sup>626</sup> As observed in Doing Business, ‘for security interests to be cost-effective, it requires quick and inexpensive enforcement in case of default’. The need for efficient enforcement procedures is a critical imperative for

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<sup>623</sup> Ibid. 67.

<sup>624</sup> Ibid..

<sup>625</sup> World Bank (2009) ‘Financial Infrastructure’ 18.

<sup>626</sup> World Bank Making finance work for Nigeria 192.

movable property, which by its nature, depreciates over time. The implication as it were, is that the efficiency of enforcement can influence the accessibility and terms of credit. So, it has been suggested that there should be legal provision allowing the parties to a security agreement to agree to some form of out-of-court enforcement.<sup>627</sup>

### **6.3.5 Insolvency law, practice and creditor rights**

The enormity of the challenges besetting insolvency system in Nigeria must be appreciated, and without gain-saying, the legal infrastructure for insolvency system and practice in Nigeria needs a sweeping reforms and modernization.<sup>628</sup>

As rightly observed in a study,<sup>629</sup> Nigeria has a relatively developed legal and judicial system, however, the legal framework for the Nigeria's financial sector 'remains antiquated and unsophisticated'.<sup>630</sup> As pointed out in the study:

the legal framework has not been updated for many years and does not provide adequate foundation for a modern financial system. It suffers from a number of weaknesses affecting many developing countries, such as antiquated concepts, absence of laws for new developments, non-consolidation of laws and overlap in laws.<sup>631</sup>

Besides, enforcement is also very problematic!<sup>632</sup>

In Nigeria, banks and other financial institutions prefer immovable assets as collateral than other forms of security interests over movable assets. Though the Nigeria's legal framework for credit and creditor rights makes room for different kinds of security mechanisms, the apex bank, the CBN, through its regulatory oversight powers, outrightly prohibits unsecured lending practices by financial institutions, and the security over immovable assets still remains the preferred option. Regrettably, registration of charges over immovable usually suffers delays due to the statutory requirement that makes it mandatory to obtain the Governor's consent to legally grant a mortgage.<sup>633</sup>

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<sup>627</sup> Ibid. 44.

<sup>628</sup> Ibid.

<sup>629</sup> Ibid.

<sup>630</sup> Ibid. 152.

<sup>631</sup> Ibid.

<sup>632</sup> Ibid.

<sup>633</sup> Ibid.

Similarly, the law requires that securities over immovable assets must be registered at Lands Registry of the particular state of the federation within which the property of the collateralized immovable asset registered and where it involves a company, also at the Corporate Affairs Commission's Registry. Unfortunately, the states' Lands Registries are not linked with the Registry at the Corporate Affairs Commission, hence, searches conducted for details of a given security by a borrower is not reliable for obvious reasons. Thus, the prohibitive costs of registration of a security are a critical 'disincentive to accurate registration'.<sup>634</sup>

Also, it must be noted that lenders generally, including banks, rely on equitable charge 'whereby possession of the title deeds secures the lender, usually in connivance with the borrower to avoid the charges associated with the registration of the security' as against legal charge which requires registration. In few instances 'where charges are registered, understating the sums involved is common-place with the lender relying on its ability to up-stamp the security before having to rely on it in court'.<sup>635</sup>

Thus, the legal environment for creditor rights in Nigeria is weak in very many areas especially the aspect of 'laws relating to insolvency and corporate re-organization'.<sup>636</sup> Generally, Nigeria's legal framework for credit and creditor rights is inefficient and this inefficiency is characterized by 'antiquated and unsophisticated insolvency legislation, jurisdictional challenges and an inefficient judicial system, and a weak secured transactions regime'.<sup>637</sup> Thus, modernization of the legal framework will enhance 'commercial confidence and predictability by enabling markets to more accurately price, manage and resolve default risk'.<sup>638</sup> Bank and other financial institutions rely 'on effective creditor rights to reduce deterioration of asset values' and improve access to credit.<sup>639</sup>

These systems are crucial in generating and attracting domestic and foreign investment which in turn rev up the economic system for growth and development. In

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<sup>634</sup> Ibid.

<sup>635</sup> Ibid.

<sup>636</sup> Ibid.

<sup>637</sup> Ibid.

<sup>638</sup> Ibid.

<sup>639</sup> Ibid.

the area of insolvency, ‘where businesses are non-viable, enforcement and liquidation procedures offer a means to recycle assets in the local economy to more efficient market users’.<sup>640</sup> Another benefit of having these kinds of systems in place is that they help to maintain ‘checks and balances’ in relationships that are commercial-oriented ‘through incentives that’ give boost to ‘responsible corporate behaviour and governance and through disincentives that penalize management and owners’ that are financially indisciplined or irresponsible.<sup>641</sup>

So the argument is that Nigeria needs the insolvency and security enforcement mechanisms to transform into ‘a modern, credit-based economy’. As noted earlier on in this chapter, the insolvency and security enforcement systems need to be supported by a strong legal infrastructure that will provide for creation of security interests in all kinds of assets-‘movable and immovable, tangible and intangible, present and future, and on a global basis’- by different kinds of borrowers in favour of lenders and other credit providers.<sup>642</sup>

Effectiveness of the appropriate legal infrastructure will be hinged ‘upon straightforward, inexpensive security registration mechanisms, the predictable, swift and affordable enforcement of secured claims without the requirement for insolvency procedures; and a sound insolvency system that provides an orderly, efficient and equitable debt collection mechanism for failed or failing enterprises’.<sup>643</sup> With these legal fundamentals in place, the investing public will be able to have a wider access to credit for investment on terms that are reasonable and favourable, so lenders cum providers of credit ‘are able to reach informed credit decisions based on more accurate assessments of the risk inherent in the underlying transaction, and financial discipline is generally instilled in market participants’.<sup>644</sup>

Again, as observed above, Nigeria’s ‘insolvency and security enforcement systems are considered inefficient, time-consuming, expensive and discriminately favourable to the debtor’. Added to this is the fact that the Nigeria’s credit secured laws lack the

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<sup>640</sup> Ibid. 153.

<sup>641</sup> Ibid.

<sup>642</sup> Ibid.

<sup>643</sup> Ibid.

<sup>644</sup> Ibid.

mechanism to ‘prevent the dismemberment of the debtor’s estate’ and the lack ‘of effective provisions for reorganization proceedings in Nigeria is indicative of the deficiency of the legal framework’.<sup>645</sup>

Writing about the role of the insolvency system in an emerging economy like Nigeria, the World Bank study<sup>646</sup> provides an insight into its importance as follows:

[I]nsolvency systems, like general systems for debt recovery and enforcement, stabilize commercial relationships by enabling market participants to more accurately price, manage and control risks of default and corporate failure. Insolvency procedures offer a means for collective resolutions when the threat of financial failure raises questions about that enterprise’s viability and, therefore, its ability to continue into the future. Consequently, an insolvency system plays a vital role in maintaining commercial and market confidence and in stabilizing the financial system, serving as a disciplinary mechanism for both the financial and corporate sectors. Effective insolvency processes encourage prudent lending and a sound credit culture by:

- establishing mechanisms for the financial restructuring of firms whose going concern value exceeds their liquidation value, thus preserving both value and employment;
- providing an orderly exit mechanism for failed enterprises;
- ending the unproductive use of potentially valuable business assets and transferring them through a liquidation process to more efficient market participants;
- providing a final and equitable debt collection mechanism for creditors;
- improving the enforcement of creditor rights to expand credit flows; and
- providing a transparent mechanism for the exercise of sanctions against those guilty of wrongful trading and other insolvency related offences.

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<sup>645</sup> Ibid.

<sup>646</sup> Ibid. 153-4.

However, the challenges confronting the Nigeria's insolvency system which is intrinsically linked to the credit information system are summed up in the same study<sup>647</sup> thus:

[T]here is widespread disregard for the effectiveness of the insolvency system in Nigeria. The legislation is so old and poorly written that it is almost ineffectual in terms of sanctions against the directors of failed companies. There are no provisions for the disqualification of directors for simple mismanagement or personal liability for wrongful trading. The implication of this is that directors of companies faced with the threat of insolvency proceedings being able to transfer such assets as remain to other entities contrary to the interests of creditors. There is no system of credit referencing in Nigeria. This is an obstacle to the development of Nigeria as a credit-based society. Most other societies that have emerged into fully functioning market economies have benefited from a growth in consumer credit which is only possible with systems that permit providers of credit to manage the risk involved. This will frequently involve systems of establishing national identity, such as passports and national identity cards.

Financial institutions are required to rely on collateral for lending as unsecured lending by Nigerian banks is not permitted by statute.<sup>648</sup> Hence, in Nigeria, financial institutions only advance loans or overdrafts to borrowers against the security of real estate, regardless of the difficulties encountered in its realization. As rightly observed by a study, apart from the companies' charges register with the Corporate Affairs Commission, 'there is neither omnibus law providing for the registry of immovable assets in Nigeria nor any dependable method of establishing what, if any, charges exist over such assets'. Though 'each state and the federal government are expected to have their own land registries for the registration of all interests and charges in respect of land, the absence of a national land registry system is a serious' defect.<sup>649</sup>

One other serious defect observable in the entire process 'has to do with the stamp duty and filing fees for registration of mortgages and the statutory requirement to

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<sup>647</sup> Ibid. 154-5.

<sup>648</sup> See sections 17 (1) and 20 (1)(b) of The Banks and Other Financial Institutions Act, Law of the Federation of Nigeria, 2004.

<sup>649</sup> World Bank, Making finance work in Nigeria 155.

obtain ‘Governor’s Consent’ to any transaction including the taking of security with its attendant considerable costs and delays’. Consequently, ‘there is widespread practice of taking but not registering security over land, especially where borrowing was intended to be relatively short term, in order to avoid the costs of registration. This results in land registries being inaccurate and of little use to lenders seeking to establish the credit-worthiness of potential borrowers’.<sup>650</sup>

Another challenge observed is that the process of ‘enforcement of security and of pursuing unsecured claims in Nigeria is expensive, time-consuming and prone to delay tactics’.<sup>651</sup> Typically, foreclosure and receivership are ‘met or even anticipated by litigation by the debtor aimed at preventing the exercise of the security’. This problem is further underscored in the study<sup>652</sup> when it commented that:

[P]ractices that would almost certainly be deemed an abuse of process in similar jurisdictions are tolerated by the Nigerian courts. There have been a number of cases in which courts have shown what bankers feel is a disproportionate sympathy for the borrowers and a variety of delay tactics are adopted by the legal profession regardless of the merits of the defence. In the course of such delays, any equity in the assets securing the borrowing is depleted. As a result, both secured and unsecured creditors resort to enforcement mechanisms not requiring the supervision of administrative or judicial authorities. Undoubtedly the inefficiency in recovery of secured lending adds to the cost of lending across the market.

Moreover, the antiquated, fragmented laws relating to security over movables have failed to offer Nigerian businesses effective means of raising capital on the security of these assets. For example, the governing law for bill of sale in Nigeria is the United Kingdom’s Bills of Sale Acts 1878 and 1882 as amended by the United Kingdom’s Bills of Sale Acts 1890 and 1891. These laws apply to Nigeria as a statute of general application. Obviously, these laws are outdated and inefficiently out-of-touch with the contemporary realities.<sup>653</sup> Aside the outlandish procedure for registration, the main weakness has to do with the documentary requirements. Consequently, ‘the practice

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<sup>650</sup> Ibid.

<sup>651</sup> Ibid.

<sup>652</sup> Ibid.

<sup>653</sup> Ibid. 156.

of asset-based lending utilizing movable business assets as security has not yet developed in Nigeria and there is a lack of evolution in more sophisticated financial transactions such as securitizations and derivative transactions to hedge interest rate and currency risk'.<sup>654</sup>

Though there exist a system of registering floating charges over corporate assets at the Corporate Affairs Commission, the age-long 'practice of understating the value of such security for the purpose of avoiding or delaying the payment of the filing fees involved, renders such records of little value'.<sup>655</sup> Against the grains of the laws, the Corporate Affairs Commission still allows late registration of such security.<sup>656</sup>

Also commenting on the problems of the insolvency practice in Nigeria, the study rightly observed that:<sup>657</sup>

[A]lthough the Companies and Allied Matters Act sets out the priority of claims, secured creditors prefer not to participate in the liquidation process but to enforce their security through out-of-court procedures. A creditor secured by a fixed legal charge generally has the right to foreclose on the secured asset or appoint a receiver to manage any interest in the secured property. Banks exercise these extra-judicial powers instead of exploring opportunities for rehabilitation or revival of viable businesses.

Regarding the landscape of corporate insolvency, the legal framework too is antiquated and cries for urgent re-jigging. The laws governing winding up of companies in Nigeria is the Companies and Allied Matters Act (CAMA) was fashioned after the Companies' Act of 1948 in the United Kingdom which account for the ineffectiveness of the present legal regime for corporate insolvency in Nigeria.<sup>658</sup>

It is also important to note that 'the insolvency regime for individuals and partnerships is based on the Bankruptcy Act which dates back to the 1880s. Several aspects of companies' insolvency legislation, such as the rules pertaining to fraudulent

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<sup>654</sup> Ibid.

<sup>655</sup> Ibid.

<sup>656</sup> Ibid.

<sup>657</sup> Ibid.

<sup>658</sup> Ibid.

trading and the agreement of creditors' claims, are imputed to the companies' legislation from the bankruptcy laws'.<sup>659</sup>

This study cannot but agree with the World Bank study that 'the relatively low experience of many bankers, lawyers and even judges in insolvency proceedings under companies' legislation in Nigeria accounts for 'the low regard that the Nigerian business and commercial community has for the usefulness of the present system'.<sup>660</sup>

Commenting further the World Bank study<sup>661</sup> observes that from a creditor's perspective, the insolvency law-

does not offer any credible threat to a recalcitrant debtor. The delays that are possible through the court-driven procedures deter creditors from using them. It is commonplace for debtors to challenge the creditor's notice of demand or seek injunctive relief against the creditor on spurious grounds such as abuse of human rights. Also as an indicator of the attitude and usefulness of the insolvency process to creditors, it appears that the Nigerian Revenue rarely threaten insolvency proceedings against non-payers.

Also, the applicable insolvency regime in Nigeria 'does not incorporate any modern or efficient means by which a financially troubled debtor, individual, partnership or limited liability company can seek to rearrange their affairs and preserve a potentially profitable entity. The Scheme of Arrangement procedure in the case of companies is cumbersome, costly and .....virtually unheard of' in Nigeria.<sup>662</sup>

It has also been observed that insolvency proceedings do not seek to maximize the value of the debtor's estate whether commenced by the debtor or by any one of its creditors. As a result, creditors rarely get involved in insolvency process or in the creditors' committee. And mortgagees and secured creditors are unable to enforce their security once insolvency proceedings have been commenced. The fall-out of this is that the secured property is left to be sold by the liquidators, in most cases, to themselves. Besides, 'the reorganization of debts between a financially troubled

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<sup>659</sup> Ibid.

<sup>660</sup> Ibid.

<sup>661</sup> Ibid. 157.

<sup>662</sup> Ibid.

debtor and its creditors, the only procedure that has the effect of preserving a business is receivership'.<sup>663</sup>

The study also observed that 'although there are provisions permitting a liquidator to set aside various transactions detrimental to the creditors, there is little evidence of these provisions ever being used. As a result, asset stripping of financially troubled companies in Nigeria is common-place'.<sup>664</sup>

Another issue with the Nigeria's insolvency laws is that they 'contain no sufficient sanctions against such directors'<sup>665</sup> which would impose financial liability on these directors to compensate the creditors affected by their decision to continue trading'.<sup>666</sup>

The provisions of Nigeria's insolvency law do not provide sufficient motivation for a debtor-company or its directors to prefer reorganization proceedings. This tends to discourage good corporate governance practice.<sup>667</sup>

Obviously, the insolvency landscape is devoid of the pre-qualification requirements for admitting professionals as practitioners in insolvency industry. In other words, the insolvency practice is not regulated and this has contributed to the challenges facing the insolvency industry in Nigeria. For example, 'there is no requirement for insolvency practitioners to be qualified, licensed, bonded or regulated'.<sup>668</sup>

### **6.3.6 Contract law**

Generally, contract law can be described as that branch of the law which determines the circumstances in which a promise should be legally binding on the person or persons making it. It is an agreement which is intended to have legal consequences.

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<sup>663</sup> Ibid.

<sup>664</sup> Ibid. 158.

<sup>665</sup> Who contributed to the company's insolvent liquidation.

<sup>666</sup> Making finance work in Nigeria 158.

<sup>667</sup> Ibid.

<sup>668</sup> Ibid. It should be noted that the insolvency as a profession is designing a professional body targeted at enhancing the 'skills, resources and reputation of the insolvency profession of Nigeria'. The World Bank study-Making finance work in Nigeria-noted that substantial investment and support will be needed by introducing minimum standards to enhance professional competence in the insolvency practice and industry in Nigeria.

Thus, the rules of law governing contracts play a critical role in the infrastructure projects related contracts involving private sector. For example, a private investor or concessionaire involved in infrastructure development project enters into contract agreements of different shades and characters with sub-contractors, suppliers and other private parties like the lenders.<sup>669</sup>

An adequate domestic contract law would allow for flexibility by recognizing the concept of freedom of contract or parties' autonomy and embrace the essential components of an adequate contract law such as judicial enforceability of contract obligations<sup>670</sup> and adequate remedies for breach of contract. So it behoves the host state to create a legal system that will be favourably disposed to enhancing the private sector investment in infrastructure in infrastructure projects by facilitating contractual agreements needed for successful implementation of the projects.<sup>671</sup>

In the same vein, it is instructive to note that part of an adequate legal infrastructure is to create a legal environment for the application of rules of conflict of laws of private international law to take care of contracts entered into by the private parties in infrastructure development which involve foreign elements.<sup>672</sup>

As part of the imperative for an adequate legal infrastructure, legal certainty in the area of international sales contract is also crucial for transactions involving importation of large quantities of consumable supplies and machineries. Thus, the legal infrastructure of a host country must provide for rules that are specifically adapted to international sales contract.<sup>673</sup>

The enforcement of contracts is very problematic in Nigeria. The country is ranked amongst the nations 'with the least efficient systems of enforcing contracts and settlement of commercial disputes'.<sup>674</sup> According to the Vision Document, it takes an

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<sup>669</sup> UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects 197.

<sup>670</sup> The enforcement of contracts is very problematic in Nigeria. In the World Bank Survey, Doing Business, Nigeria is ranked number 97 with '40 procedures, minimum duration of 457 days and minimum costs of 30 percent of claims value.

<sup>671</sup> Ibid.

<sup>672</sup> Ibid.

<sup>673</sup> UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects 198.

<sup>674</sup> Nigeria Vision 20:2020 17.

average of fifty months to resolve contract disputes; 42 months to resolve a land or property matter. Without doubt the enforcement of court decisions strongly affects the quality of a judicial system. When there are delays in settlement of disputes, litigants are forced to resort to self help in settling such disputes and this will be implicated in erosion of the public confidence in a country's judiciary.<sup>675</sup>

According to the World Bank Survey<sup>676</sup> in enforcement of contract Nigeria is ranked number 97.<sup>677</sup> According to the survey, it takes 457 days to prosecute a case at the cost of 32 per cent of the total claims involved and 40 procedures to enforce a contract. This estimated days start from filing and service, to trial and judgment and the enforcement of the judgment, while the cost covers the counsel's fee, cost of instituting the action and the enforcement cost. And in all, it will involve forty procedures from filing and service to enforcement of judgments.<sup>678</sup> The implication of this is poor global perception and ranking of Nigeria 133 out of 183 economies in 2012 in 'ease of doing business'.<sup>679</sup>

#### **6.4 Judicial system reforms**

The view that legal institutions are critical to the process of economic development still holds true today. In all nations of the world, the conclusion is that 'a complex and costly judicial system is often prone to abuse and limits citizen's accessibility to justice, particularly the poor, while a simplified judicial system that dispenses justice timely, reliably and is affordable, increases investors confidence in an economy'.<sup>680</sup> This underscores the critical role of the judicial system in creating the enabling operating environment for inflow of investment into the economy.<sup>681</sup>

Misunderstanding and disputes are inevitable between parties involved in a business transaction. So, the mechanism for dispute resolution is of critical importance in the legal and judicial systems of a country especially if one of the parties to the

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<sup>675</sup> Ibid.

<sup>676</sup> Doing Business, 2012.

<sup>677</sup> Out of 181 comparator countries and as against 98 in 2011.

<sup>678</sup> Ease of doing business in Nigeria, Doing Business Data for Nigeria, World Bank, 2012 1-last assessed on 24 May 2012 at [www.doingbusiness.org/data/exploreeconomies/Nigeria/](http://www.doingbusiness.org/data/exploreeconomies/Nigeria/).

<sup>679</sup> Ibid.

<sup>680</sup> Nigeria Vision 20:2020 The First National Implementation Plan (2010-2013) Volume III: Sectoral Plans and Programmes, May 2010 16.

<sup>681</sup> Ibid.

commercial dispute is a foreign investor. Generally, private investors will be encouraged to engage their capital in infrastructure projects in a country where there is evidence that if any disputes arise out of the legal agreements forming part of the infrastructure project transaction, such disputes will be resolved fairly and efficiently.<sup>682</sup>

However, a key issue for investors, both domestic and foreign, is the ability of courts to deliver commercial justice impartially, promptly and consistently. On these matters, Nigeria's record remains poor. A recent comparative survey—the World Bank's World Business Environment Survey (WBES, 2000)—found that over 60% of investors were dissatisfied with respect to the fairness and impartiality, honesty, absence of corruption, and consistency of judgements. Ninety percent held negative opinions regarding the speed of judicial system. Among Nigeria's main competitors for FDI attraction in the continent, only Kenya seemed worse in all counts.<sup>683</sup>

Thus beside the reform of the laws, to successfully attract and secure the needed long-term private capital for infrastructure financing, it is needful to make the judicial process and institutions more responsive and effective in enforcing the rules and agreements all in a bid to inspire confidence of investors both within and without. Lack of judicial infrastructure hinders the enforcement of agreements and this serves as a disincentive to would-be investors in PPP transactions. There is therefore need for strict enforcement of agreements so as to engender confidence of investors, local and foreign.<sup>684</sup>

In other words, an independent, well-functioning judiciary is vital. In enforcing laws, the courts must be strengthened to interpret the laws, the antiquated court rules and procedures must be updated and the independence, competence and integrity of judicial personnel must be guaranteed. In strengthening the law, all the related laws must be harmonized and promulgated into law. This will improve the delivery of judicial services and protect private rights and sanctity of contractual obligations.<sup>685</sup>

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<sup>682</sup> UNCITRAL Legislative Guide 173.

<sup>683</sup> UNCTAD 'Investment Policy Review Nigeria' (2009) 4.

<sup>684</sup> Ibid.

<sup>685</sup> Charlier F & N'Cho-Ogie C (2009).

Generally, the Nigeria's legal system is characterized by 'obsolete law, complex process, high cost of legal services and the lengthy legal process; the court system in particular is 'demonized' by heavy caseloads, inexperienced judicial officers and poor court's infrastructure, lack of information and communication technology penetration and usage in record keeping and delivery of justice, impartiality, manual operations such as the recording processes that 'slow down justice...and attitudinal and ethical issues that encourage unnecessary postponements, adjournments and delays..' <sup>686</sup>

Also, the Nigerian courts are typically 'under-resourced and overburdened and this affects their ability to adequately serve the financial community'. Hence, the court system is characterized by substantial delays in all litigations and serves no use in preserving what little asset value remains for creditors. As observed in a report, <sup>687</sup> this failure 'to preserve what little asset value remain for creditors' and the predisposition 'of the courts to tolerate extensive delay tactics, is a major deterrent to the use of the court system in Nigeria. <sup>688</sup>

And as pointed out above in this study, Nigeria is ranked amongst the nations 'with the least efficient systems of enforcing contracts and settlement of commercial disputes'. <sup>689</sup> So, in enforcing contracts, Nigeria is ranked 97 out 181 comparator countries in 2012 as against 98 in 2011. According to the survey, it takes 457 days to prosecute a case at the cost of 32 per cent of the total claims involved and forty procedures to enforce a contract. This estimated days start from filing and service, to trial and judgment and the enforcement of the judgment, while the cost covers the counsel's fee, cost of instituting the action and the enforcement cost. And in all, it will involve forty procedures from filing and service to enforcement of judgments. <sup>690</sup> The implication of this is poor global perception and ranking of Nigeria 133 out of 183 economies in 2012 in 'ease of doing business'. <sup>691</sup> Also, it takes a minimum of 42 months to resolve a land or property matter.

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<sup>686</sup> Nigeria Vision 20:2020 18.

<sup>687</sup> World Bank Making Finance Work for Nigeria 158.

<sup>688</sup> Ibid.

<sup>689</sup> Nigeria Vision 20:2020 17.

<sup>690</sup> Ease of doing business in Nigeria, Doing Business Data for Nigeria, World Bank, 2012 1-last assessed on 24 May 2012 at [www.doingbusiness.org/data/exploreeconomies/Nigeria/](http://www.doingbusiness.org/data/exploreeconomies/Nigeria/).

<sup>691</sup> Ibid.

Without doubt, the enforcement of court decisions strongly affects the quality of a judicial system. When there are delays in settlement of disputes, litigants are forced to resort to self help in settling such disputes and this will be implicated in erosion of the public confidence in a country's judiciary.<sup>692</sup>

According to the World Bank survey, Doing Business,<sup>693</sup> in the area of resolving insolvency, Nigeria is ranked in a distant position of 98 in 2012 as against 105 in 2011. Using indicators like time, cost and recovery rate, in Nigeria, it takes minimum of two years to resolve insolvency matter; cost 22 per cent of the value of the estate and a recovery rate of 28.2 cents on the dollar.<sup>694</sup> This may partly explains the reluctance of foreign investors to invest in the real sector of the Nigeria economy, and it is this sector that creates reasonable quantum number of jobs for the teeming population of the unemployed youth in Nigeria.

Hence, the concern about the Nigerian judicial system's inability to deal with the dispute resolutions as provided for in the contracts. Nigeria's legal and judicial systems are inadequate to support the needs of the investors. There is therefore an urgent need to upgrade national laws and to further reform legal and judicial systems and institutions.<sup>695</sup>

Regarding the infrastructure concession contracts, settlement of disputes is an important element. The confidence of private sector (this includes concessionaires, financiers and contractors) will receive a boost and encourage investors to participate in the process if they are sure that disputes arising thereto would be resolved fairly and efficiently.<sup>696</sup>

So, the imperative for a progressive legal framework within the commercial law regime is therefore not misplaced. Nigeria is in dire need of legal and judicial systems that instil commercial certainty and a legal environment that facilitates flow of investment into provision of public infrastructure and services. This includes a range

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<sup>692</sup> Ibid.

<sup>693</sup> Ease of doing business in Nigeria 11.

<sup>694</sup> Ibid.

<sup>695</sup> Ibid.

<sup>696</sup> Ibid.

of legislation that supervises disputes; that protects sanctity of contract, the law and independent courts that ensure respect for commercial rights and obligations-where damages are compensatory and not punitive-mediation, arbitration and other forms of dispute resolution are used. The independence of the judiciary is guaranteed under the constitution-where no person or organ of state may interfere with the functioning of the courts.<sup>697</sup>

The good news is that Lagos State has successfully made some reforms in the state's judicial system. For an instance, in 2008, a practice direction for the management of cases on fast track was released. The objective of the Fast Track Court is to substantially reduce the time spent on litigation to a period not exceeding 8 months. Cases qualified for fast track are those in the value of 100,000,000 or more; or one or more of the parties is or are a non-resident investor in the Nigerian economy or the claim involves a mortgage transaction. This stride, without doubt, has made possible the quick and efficient resolution of some commercial disputes within the jurisdiction of Lagos State.

#### **6.4.1 Non-judicial institutions**

Globally, dispute resolutions take place in the courts; however, foreign investors prefer alternative dispute resolution mechanisms like arbitration. In a situation where the legal and judicial systems have been run down and do not offer a reliable basis for dispute resolution, protection of property rights and enforcement of contracts are at peril.

As explained above, domestic courts are usually encumbered with caseloads that 'impose a real burden on the economy, tying up the normal flow of business activities sometimes for years.'<sup>698</sup> Addressing the judicial congestions is imperative because ordinary congestion not only brings with it adverse effects on the individual business, but it also suggests the impact of delay on the business community and economy as a whole.<sup>699</sup>

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<sup>697</sup> Doing Business 2011 Making a difference for entrepreneurs, The World Bank and International Finance Corporation.

<sup>698</sup> Griffith J (1984) 'The Legal Environment of Business' John Wiley: 3.

<sup>699</sup> Ibid.

Thus, an unrestricted access to non-judicial dispute settlement mechanisms is another important prerequisite for measuring the quality and soundness of the judicial system of a country. So as a way to avoiding lengthy court trials, there is need to encourage, develop and improve the systems of alternative dispute resolution as a way to bypass the courts in Nigeria in tandem with the global practice.<sup>700</sup> In other words, part of the judicial system reforms is to make alternative dispute resolution more functional and accessible in settlement of commercial disputes. Thus, due to the problem of court congestion, many disputes are now resolved by the parties involved without resorting to the tortuous path of litigation. The use of alternative dispute settlement mechanisms are encouraged by the economies of the situation. For example, litigations are expensive to both parties involved in the dispute and normally, each party pays his or her attorney's fees, and the judgment debtor must also pay the court costs.<sup>701</sup>

Also close issues of liability, as well as the size of the awards, are frequently resolved against businesses because of their presumed ability to pay. As a result, a business often seeks to settle disputes rather than submit them to court process for decision.<sup>702</sup> However, making the arbitral awards enforceable lies at the heart of these reforms.

Again, Lagos State has established the Lagos Multi Door Court House in 2007 for settlement of disputes as against adversarial litigation that has dominated judicial space in Nigeria. According to the Lagos Multi Door Court House Practice Direction which is pursuant to section 274 of the Constitution of the Federal Republic of Nigeria 1999 as amended, it is expected to serve as alternative avenues for dispute resolution 'by providing enhanced, timely cost effective and user-friendly access to justice for would be and existing plaintiffs and defendants.'

## **6.6 Concluding remarks**

In the chapter above, the imperatives for reforms of legal infrastructure was interrogated. It argues that an appropriate and effective legal infrastructure is a critical imperative for creating an environment that promotes private investment in infrastructure and reviewing the existing infrastructure laws is critical to the

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<sup>700</sup> Ibid.

<sup>701</sup> Ibid. 31.

<sup>702</sup> Ibid.

entrenchment of private involvement in infrastructure procurement and service delivery.

This argument is underscored by the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects when it avers that the existence of an appropriate legal infrastructure is a critical imperative to creating an environment that enhances private sector investment in infrastructure sectors of the economy. The level of development of a host state's laws relevant to private sector investment in public infrastructure coupled with the stability of its legal system and how adequate are the available legal remedies for private investors are essential components of the entire spectrum of the legal infrastructure for private sector participation in public assets financing.

The chapter takes a critical look at the entire legal infrastructure of Nigerian infrastructure sector and argues that there are gaps in the related laws and that the inadequacy and ineffectiveness of laws and legal institutions are significantly responsible for the huge financing gaps in the Nigeria's infrastructure market and that with appropriate reforms of the legal infrastructure, the untapped domestic resources will be mobilized and adequate foreign capital attracted for procurement of public infrastructure and service delivery.

Thus, it further argues that by reviewing and improving the relevant laws as appropriate in those areas of immediate relevance for private investment in public infrastructure, the host state would have made a vital impact in securing a positive legal environment for attracting private capital in infrastructure development.

This is implicated in that rules are therefore very significant in defining the terms and the templates upon which financial capital flows.

The review covers some sector and industry-specific laws. Also, outside the laws with immediate relevance to private investments in public infrastructure, other supportive elements of legal infrastructure are also discussed.

The conclusion is that the Nigerian legal and judicial systems are inadequate to support the needs of investors and that private sector investments in public infrastructure development will be greatly enhanced with appropriate legal infrastructure in place. This may also encourage some transactions important to private execution of public infrastructure projects.

## CHAPTER 7

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### FINANCIAL INFRASTRUCTURE: OVERVIEW AND CHALLENGES

- 7.1 Introductory remarks
- 7.2 Explaining the term ‘financial system’
- 7.3 Types of financial markets
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    - 7.7.2.2 Payment and securities settlement
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## 7.1 Introductory remarks

One problem which this chapter seeks to resolve is the inability of Nigeria's financial system to effectively intermediate, by way of mobilizing and allocating, financial surplus for infrastructure development in the country. This failure stemmed from the apparent weakness and shallowness of the financial system which has led to stunted economic growth in all sectors of the economy infrastructure sector in particular.

So, the argument here in this chapter is that inefficient financial system is partly responsible for the huge financing gaps in the Nigeria's infrastructure market and with financial system's reforms, access to funds through a range of innovative mechanisms will be broadened to finance critical public infrastructure in Nigeria.

Thus, the question that this chapter would seek to answer is: how can the financial system reforms and development widen access to market-driven financing for private investment in public infrastructure in Nigeria?

In answering this question, it is intended in this chapter to examine how the weak and illiquid banking sector and shallow domestic capital market have failed in their roles in mobilizing and allocating financial resources and the impact on infrastructure financing in Nigeria. The chapter will also explore the role of financial system reforms and development as a means to enhance the financial sector's capacity to fund infrastructure projects development in Nigeria.

The starting point however, is to examine the meaning and nature of financial system.

## 7.2 Explaining the term 'financial system'

Financial system provides the architecture and the physical infrastructure for capital to flow.<sup>703</sup> Generally, a nation's financial system is made up 'of entities that help facilitates the flow of funds from those that have funds to invest to those who need funds to invest'.<sup>704</sup> This agrees with Walter Baghehot's description of the London

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<sup>703</sup> DBS & NEPAD (2003) Development Report: Financing Africa's Development: Enhancing the role of private finance 44

<sup>704</sup> Drake, Pamela and Frank Fabozzi (2010) The basics of finance An introduction to financial markets, business finance, and portfolio management, John Wiley & Sons, p. 13

money market in 1864: ‘It is an organization of credit, by which the capital of A, who does not want it, is transferred to B, who does want it’.<sup>705</sup>

In this regard, a well-functioning, diversified and strong financial system which would allocate resources in an efficient, competitive, sound and stable manner and also ensure that risks in the economy are well spread out among the various sectors, remains a critical imperative.<sup>706</sup>

Drake and Fabozzi present a graphic illustration of the role of financial system thus-  
[C]onsider if you had to finance a purchase of a home by rounding up enough folks willing to lend to you. This would be challenging-and a bit awkward. In addition, this would require careful planning-and lots of paperwork-to keep track of the loan contracts, and how much you must repay and to whom. And what about the folks you borrow from? How are they going to evaluate whether they should lend to you and what interest rate they should charge you for the use of their funds?<sup>707</sup>

Thus, they explain that a financial system facilitates an efficient transfer of funds by mitigating the information asymmetry problem between those with funds to invest and those needing funds.<sup>708</sup>

The importance of a financial system in a nation’s economy was further underscored by Henry Paulson, Jr.<sup>709</sup> when he said:

[A] strong financial system is vitally important-not for the Wall Street, not for bankers, but for working Americans. When our markets work, people throughout our economy benefit-Americans seeking to buy a car or buy a home, families borrowing to pay for college, innovators borrowing on the strength of a good idea for a new product or technology, and businesses financing investments that create jobs. And when our financial system is under

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<sup>705</sup> Bagehot, Walter (1978) ‘The Collected Works: Economics Essays, Volume 9, London: The Economist, cited in Spratt, S (2009) Development finance Debates, dogmas and new directions, Routledge London and New York, 2.

<sup>706</sup> World Bank Making finance work for Nigeria 123.

<sup>707</sup> Drake and Fabozzi, 13.

<sup>708</sup> Ibid.

<sup>709</sup> One time Secretary of the United States’ Department of the Treasury, March 31, 2008 cited in Drake and Fabozzi 13.

stress, millions of working Americans bear the consequences. Government has a responsibility to make sure our financial system is regulated effectively. And in this area, we can do a better job. In sum, the ultimate beneficiaries from improved financial regulations are America's workers, families, and businesses-both large and small.

Based on the descriptions enumerated above, the functions of a financial system could be summarized as follows-

- to mobilize savings and allocate credit. In playing this role, banks and other financial institutions intermediate between savers and borrowers or investors. Households with surplus funds place the funds with the banks which then lend to those who need the funds. In the same vein, asset management companies and 'contractual savings institutions also mobilize savings and allocate the funds as investments which in most cases, public capital market;<sup>710</sup>
- it provides clearing and settlement services that enable businesses and individuals to settle financial balances like cheques, credit and debit cards for small balances or large value payments between financial institutions which are usually settled centrally through the national central banks;<sup>711</sup>
- it also facilitates governments borrowing to meet wide and varied financial obligations. For example, the government may issue sovereign bonds which are bought by the financial system-both domestically and internationally-to provide the resources needed to finance government expenditure;<sup>712</sup> and lastly
- the financial system is often used by the national governments in variety of ways to regulate and superintend the economy and steer the ships of states like financial policies.<sup>713</sup>

Broadly, the financial system has five components: financial markets-where transactions take place; financial intermediaries-the facilitators of the transactions; financial products and services-which are meant to meet the wide and varied needs of

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<sup>710</sup> Spratt 3.

<sup>711</sup> Ibid.

<sup>712</sup> Ibid. 3-4.

<sup>713</sup> Ibid.

both those who have surpluses and those who have unfunded expenditure intentions;<sup>714</sup> financial infrastructure-which are to connect institutions and markets and facilitate transactions<sup>715</sup> and regulators of financial activities-those who ensure fair play within the financial system.<sup>716</sup>

Financial markets comprise: capital market, money market and insurance market. Three main functions are provided by the financial markets. First is the price discovery; second is liquidity; and the third function is reduced transactions costs.<sup>717</sup>

By price discovery, it means ‘that the interactions of buyers and sellers in the financial market determine the price of the traded asset’.<sup>718</sup> As explained by Drake and Fabozzi, equivalently, they determine the required return that participants in a financial market demand in order to buy a financial instrument.<sup>719</sup> The financial markets show how the funds available from investors are allocated among those who need the funds.<sup>720</sup>

Another major economic function of financial markets is provision of platform for investors to sell financial instruments and thereby provide liquidity for investors. In this context, liquidity is about availability of buyers and sellers to trade. Where there is no liquidity, investors would be forced to hold onto financial instruments until either: conditions arise that allow for the disposal of the financial instruments, or the issuer is by contract under obligation to pay it off.<sup>721</sup>

The third economic function is that it reduces the cost of transacting when parties want to trade a financial instrument.<sup>722</sup>

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<sup>714</sup> DBS & NEPAD Development Report (2003).

<sup>715</sup> Ibid.

<sup>716</sup> Spratt (n 18 above).

<sup>717</sup> Ibid.

<sup>718</sup> Ibid.

<sup>719</sup> Drake and Fabozzi 13

<sup>720</sup> Ibid.

<sup>721</sup> Ibid.

<sup>722</sup> Ibid.

### **7.3 Types of financial markets**

A given country's financial market can be broadly divided into: internal and external markets. The internal market consists of two parts: the domestic and foreign markets. In domestic market, issuers domiciled in the country issue securities and investors trade those securities. The foreign market is the market where securities of issuers not domiciled in the country are sold and traded.<sup>723</sup>

The other sector of a country's financial market, the external market, is the market where securities with the characteristics are traded: at issuance, the securities are offered simultaneously to investors in more than one country; and the securities are issued outside the jurisdiction of any single country. This is also referred to as the 'international market', 'the offshore market', and 'the Euromarket'.<sup>724</sup>

The internal market, which forms the fulcrum of discussion in this segment, is made up of five markets which are discussed hereunder.

#### **7.3.1 The money market**

Money market is a market for, such as bankers' acceptances, commercial paper and government bills. They are usually characterized with short maturities. The securities traded in the market are generally used to provide liquidity to companies and banks-including over night loans to meet their reserve requirements as usually determined by the central bank. Generally, by their nature, they attract low credit risk which is reflective of their short maturities and the low credit risk of the participants in the market.<sup>725</sup>

#### **7.3.2 The capital market**

The capital market is the segment of the financial market where long term financial instruments issued by corporate and government bodies are traded. 'Long term' in this regard means a financial instrument with an original maturity greater than one year and perpetual securities that do not have maturity.<sup>726</sup>

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<sup>723</sup> Ibid.

<sup>724</sup> Ibid.

<sup>725</sup> Ibid. 6.

<sup>726</sup> Ibid. 28.

The capital market is made up of two markets: bond market and the equity market. There are however two types of capital market securities: those that represent shares of ownership interest called ‘equity’ issued by companies and those that represent indebtedness, issued by corporate organizations and government called ‘debt instrument’ like bonds.<sup>727</sup>

In debt instrument, the issuer agrees to pay investor interest, plus pay the amount borrowed. The investor who lends the funds and expects interest and the repayment of the debt is a creditor to the issuer. However, the investor in a debt instrument can realize no more than the contractual amount. Hence the debt instruments are referred to as ‘fixed income instruments’.<sup>728</sup> Debt securities include: bonds, notes, medium-term notes, and asset-backed securities.

In contrast, an equity instrument states that the issuer pay the investor an amount based on earnings, if any, after the obligations that the issuer is required to make to company’s creditors are paid.<sup>729</sup>

Some financial instruments however, have the attributes of the two types of capital market securities. Preferred stock is an example of such a hybrid in that it looks like debt instrument because investors that invested in these securities are only entitled to receive a fixed contractual amount. The preferred stock also resembles equity because the payment to investors is only made after obligations to the company’s creditors are satisfied.<sup>730</sup>

### **7.3.2.1 Bond markets**

Bond markets are markets where bonds are traded. A bond is a debt instrument in which an investor loans money to an entity (corporate or public) that borrows the fund for a defined period of time at a fixed interest rate.

Bonds are typically referred to as fixed income securities and are one of the three main asset classes along with equities and cash equivalents. In bond market, the

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<sup>727</sup> Ibid.

<sup>728</sup> Ibid. 15.

<sup>729</sup> Ibid. 16.

<sup>730</sup> Ibid. 16.

indebted entity (issuer) issues a bond that states the interest rate (coupon) that will be paid and when the loaned funds (bond principal) are to be returned (maturity date). Interest on bonds is paid periodically (every six months, for example). Categories of bonds include corporate, local government or municipal bond, state government bond, federal government bond, infrastructure bond etc.<sup>731</sup>

So, bond markets (or ‘fixed income’ markets) allow governments and companies to borrow directly from investors in the capital markets via the issuance of bonds. Bonds are issued in the primary market and traded in the secondary market. The debt provides the investors that purchase the bonds with a regular stream of income payments through ‘coupons’ (that is, interest payments) for the life of the debt as well as the payment of debt’s ‘principal’ upon maturity. The interest rate is set at the time of issuance, hence the description of bond interest and market as fixed interest and fixed income markets. Bond instruments are used by companies and all tiers of government (federal, state or local governments) to finance a variety of projects and activities.<sup>732</sup>

### **7.3.2.2 Equity markets**

Equity markets however, enable investors a percentage of the ownership of the company in question. Equity market is made up of (i) public equity market (share markets/stock exchanges) where companies ‘list’ their shares for trading purposes, with the total value of the company’s outstanding shares termed ‘market capitalisation’ - the investors purchase a company’s profits in proportion to their stake in the form of ‘dividends’, which are usually paid annually;<sup>733</sup> (ii) private placement where shares are not listed on a public market, but are sold directly to investors.<sup>734</sup>

### **7.3.2.3 Derivative market**

Derivatives markets are markets that provide instruments for the handling of financial risks. In the market, instruments that hedge investors against future movements in asset prices are sold. Therefore, a derivative is a financial contract whose value is derived from a financial instrument such as stock or bond, an asset (such as

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<sup>732</sup> See Stockwatch, The Guardian Newspaper, Monday, October 26, 2009 29.

<sup>733</sup> Ibid.

<sup>734</sup> Ibid.

commodity), a currency or a market index.<sup>735</sup> Typically, some financial instruments are contracts that specify that the contract holder has either the obligations or the choice to buy or sell something at or by some future date. The ‘something’ that is the subject of the contract is the underlying asset. This can be a stock, a bond, a financial index, an interest rate, a currency, or a commodity. Such contracts derive their value from the value of the underlying and hence these contracts are referred to as ‘derivative instruments’ and the market in which they are traded is called ‘the derivative market’. The primary function of ‘a derivative instrument is to provide a ‘transactionally’ efficient vehicle for protecting against various types of risks encountered by investors and issuers’.<sup>736</sup>

### **7.3.3 Primary market**

This is a market where new securities are issued. Companies sell new issues and then raise new capital in the primary market. The primary market is made up of both a public market and a private placement market. The modes of offer for the securities traded in this market include: offer for subscription, right issues, offer for sales and private placements.<sup>737</sup>

### **7.3.4 Secondary market**

In secondary market, financial instruments that already exist are traded. The derivatives of or contract on existing securities are traded in secondary market. New issues are not sold in this market and as such the issuers of the securities do not receive proceeds from the sale. The buying and selling of securities in this market are usually facilitated by stockbrokers. Thus, the secondary market is a consequential market where securities as evidenced by certificates are exchanged for funds. Categorization of secondary markets is hinged on the way existing financial instruments are traded in those markets. This is referred to as the market structure.

‘Market structure is the mechanism by which buyers and sellers interact to determine price and quantity’. There are however, two overall market structures for trading financial instruments in the secondary markets-order driven and quote driven. In order

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<sup>735</sup> Ibid.

<sup>736</sup> Ibid. 29.

<sup>737</sup> Ibid. 30.

driven, also known as auction market, buyers and sellers submit their bids through the stockbroker who sends these bids to a centralized location for bid-matching, and transaction execution, while in a quote-driven market structure, intermediaries-market makers or dealers-quote the prices at which the public participants trade.<sup>738</sup>

#### **7.4 Financial sector**

A sizeable number of players in the financial system who are involved in buying and selling of financial instruments constitute what is ‘financial sector’. Therefore, financial sector can be defined as ‘all the wholesale, retail, formal and informal institutions in an economy offering financial services to consumers, businesses and other financial institutions’.<sup>739</sup> So, in its widest sense, ‘it includes everything from banks, stock exchanges, and insurers, to credit unions, microfinance institutions and money lenders’.<sup>740</sup>

The imperative of the financial sector is well-rehearsed in a World Bank report<sup>741</sup> in this way:

[T]he financial sector is the brain of the economy. When it functions properly it allocates resources (in the form of savings and investment) to the most productive and efficient uses. Just as when the brain malfunctions the impact is seen in the rest of the body, a crisis in the financial sector will always have contagion effects and a significant impact on the real sector unless the situation is dealt with quickly and effectively. In this regard the financial sector can be seen as more important than any other sector of the economy...The stability of the ....sector is now seen as vital not just for continued growth and prosperity but also for peace and political stability.

Hammering on the development objective of the financial sector, the report<sup>742</sup> argues that:

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<sup>738</sup> Ibid. 30-1.

<sup>739</sup> Department for International Development (DFID) (2004) Importance of financial sector development for growth and poverty reduction, Policy Division Working Paper 6.

<sup>740</sup> Ibid. Drake and Fabozzi et al at page 43 say: ‘The financial sectors include enterprises that and regulators that provide the framework for facilitating lending and borrowing’.

<sup>741</sup> World Bank Making Finance Work for Nigeria 24.

<sup>742</sup> Ibid 23.

[T]he objective of the financial sector should be to develop a more resilient, competitive and dynamic financial system drawing on best practices, that support and contribute positively to the growth of the economy through the business cycle. A solid financial sector strategy should also create a core of strong and forward looking domestic financial institutions that are technology-driven and ready to face the challenges of liberalization and globalization. A diverse and strong financial system is important for continued economic growth and development. It can ensure that risks in the economy are well spread-out among the various sub-sectors. A well-functioning financial sector will allocate capital to firms that are more efficient, competitive, and sound and stable.

New growth theories have proven ‘the financial sector as critical driver of the economic growth. In particular, they underscore the sector’s role in engendering greater efficiency of the intermediation process as well as in increasing both the productivity of capital and the savings rate’.<sup>743</sup>

Typically, a domestic financial sector may be classified into four broad financial institutions that facilitate lending and borrowing within the financial system. These are:

- depository institutions;
- non-depository financial institutions;
- insurance companies; and
- investment companies.

#### **7.4.1 Depository financial institutions**

These include commercial banks and thrifts.<sup>744</sup> These institutions accept deposits. With the deposits and other non-deposit sources usually obtained by issuing debt obligations in the financial market, these depository entities advance loans to those that need the funds.

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<sup>743</sup> Kasekende Louis 64.

<sup>744</sup> Thrifts include: savings and loan associations, saving banks, and credit unions.

Commercial banks stand as an important example of a depository institution in a typical national economy and they play a crucial role by facilitating economic growth through the channelling of surplus funds to productive investments.

#### **7.4.2 Non-depository financial institutions**

These are financial institutions that not accept deposits but however, give loans to customers including business enterprises. Mortgage loan companies and finance companies are typical examples of this category of financial institutions.

#### **7.4.3 Insurance companies<sup>745</sup>**

The principal function of insurance is risk-bearing. Insurance companies play an important role in an economy in that they are risk bearers or the underwriters of risk for a wide range of insurable events. Moreover, aside their risk bearer role, insurance companies are major players in the financial market as investors.<sup>746</sup> By reason of their principal function, the insurance companies accumulate large funds which they hold as custodians and out of which claims and losses are met. Also because of the investment policy of the insurance companies, their reserve funds are not static, but are used productively. For example, as compensation for insurance companies selling protection against the occurrence of future events, they receive one or more payments over the life of the policy. The payment that they receive is called a premium. Proceeds made by the insurance company between the time the premium is made by the policy holder to the insurance company and a claim on the insurance company is paid out (if such a claim is made), can be invested in the financial market,<sup>747</sup> for example, in infrastructure bonds for infrastructure development.

The insurance products sold by insurance companies are many and they include: life insurance; health insurance; property and casualty insurance; liability insurance; disability insurance; long-term care insurance; structured settlements; investment-oriented products; and financial guarantee insurance. However, of particular relevance to the theme of this study is the financial guarantee insurance. The risk insured by this product is the credit risk that the issuer of an insured bond or other

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<sup>745</sup> In some countries, insurance companies come under the category of “contractual savings institutions’ like pension funds.

<sup>746</sup> Drake 47.

<sup>747</sup> Ibid.

financial contract who fail to make timely payment of interest and principal. A bond or other financial obligation that has such a guarantee is said to have an insurance ‘wrap’.<sup>748</sup>

#### **7.4.4 Investment companies<sup>749</sup>**

The investment companies manage the funds of customers and are paid the services rendered by fees they charge their clients. The fee charged is hinged on ‘the amount that is managed for the client and, in some cases, to the performance of the assets managed’.<sup>750</sup> Pension funds, hedge funds, unit trust and other contractual savings institutions are grouped under this category. Most of these investment companies are subsidiaries of banks, insurance companies, and investment banks.<sup>751</sup>

The opening up the infrastructure procurement processes to pension funds and insurance assets will help scale-up liquidity in the capital market.

#### **7.5 Nigeria’s financial system**

Like any other modern nation, Nigeria’s financial system also consists of five components: financial markets; financial intermediaries; financial products and services; financial infrastructure; and regulators of financial activities.

Regarding the types of financial markets, Nigeria’s financial market too can be broadly divided into: internal and external markets. The internal market consists of two parts: the domestic and foreign markets. In Nigeria’s domestic market, issuers domiciled in the country issue securities and investors buy those securities. The foreign market is the market where securities of issuers not domiciled in the country are sold.

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<sup>748</sup> Ibid. 48.

<sup>749</sup> They are also referred to as ‘asset management companies’. In some jurisdictions, these investment companies are called ‘contractual savings institutions’.

<sup>750</sup> Drake 48.

<sup>751</sup> Ibid. 49.

Nigeria's internal market is also has five markets along the lines of the divisions in the general discussion on financial system above.

### 7.5.1 Nigeria's financial sector

Generally, Nigeria's weak financial sector has been identified as a clog to growth, in particular, in the non-oil sector of the economy which has resulted in a lack of local financing for private sector development and very little access to formal financial services (especially savings) to rural communities. Despite significant consolidation in the banking sector, Nigeria's financial system remains shallow and considerable benefits will result from continued financial deepening both in terms of higher growth and poverty reduction.<sup>752</sup>

Nigeria's financial sector is said to be characterized 'by limited diversity and missing markets'.<sup>753</sup> As observed by the World Bank Investment Climate Assessment (ICA) 2009 cited in the World Bank report, a sizeable number of Nigerian businesses lack access to formal financial service providers.<sup>754</sup> It is also indicated in the report that 'bank credit remains the main source of external funding of investment by Nigerian firms' and 'non-bank financial sector and capital market development remain substantially below comparator countries'.<sup>755</sup>

Also, in the equity market only the largest firms are served and 'market turn-over is largely driven by the banking sector, which accounted for between 65 and 75 percent of total market capitalization in recent years'. This investigation cannot but agree with the observation of the report that 'the bond market is weak with little secondary trading' and 'the corporate bond market is virtually non-existent'.<sup>756</sup>

Regarding the insurance sector and as rightly observed in the report, the insurance premiums are negligible compared to GDP and the sector fails to provide essential risk mitigation and savings instruments like private health insurance, property

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<sup>752</sup> World Bank Making Finance Work for Nigeria 2009 27.

<sup>753</sup> Ibid.

<sup>754</sup> Ibid.

<sup>755</sup> Ibid

<sup>756</sup> Ibid. 28.

insurance or life insurance to a broad section of the Nigerian population. Property and casualty insurance is primarily targeted at corporate customers.<sup>757</sup>

However, in the drive to attain the vision to fix the Nigeria's constraining infrastructure deficit, the financial sector has a critical role to play in effectively mobilizing resources for infrastructure development. Thus, improving private investors' access to finance is critical to Nigeria's quest to bridge the funding gaps in infrastructure financing and development in Nigeria.

The argument is that deepening the financial system will aid the unlocking of domestic resources and foreign capital for infrastructure financing in Nigeria. For instance, reviewing the investment limits of pension funds and other regulated collective investment schemes-like unit trust and cooperative societies under the appropriate legal frameworks-will considerably improve portfolio yields and free up resources that can be invested in infrastructure development in the country.

In summary, the score card of the Nigerian financial sector is: bank credit remains the main source of external funding of investment by Nigerian firms. Non-bank financial sector and capital market development remain substantially below comparator countries. Insurance premiums are negligible compared to GDP and the sector fails to provide essential risk mitigation and savings instruments like private health insurance, property insurance or life insurance to a broad section of the Nigerian population. Property and casualty insurance is primarily targeted at corporate customers. The equity market caters only to the largest firms and market turn-over is largely driven by the banking sector, which has accounted for between 65 and 75 percent of total market capitalization in recent years. The bond market is weak with little secondary trading. The corporate bond market is virtually non-existent.<sup>758</sup>

## **7. 6 The imperatives for financial sector reforms and development**

The work of Joseph Schumpeter at the beginning of the last century established the theoretical foundation of financial sector development by postulating that "a well-developed financial sector mobilizes and intermediates surplus capital (that is,

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<sup>757</sup> Ibid.

<sup>758</sup> Ibid.

savings) and allocates this capital to its most productive uses within the economy', the outcome of which is higher productivity and higher values of economic growth.<sup>759</sup>

Financial system reforms could therefore facilitate the drive for resource mobilization through development of the financial sector and the upgrading of the outdated and moribund financial infrastructure<sup>760</sup> and effecting institutional changes in the areas of regulations and policy guidelines. An improved financial infrastructure would help modernize the financial sector considerably and lead to expansion of access to finance to be channelled into infrastructure project development.<sup>761</sup>

The existence of a modern 'financial infrastructure enables the continuing smooth functioning of the financial system intermediation process. A stable financial system contributes to broader economic growth and rising living standards'.<sup>762</sup>

Therefore over the years, the nexus between financial sector development and economic growth is no longer in doubt. This is because of the established consensus that a well-functioning financial system is necessary to reduce information asymmetry and transaction costs between savers and investors to diversify risk and enhance efficient intermediation by allocating resources in the most efficient manner. The outcome is that a well-functioning financial sector will lead to rapid accumulation of physical and human capital, enhance technological innovation and therefore lead to economic growth and poverty reduction.<sup>763</sup>

As argued by Eatwell,<sup>764</sup> these effects of financial sector development-higher productivity and higher values of economic growth-are derived from a combination of theoretical positions. The finest of these is the 'fundamental theorem of welfare economic' which states that competitive markets produce 'Pareto optimal equilibria'.

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<sup>759</sup> Ibid. 56.

<sup>760</sup> For definition of 'financial infrastructure', see paragraph 2 on page 214 (infra).

<sup>762</sup> CBN Financial Stability Report-January 2009-June 2010-  
[www.cenbank.org/out/2010/publications/bsd/financial stability final t printer-15102010.pdf](http://www.cenbank.org/out/2010/publications/bsd/financial%20stability%20final%20printer-15102010.pdf)].

<sup>763</sup> Rusagara C (2010)'Financial Sector Development Programme (FSDP): The Case of Rwanda' 299.

<sup>764</sup> Eatwell, J (1997) 16.

The second is the efficient market hypothesis which states that financial markets use information efficiently and allocate resources optimally.<sup>765</sup>

Spratt argues that the financial sector development may also be a spur to economic growth through its impact on transaction costs, which increases the economic viability of many productive ventures. That is, the higher the transaction costs involved in a commercial venture then the higher rate of return needed to make the venture viable. As transaction costs fall, therefore, ventures that were previously not viable, in the sense, increasingly become so.<sup>766</sup>

The World Bank has undertaken extensive research into this issue since the early 1990s. The results suggest that financial sector development does indeed cause growth rates to rise-though this does not mean that economic growth does not also cause financial sector development as a positive feedback.<sup>767</sup> The size of the banking sector and size and liquidity of the capital markets are both strongly correlated with growth in GDP and can be shown to ‘cause’ this growth.<sup>768</sup>

One of the World Bank reports avers that there are ‘causal links between financial sector deepening and economic growth. By the beginning of the 21<sup>st</sup> century, there was little debate that a well-functioning financial sector would boost growth and poverty reduction efforts in the developing world’.<sup>769</sup>

Spratt also pointed out that ‘although this work is very much ongoing, the evidence gathered to date strongly suggests that financial sector development has a real impact on economic growth rates, as modern growth theory predicts. Furthermore, this impact appears to be significantly greater in developing than developed economies’.<sup>770</sup>

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<sup>765</sup> Spratt 56.

<sup>766</sup> Ibid.

<sup>767</sup> Ibid. 53.

<sup>768</sup> See Levine R et al (2000) 31-77 cited in Spratt 53 for evidence of causality in this regard.

<sup>769</sup> World Bank Making Finance Work in Nigeria 24.

<sup>770</sup> Spratt 53.

One of the immediate outcomes of the extensive research undertaken by the World Bank early 1990s is the discovery that access to different forms of finance is strongly determined by factors such as the legal system and the extent of financial sector development in a particular country. Besides, the body of this research has also demonstrated that access to external financing, in general, is shaped by these same factors. Meaning: that not only does a country's legal system and financial sector development strongly influence the sort of financing available, it also has a strong impact on the availability of external finance of any sort. This is implicated in the fact that in countries with weak legal systems, and consequently, weak financial systems, investors have less access to external financing which then in turn results in lower growth.<sup>771</sup>

The overarching vision of the financial sector development is 'to develop a stable and sound financial sector that is sufficiently deep and broad, capable of efficiently mobilizing and allocating resources to address the development needs of the economy and reduce poverty.'<sup>772</sup>

Other objectives that financial sector development is intended to achieve specifically include:

- to enhance access and affordability of banking and other financial services, by developing a strong, efficient, and competitive banking sector offering a diversified range of financial products and services;
- to enhance savings mobilization by creating an appropriate environment, developing institutions and fostering market incentives for the development of long term financial instruments and an efficient capital market;
- to develop an appropriate policy, legal and institutional framework for effective regulation of non-bank financial institutions;
- to organize and modernize the payment system.<sup>773</sup>

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<sup>771</sup> Ibid.

<sup>772</sup> Rusagara 301.

<sup>773</sup> Ibid.

In pursuit of the above-stated objectives, a national financial sector development programme must strive to focus on the four major areas of the financial system: access to finance; capital market development; reforms and regulation of banks and non-bank financial institutions and other core components of financial infrastructure like the payment systems.<sup>774</sup>

### **7.6.1 Financial sector development in Nigeria**

The need to develop and deepen the Nigeria's financial sector has long been identified by the government and the push towards reforms of the financial sector indeed commenced in 2004 with a 13-point reform agenda conceived by the apex bank, Central Bank of Nigeria (CBN). The kernel of the reform agenda is 'to transform the financial sector into a growth catalyst, focusing on increasing minimum capitalization for banks to N25 billion from December 2005'.<sup>775</sup>

In pursuance of this reform agenda, 'the financial sector reform efforts also witnessed the phased withdrawal of public sector funds from the banking sector, the adoption of a rule-based regulatory framework and an automated process for the rendition of returns by banks and other financial institutions through the enhanced Financial Analysis and Surveillance System (e-FASS)'.<sup>776</sup>

Host of specific financial sector-related legislation were modernized and new ones enacted to give the reform agenda legal teeth.

The two fundamental 'reform initiatives relate to the pension sector, including the establishment of the Pension Commission in 2004, and the creation of the Debt Management Office (DMO) in 2000 to oversee sovereign debt management'.<sup>777</sup>

Shortly before the 2007 elections, the Central Bank of Nigeria (CBN) came up with a comprehensive vision for the financial sector tagged: the Financial Sector Strategy

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<sup>774</sup> Ibid.

<sup>775</sup> World Bank Making Finance Work in Nigeria 28.

<sup>776</sup> Ibid.

<sup>777</sup> Ibid.

2020 (FSS2020) which was an off-shoot of the broader Vision 2020<sup>778</sup> and remains the most comprehensive financial sector development strategy in the country.<sup>779</sup>

Financial System Strategy (FSS2020) as a comprehensive, long-term, strategic plan for the development of the financial sector is the only component of the Government's broader Vision 2020 to be well-defined. Based on its conception, the FSS2020 steering committee defined the vision for the strategy as being: "...the safest and fastest growing financial system amongst emerging market countries".<sup>780</sup>

FSS2020 was conceived as a plank 'to transform Nigeria's financial system into a catalyst for growth by strengthening domestic financial markets, enhancing integration with external financial markets and developing an international financial centre'. As indicated by the World Bank report, the primary 'objective is to turn Nigeria into Africa's financial hub and one of the 20 largest economies in the world by the year 2020'.<sup>781</sup>

The financial sector development strategy covers all the core priority areas, and it is targeted to build on the success of the previous financial sector reforms to promote greater stability, depth and diversity for the entire financial system.<sup>782</sup>

Though the implementation of the sweeping reforms in the financial sector accompanied by strengthened supervision has increased the soundness of the financial sector, however, this is yet to lead to policy objective of a diversified efficient sector that effectively supports real sector activities.<sup>783</sup>

Needless to say, the financial sector in Nigeria is shallow and weak and over the years, the shallowness and weakness of this sector of the economy has constrained the country's growth potential, especially in the area of infrastructure financing and

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<sup>778</sup> A vision to make Nigeria one of the 20 largest economies in the world by the year 2020

<sup>779</sup> World Bank Making finance work in Nigeria 8.

<sup>780</sup> Ibid.

<sup>781</sup> Ibid. 29.

<sup>782</sup> Ibid.

<sup>783</sup> Kasekende 72.

development.<sup>784</sup> This explains the lack of access to the required funds for infrastructure investment, the problem which this study seeks to solve.

In admonishing Nigeria, the report advises that it is important for the financial system, particularly the domestic financial institutions to be transparent, resilient and efficient if Nigeria is to ensure that its financial sector remains effective and responsive in the face of a more complex global and domestic environment.<sup>785</sup>

For an instance, Nigeria like many African nations went through a period of banking crisis in the 80s and 90s, which was as a result of ‘weak legal and regulatory systems to support banking laws, contract enforcement, accounting and disclosure standards as well as transparency and supervision’.<sup>786</sup> This weakness in the financial sector made it difficult for the sector to give the needed support the growth process in Nigeria.<sup>787</sup>

As argued by Kasekende<sup>788</sup> there exists a correlation between the financial sector development with broad economic growth and development, though this depends on having a sound and safe financial sector, and its ability to adequately play its role in supporting the real sector and efficiently allocate resources within the economy. He further contends that an efficient financial sector mobilizes savings that are channelled into productive investments like infrastructure development, which in turn, improves the efficiency and productivity of investments and that such a sound financial environment acts as a signal for a healthy economic environment, which in turn supports resource mobilization and attracts foreign capital.<sup>789</sup>

Unfortunately, in Nigeria today, the financial sector has been ineffective in playing the crucial role of giving support to the real sector and allocation of resource within the economy.<sup>790</sup>

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<sup>784</sup> Ibid.

<sup>785</sup> Ibid. 23.

<sup>786</sup> Kasekende 63.

<sup>787</sup> Ibid.

<sup>788</sup> Ibid.

<sup>789</sup> Ibid.

<sup>790</sup> Ibid.

It is however important to note that due to the heavy prevalence of commercial banks in the Nigeria's financial system, 'there is a heavy concentration of financial assets in the short term end of the market, leading to a significant unavailability of long-term financial resources to the real sector', in particular, the infrastructure sector which is necessary for productive investments and enables the economy and the society at large.<sup>791</sup>

So, the point is that significant and deep reforms will liberalize and improve the efficiency of financial markets.

Financial sector development entails the development of the financial infrastructure which broadly includes the re-jigging of the banking system, the deepening of the capital market and reforms of the insurance industry and the pension schemes through the upgrading of critical components of the financial infrastructure such as credit reporting, remittances, and payment systems to meet international best practices and standards, securities settlements, remittances, and secured transactions.<sup>792</sup>

#### **7.6.1.1 Banking reforms**

Though the Nigerian financial systems are made of various institutions, including, among others, financial advisers or brokers, insurance companies, collective investment schemes, pension funds, to mention few, the banks remain the soul of financial intermediaries in the country. Like other developing countries or emergent markets, the banking sector is still the most-predominant source of funding. This explains why the banks' operating environment must be characterized by 'a robust legal and regulatory framework' and 'a high level of transparency in monetary and supervisory policies-requirements that collectively imply the existence not just of strong central banks, but also sound banking laws together with contract enforcement'.<sup>793</sup>

One of the primary roles of banks and other financial institutions in a nation is to provide funds to stimulate and promote economic activities. However, in doing that,

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<sup>791</sup> Ibid. 64.

<sup>792</sup> World Bank Financial Infrastructure 18.

<sup>793</sup> Kasekende 67.

the banks and other financial institutions are ordinarily expected to exercise due diligence and utmost prudence in the management of the available resources to guarantee the security of the depositors' money and the return to the owners when required. It must also be noted that banks in Nigeria are under strict prudential loan loss provisioning requirements that any material delay or deviation in project implementation or drastic reduction in actual cash flows has the potential to affect the performance of the banks.<sup>794</sup>

According to Kinsley Moghalu, the banks are usually at the receiving end once contracts are reneged or the projected cash flows and/or continuous performance of the projects are inhibited through the actions or inactions of the parties especially the government agencies.<sup>795</sup>

However, measures must be put in place by the Central Bank to encourage commercial banks to lend to real sector. The apex bank has also approved the amended prudential guidelines on loan loss provisioning and rules and regulations on margin lending. Part of the on-going reforms is the reversal of universal banking structure to give room for specialized banks that would be involved in infrastructure financing. Also, section 3.2.12 (h) of the CBN Monetary Policy Circular No. 38 for the 2010/2011 fiscal year states that infrastructure development remains grossly inadequate relative to the nation's infrastructure requirement due to lack of finance and in March 2010 the CBN approved the establishment of Infrastructure Finance Office in the Development Finance Department with a mandate to, among others, evolve a sustainable financing framework to stimulate long term financing for infrastructure development in Nigeria.<sup>796</sup>

It must be mentioned that some concrete steps have been to scale-up infrastructure financing. These measures: the N300 billion Power and Airline Intervention Fund; review of the prudential guidelines; review of the universal banking model; review of

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<sup>794</sup> Moghalu K (2011) Taking infrastructure finance to the next level 14.

<sup>795</sup> Ibid. 15.

<sup>796</sup> Ibid. 7-8.

development finance institutions; came up with infrastructure finance policy for Nigeria; and encourage the activities of the Bankers' Committee.<sup>797</sup>

These measures will be examined briefly.

First measure in the plate is the N300 billion power intervention fund. This is conceived as part of the broader macroeconomic policy framework needed to unlock the credit market and stimulate the economy, the Bank provided N300 billion facility for investment in debentures issued by the Bank of Industry (BOI) in accordance with the section 31 of the CBN Act of 2007, for investment in commercially viable power projects. These funds are routed through the Bank of Industry for on-lending to commercial banks at a maximum interest rate of 1.0 per cent for disbursement of loans with a tenor of 10-15 years at concessionary interest rate of not more than 7.0 per cent. In this regard, the African Finance Corporation gives technical advice.<sup>798</sup>

According to Moghalu, the main objective is to provide capital for private sector investment in the power sector. Unfortunately, the objective could not be achieved because of different challenges. Quoting Moghalu, 'the major constraints in respect of power projects....included the inability to produce regulatory permits and/or licenses while many others were unable to tender evidence of additional funds required for completion of the project, or produce acceptable plans to remobilize their engineering contractors to site'.<sup>799</sup> According to him, the total sum of N54.3 billion already approved for 5 power projects is awaiting disbursements due to the inability of the promoters to fulfil most of the conditions mentioned above.<sup>800</sup>

Second is the review of the prudential guidelines to recognize the peculiarities of the long term financing This is in furtherance of the measure by the CBN to encourage banks to lend to the real sector of the economy, to finance infrastructure in particular, the Board of Directors of the CBN gave approval for 'the amendment to the prudential guidelines on loan loss provisioning, rules and regulations on margin lending'. The wisdom is to take into cognizance the present 'dynamics in the industry

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<sup>797</sup> Ibid.

<sup>798</sup> Ibid.

<sup>799</sup> Ibid.

<sup>800</sup> Ibid. 9.

and provide guidance on the recognition and measurement of loans, establishment of loan losses allowances, credit risk disclosure and related matters'. Under the regime of the newly reviewed prudential guidelines, recognition is given to the use of a time-based approach for specialized loans. The time-based approach establishes longer time-lines for measuring asset quality, based on the gestational periods for projects in the target sectors.<sup>801</sup>

Third on the list is the review of the universal banking model. The universal banking model adopted in the country in 1990 allowed banks to engage in a broad range of financial services that exposed Nigerian banks to higher operating risk which in turn increased the propensity to put depositors' funds into risky non-businesses. This has however been modified by the CBN through the Regulation on the Scope of Banking Activities and Ancillary Matters No. 3, 2010, in favour of monoline and specialized banking so as to encourage innovation and specialization amongst banks. The belief is that this new policy shift would in the long run lead to the emergence of banks with special appetite for long term financing most ideal for infrastructure development in Nigeria.<sup>802</sup>

Another initiative on the part of the apex bank is the review of the development finance institutions. As part of the strategy to unlock domestic resources, the CBN also identified the imperative to review the operations of the Development Finance Institutions (DFIs) so as to enable them play a significant role in driving the economic development of the country. By definition, DFIs are financial institutions set up by the government to provide long-term financial and technical assistance to some specific economic sectors that other providers of capital may not want to go into. They are sometimes referred to as 'policy-based financial institutions whose roles and mandates are linked closely to the country's national development objectives'. This is evidenced from the establishment of DFIs with specific purposes to promote the development of the real sector like infrastructure development. The DFIs should be able to complement the conventional banking institutions in meeting the financial requirement of the economy, particularly in supporting the economic and social development of the country. Accordingly, the apex bank is presently reviewing the

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<sup>801</sup> Ibid.

<sup>802</sup> Ibid. 10.

activities of the nation's Development Finance Institutions (DFIs) where it has equity interest with a view to restructuring them for effective contribution to nation building especially in the area of infrastructure finance.<sup>803</sup>

Besides, the Central Bank has in principle agreed to partner with the relevant stakeholders to develop an infrastructure finance policy for the country. The overarching objective is to come up with a framework for raising long-term funds for infrastructure financing and fashion out incentives for private sector participation in infrastructure project development. The effect of this is that such a collaborative effort among the stakeholders will lead to creation of a positive environment in facilitating and sustaining commercially viable, bankable and affordable sources of equity and long-term financing framework which is necessary for sustainable investments in the critical and much needed infrastructure projects in the country.<sup>804</sup>

Wenn Bruno,<sup>805</sup> argues that it is imperative for local banks to provide the sort of long term financing required for infrastructure projects and the local resources to avoid getting bogged down in hedging currency risk.<sup>806</sup>

This informed the statement made in a public function by Mallam Sanusi, the governor of Nigeria's Central Bank that the CBN is ready to secure, guarantee and lend funds to genuine investors who would channel the money into infrastructure projects. This becomes imperative in the view of the fact that 'the balance sheets of the banks are made up of short term funds which cannot support infrastructure funding'.<sup>807</sup>

Proper regulation in the banking sub-sector will inspire confidence on the part of the investors and attract more FDI into the country. Ensuring well regulated environment

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<sup>803</sup> Ibid.

<sup>804</sup> Ibid. 13.

<sup>805</sup> Chairman of Germany's DEG. DEG is part of the KFW Banking Group, one of the Europe's largest finance institutions (DFIs).

<sup>806</sup> See Infrastructure Investor Africa An Intelligence Report (2011) 26.

<sup>807</sup> Central Bank on Nigeria 'CBN targets N2 trillion pension funds to finance infrastructure'- [www.cbn.gov/](http://www.cbn.gov/)-accessed last 15<sup>th</sup> September, 2011.

and operating in line with best international standards could prove to be a major key in capturing the interest of the foreign investors.<sup>808</sup>

### **7.6.1.2 Reforms of the insurance industry**

Insurance industry is one of the components of the financial sector of the economy in Nigeria. In Nigeria, the insurance sector is small, with premiums amounting to less than 1 % of GDP. This in large part reflects the poor reputation of the sector, often cited for providing fraudulent policies and in failing to honour claims. Nonetheless, growth of a trusted insurance sector will be crucial in making important products accessible to consumers of financial services, both as regards non-life products and life insurance products to pension fund members and to strengthening the reputation of the financial system.<sup>809</sup>

In the light of the above, urgent measures need to be taken to make the insurance industry responsive to its role in the Nigeria's financial sector. One measure that has been suggested is improving the enforcement capacity-strengthening law enforcement by checking that insurance companies apply reasonable pricing, terms and conditions for each key product, and ensuring those insurance companies' honour minimum service standards, including claims payments procedures, is very crucial.<sup>810</sup>

Second on the suggestions list is the issue of supervisory capacity. Broad-based strengthening of National Insurance Commission's (NAICOM) supervisory capacity, including introduction of standards as regards accounting, solvency and reserving, supported by investment in information technology to enable regular reporting by insurance companies is also proposed to make the insurance industry more liquid.<sup>811</sup>

It has also been suggested that in the aspect of enforcement actions that cracking down on shaky practices within the industry will have an immediate impact by putting pressure on industry participants by way of example. This, it is suggested should include ensuring (a) that owners of public buildings, not least the public sector, purchase compulsory insurance-both fire insurance and public liability insurance-as

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<sup>808</sup> See 'Well regulated banks will attract FDIs to Nigeria' Punch, Friday, 8 April, 2011.

<sup>809</sup> World Bank 'Making finance work in Nigeria' (2009) 15.

<sup>810</sup> Ibid.

<sup>811</sup> World Bank Making finance work in Nigeria 16.

stipulated in the law; (b) that insurance companies reliably honour the bona fide claims made by policy-holders; and (c) cracking down on fake insurance companies which are prevalent in the market for vehicle insurance cover.<sup>812</sup>

Insurance industry in Nigeria was known for its undercapitalization, under-performance and low retention capacity until it went through recapitalization process. The capitalization thresholds were raised by factors of over 1000%, the aftermath of which was spate of mergers and acquisitions that led to the emergence of seventy-one stronger companies in February 2007. The reform programme was initiated in 2005 as part of the wide-ranging reform of the financial sector of the economy by the government of President Olusegun Obasanjo.<sup>813</sup>

Some of the objectives the insurance sector reforms set out to achieve include: increase in the industry's low retention capacity which had stunted its growth. Government was especially concerned about low local underwriting capacity for big ticket risks in the oil and gas, aviation, marine and other special risk sectors and was determined to claim the huge foreign exchange outflow engendered by the situation; to attract foreign capital infusion into the industry for enhanced premium growth and profitability; achieving a consolidation that will produce companies capable of meeting claims, obligations and complete at the continental and global levels; to enable operators to attract the wherewithal for strategic investments in human capital development, that is, to attract, train and retain professional able to utilize new technologies for greater efficiencies; creating a competitive environment which leads to brand activities, increased investment and better public awareness of the benefits of insurance to the society at large; achieving the necessary economies of scale that will make insurance affordable and accessible; encourage the industry to leverage on synergies from mergers and acquisitions and other alignments to achieve superior product innovation, deeper market penetration and product distribution.<sup>814</sup>

Insurance services have been historically unpopular with the Nigerian public. Less than 1% of the country's population of 140 million according to the available

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<sup>812</sup> Ibid.

<sup>813</sup> See Insurance in Nigeria Special Report, African Business-April 2007-  
[http://www.africasia.com/uploads/ab\\_nigeria\\_insurance\\_0407.pdf](http://www.africasia.com/uploads/ab_nigeria_insurance_0407.pdf) p. 58.

<sup>814</sup> Ibid.

statistics has any form of insurance policy. Poor public awareness regarding the principles of insurance has not helped, and even among those Nigerians that do not know the benefits of insurance cover, there remains a widespread perception that Nigerian insurers are reluctant to settle claims.<sup>815</sup>

Eligible investors such as insurance companies have invested limited amounts in private infrastructure development. This can be attributed to regulatory restrictions, under-developed corporate bond markets and the absence of efficient credit risk transfer mechanisms such as securitization, credit derivatives, credit insurance, etc. Government should come up with the rules for mandatory investment by the insurance companies in infrastructure assets.<sup>816</sup>

### **7.6.1.3 Deeping the capital market**

For any economy to grow, capital market is a prerequisite! A well developed capital market is pivotal to growth of the real sector of the economy.

As it is presently, the Nigeria's capital market is equities-dominated though it remains a veritable source of long term lending. To a reasonable extent, it is still illiquid and under-capitalized. In deepening the domestic capital market, new products will need to be introduced so as to expand the range of instruments available to borrowers and investors alike. This may attract foreign investors into the domestic financial markets through portfolio investments; and one of the strategies is to develop the fixed income market of the capital market by introducing financial products like asset-backed securities into the market. It is therefore imperative to increase the domestic supply of long-term capital and promote the development of domestic capital market.<sup>817</sup>

Creating a more efficient and accessible investment market place for infrastructure seems critical to deepening of the capital market. Therefore, the use of capital markets for funding infrastructure projects should be encouraged because of the wider

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<sup>815</sup> Ibid.

<sup>816</sup> Ibid.

<sup>817</sup> World Bank Making finance work for Nigeria 117.

economic benefits of increasing the use of the bond market as an option for corporate finance.<sup>818</sup>

Adequate flow of cross border capital hinges on deepened capital market. Foreign investors seem to be averse to investing in the domestic capital market because of lack of information, severe risk perception and the small size of the market which makes stocks largely illiquid assets.

As observed by the World Bank,<sup>819</sup> the local capital market has experienced considerable change and fast growth in recent years, particularly as concerns the deepening of the government debt market. Nevertheless, to continue the deepening process of the capital market, a broad range of reforms is needful. Parts of the strategies for the reforms are: liberalization of the financial system; improving the investment climate through microeconomic stabilization and better business environment; developing new supervisory frameworks and institutions, and improving the basic infrastructure for securities' market transactions.<sup>820</sup>

But specifically, to further enhance the debt and liquidity of the domestic capital markets policy measures must be put in place to reduce transaction and issuance costs on the Nigerian Stock Exchange. The costs of transactions still remain high and steps need to be taken to ensure further reductions.<sup>821</sup>

Also in the area of trading, there is urgent need for dematerialization of all security certificates and integration of securities registration in one central securities depository would enhance the certainty of the trading process and also work towards preventing the eventual lapses in registration and frauds. Then, though considerable strides have been made in recent years in debt management, consolidation of debt portfolio management through a regular strategy of re-openings, buy-backs, switches and earmarking benchmark issues for primary dealers would deepen market liquidity and lead to the formation of so-called benchmark issues.<sup>822</sup>

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<sup>818</sup> See National Policy on Public Private Partnership 69.

<sup>819</sup> World Bank Making finance work for Nigeria op.cit.

<sup>820</sup> Ibid.

<sup>821</sup> Ibid.

<sup>822</sup> Ibid.

Lastly, there is need for improvement in information disclosure. Enhancing price dissemination consolidation already produced information on a single ‘official’ homepage and ensuring that primary dealers make available two-way quotes and post trade information based on online trade reporting would enhance the effectiveness of the secondary market.<sup>823</sup>

Nigeria’s weak financial sector has been a bottleneck to growth, in particular, in the non-oil sector of the economy and has resulted in a lack of local financing for private sector development and very little access to formal financial services (especially savings) to rural communities.<sup>824</sup> Despite significant consolidation in the banking sector, Nigeria’s financial system remains shallow and considerable benefits will result from continued financial deepening both in terms of higher growth and poverty reduction.<sup>825</sup>

Nigeria’s financial system is characterized by limited diversity and missing markets. A World Bank Investment Climate Assessment (ICA) 2009 highlighted the lack of access to formal financial service providers experienced by vast majority of Nigerian businesses. While banks’ private sector lending has expanded significantly over the recent years, it is still well below that of comparator countries and averages for SSA.<sup>826</sup>

The Nigeria’s capital market is made up of two markets-equity and bond markets. The bond market is largely driven by sovereign and sub-sovereign bonds issued by the Federal Government of Nigeria and some of the federating states.<sup>827</sup>

The escalating financing gaps in the nation’s quest for infrastructure development has made the bond market a preferred window of financing. The reason is that the debt market is considered a cheap source of funds.<sup>828</sup>

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<sup>823</sup> Ibid.

<sup>824</sup> Ibid.

<sup>825</sup> Ibid. 28.

<sup>826</sup> Ibid.

<sup>827</sup> Debt Management Office-<http://www.dmo.gov.ng>

<sup>828</sup> ‘Infrastructure gap creates need for bond financing’ BusinessDay Thursday, 11 August 2011.

Investors are getting attracted to the bond market due to increased yield while fleeing the equity market as fixed income instruments become more attractive to hold.<sup>829</sup>

Bonds provide an alternative investment to equities real estate and bank deposits. The importance of the domestic bond markets as a source of finance has been on the increase in recent years as companies are diversifying from money market to bond market for funding of long-term projects. The influx of offshore bond investors is expected to complement local bond-holders and it would in the long run rev up transactions in the fixed income market.<sup>830</sup>

Bonds are recognized as instruments that can be used to diversify an investor's portfolio to achieve stability in value and income. The bonds can be used as collateral for borrowing from banks and discount houses. The bond market by its nature can be deployed to match the needs of those investors with the relatively low risk and therefore low cost financing of the senior debt in the SPV.<sup>831</sup>

The domestic bond market in Nigeria composes of sovereign, sub-national and corporate bonds. Bond markets, which offer the principal local source of longer term financing for public infrastructure are limited.<sup>832</sup>

The federal bond market, while growing and vibrant, has only become active in the past decade. While this does include a relatively significant and increasingly traded longer-term bond market (ten and twenty years) amounting to almost N500 billion (secondary market activity on these bonds is valued at well in excess of N2000 billion), it remains a relatively thin and still somewhat volatile market. At the state (sub-national) level, the bond market is even more embryonic.<sup>833</sup>

Bond market in Nigeria is growing rapidly over the past years due to the reduction of external debt by the Nigerian government and reliance of the government on the

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<sup>829</sup> Ibid.

<sup>830</sup> 'Foreign investors in bond to grow as instrument value hits N4.5 billion' Thursday, 15 September 2011-<http://www.businessdayonline.com/NG/index.php/bondmarket/27350-foreign-investor>.

<sup>831</sup> Ibid.

<sup>832</sup> Debt Management Office-<http://www.dmo.gov.ng>.

<sup>833</sup> Ibid.

domestic debt market through long-term Federal Government bonds. There is preponderance of the FGN bonds in the bond market with tenors ranging between 2-20 years and this makes up to about 87% of the market. The market development is in the main as a result of debt financing for the ever-increasing federal and state capital expenditures in infrastructure sector. Recently, the Debt Management Office opted for shorter term bond as part of the decision to allow state governments and corporate bodies to access the market for development funds.<sup>834</sup>

It has also been observed that the potentials of the Nigerian Bond Market as a viable financing window are not been realized fully due to non-trading of fixed income securities on the floor of the Nigerian Stock Exchange. Presently, the Federal Government bonds trade on the over the counter window where primary dealers and high end investors hold sway, leaving retail investors out of bond trading.<sup>835</sup>

The argument is that it does not augur well for the development of the fixed income market which is a viable window to finance long-term development-related infrastructure projects in the sense that failure to create space for retail investors makes the bond market less efficient and shuts out the needed liquidity which could have been provided by retail investors.<sup>836</sup>

Another way to deepening the nation's capital market is through assets securitization. Asset securitization is a process whereby non-tradable or illiquid financial assets are transformed into tradable securities. It involves the transfer of an asset or a pool of assets directly or indirectly by the owner of the assets to a special purpose vehicle which is funded through an issue of debt securities backed by cash flows generated by the assets. This method is employed usually in project financing.<sup>837</sup>

Securitization has assumed the status of a global financing tool in infrastructure development around the world. It could be deployed to fund the exponential growth of

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<sup>834</sup> See 'DMO focuses on short term bonds' BusinessDay Thursday 12 September 2011-  
<http://www.businessdayonline.com/NG/index.php/markets/bond-market/27349-dmo-f>.

<sup>835</sup> 'Trading bond on NSE to enhance efficiency' Businessday, Tuesday 29 June 2010

<sup>836</sup> Ibid.

<sup>837</sup> Goldbanc Management wants market deepening through assets securitization, BusinessDay, Tuesday, 20 September 2011-<http://www.businessdayonline.com/NG/index.php/markets/companies-and-market/27>.

real sectors of the economy especially the infrastructure including housing schemes. In other words, the huge resources could be unlocked through the use of asset securitization.<sup>838</sup>

Typically, securitization offers a wide range of benefits to the originators, the investors and the financial system of a nation. From the prism of the originators, securitization improves the liquidity position by replacing receivables by cash. It removes assets from the seller's balance sheet, thus liberating capital for other uses. The implication of this is that it leads to the restructuring of the balance sheet by reducing large exposures or sectoral concentration. For example, in the housing financing, the mortgage loans could be converted or securitized and be traded in by loan originators through secondary mortgage market. This would lead to more funds being created and more people will be able to access funds to build or buy their own houses. Besides, it would relieve the financing pressure on the banking industry and allows the banks to concentrate on providing funds for other real sectors of the economy.<sup>839</sup>

Until the DMO was established, the Federal Government bond was a rarity for years. DMO is presently responsible for the floatation of sovereign bonds. Since its inauguration, the DMO has engineered market reforms which led to restructuring of the market from a mere 180 day bond to 20 year tenor. One of the outcomes of this is the creation of yield curve which serves as benchmark for the pricing of other forms of bonds.<sup>840</sup>

There have also been calls for the transfer of bond trading to the floor of the stock exchange. The argument is that by trading bonds on the floor, NSE platform and the price discovery that goes with market efficiency can be deployed to grow the debt market.<sup>841</sup>

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838 Ibid.

<sup>839</sup> Ibid.

<sup>840</sup> Ibid.

<sup>841</sup> Ibid.

A concessionaire may access the capital market to raise the required financing for public infrastructure assets and service delivery. Holders of bond take precedence over shareholders in that they are paid first ahead of payment of dividends to the shareholders.

All the tiers of government in Nigeria can finance infrastructure projects through the issuance of bond instruments. Different kinds of bonds can be structured to suit project peculiarities, investors' expectations, concerns and bond issuers' requirements.<sup>842</sup>

In furtherance of the policies geared towards deepening of the capital market, the CBN has lifted the one-year restriction on bond holding by foreign investors. The implication of this is that the bond market activity is on the increase supported by a relatively liquid market.<sup>843</sup>

The restriction according to CBN has been a disincentive to foreigners looking to buy government debt in the country because it limits their ability to exit their naira exposure.<sup>844</sup>

## **7.7 Financial infrastructure**

Financial infrastructure is a core segment of a country's financial system, and at the heart of financial sector reform is the upgrading of financial infrastructure of the financial system of a nation. How modern financial infrastructure of a financial system is, goes a long way to determine the efficiency of financial intermediation, 'the ability of lenders to evaluate risk and of borrowers to obtain credit, insurance and other financial products at competitive terms'.<sup>845</sup>

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<sup>842</sup> Arunma Oteh, (2010) Capital market as a long term option for financing infrastructure development, a paper delivered at the 'Central Bank of Nigeria Infrastructure finance conference' held at the Sheraton Hotel and Towers, Abuja 6.

<sup>843</sup> See 'Bond market peaks as CBN lifts one-year restriction for foreign investors'-Thisday, 30 June 2011.

<sup>844</sup> See 'Bonds: Nigeria's borrowing costs to drop'-DMO-The Punch, 28 June 2011.

<sup>845</sup> 'Financial Infrastructure' Building access through transparent and stable financial systems Financial Infrastructure Policy and Research Series The World Bank 2009 1.

The strategic importance of a financial infrastructure to a country's financial system as a whole is graphically underscored thus-

[A] safe and efficient financial infrastructure fosters financial stability and is imperative for the successful operation of modern integrated financial markets. On the other hand, a weak financial infrastructure can result in major disruptions to the smooth operation of financial markets, directly exposing market participants to greater financial risk.<sup>846</sup>

Then, what is the meaning of the phrase 'financial infrastructure'?

Financial infrastructure is 'a set of institutions, which provides an enabling environment for the effective operation of financial intermediaries. In broad terms, the financial infrastructure encompasses the existing legal and regulatory framework that plays a vital role in determining the structure, growth and the health of financial sector'.<sup>847</sup> It 'comprises the underlying foundation for a country's financial system' which 'includes all institutions, information, technologies, rules and standards that enable financial intermediation'. These then include the payment system, private credit registries, and collateral registries which form the core components of the financial infrastructure that could help modernize the Nigeria's financial sector and expand access to finance for infrastructure development.<sup>848</sup>

Financial infrastructure is underdeveloped in Nigeria, and the efficiency of the existing financial infrastructure must be improved to support financial transactions especially the credit advancement. These components - 'an adequate legal framework, efficient enforcement mechanisms, availability of credit information and developed payment systems' - all make up for a stable, deep, efficient and improved access to finance in a country's financial system.<sup>849</sup>

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<sup>846</sup> State Bank of Pakistan (2005) 'Pakistan financial sector assessment Research Department-Last accessed : April 6, 2012 @ [www.sbp.org.pk/publications/FSA/2005/Contents.pdf](http://www.sbp.org.pk/publications/FSA/2005/Contents.pdf).

<sup>847</sup> Ibid.

<sup>848</sup> Isern, J et al (2009) vi.

<sup>849</sup> World Bank Financial Infrastructure 5

The importance of financial infrastructure was well underscored in the World Bank study<sup>850</sup> thus:

[F]inancial infrastructure is critical for the efficient provision of financial services. The efficiency issue is especially evident in the case of payments, where the per-transaction cost is relatively easy to compare and savings from modernization efforts can be calculated. Efficiency improvements from the introduction of credit bureaus and/or credit scoring are also highly significant. Lenders armed with these data can automate or semi-automate certain market segments (such as credit cards and small business loans) and can substantially reduce other procedures such as verifying identification, securing co-signers, and visiting homes or businesses, which reduces both the time and cost of extending credit. In case of collateral registries, they can also increase efficiency by facilitating credit evaluation for easily-valued assets such as new cars, computer equipment, and even commodities. In case of non-payment, collateral registries and the systems which support them can help liquidate the asset and reduce loan losses. Similarly, good corporate governance and strong accounting and auditing standards promote more efficient evaluation of companies.

The World Bank Report avers further that ‘better financial infrastructure is closely correlated with deeper financial markets and .....countries with weak financial infrastructure tend to have lower levels of credit as measured by the ratio of private credit to GDP’ and that ‘the level of development of financial infrastructure is closely correlated with financial system soundness as measured by percent of non-performing loans (NPLs) in the financial system using NPL data through 2006’.<sup>851</sup>

Critical financial infrastructure elements such as reliable credit bureaus, strong enforcement of collateral and functioning payment, securities settlement, and a well-developed remittance systems, are often the attributes of a developed market while the absence or under-development of these core financial infrastructure components characterize an emerging market.<sup>852</sup>

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<sup>850</sup> Ibid.

<sup>851</sup> Ibid. 7.

<sup>852</sup> Ibid. 1.

Furthermore, the Report also indicates that ‘by improving the security and efficiency of the system and protecting investors’ and creditor rights, financial infrastructure promotes stability’.<sup>853</sup> Importantly, it noted that ‘each element of financial infrastructure has a potential to contribute to the deepening of the financial markets.’<sup>854</sup>

By implication, it is obvious that the financial infrastructure is also critical to improving access to finance; it can also reduce transactions costs, allowing private lenders to serve more people, profitably. For example, strong creditor rights reduce the time and expense lenders face in dealing with delinquent or defaulted loans, and credit bureaus reduce the time and cost required for loan processing and due diligence.<sup>855</sup>

### **7.7.1 The need to upgrade financial infrastructure**

One cannot but agree with the World Bank Report that avers that ‘financial infrastructure strengthens financial markets which in turn support business investment and consumption expenditures and help reignite economic growth’.<sup>856</sup>

It has become compelling to improve the core components of the Nigeria’s financial infrastructure which will include designing new laws, regulations and guidelines and also to upgrade the payment system, private credit registries and collateral registries.

The broader spectrum of financial infrastructure covers credit bureaus, collateral frameworks, payment, remittance, and securities settlement systems for financial intermediation, credit rating agencies, business credit reports, corporate registries, corporate governance and auditing and accounting practices and standards.<sup>857</sup>

However, for the purposes of this study, the focus will be on the core components of financial infrastructure which are relevant to improving access to financing for public infrastructure assets in Nigeria. These are: collateral system, credit information system, payment and securities settlement systems, and remittances. Generally, all

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<sup>853</sup> Ibid.

<sup>854</sup> Ibid. 9.

<sup>855</sup> Ibid.

<sup>856</sup> Ibid. 2.

<sup>857</sup> Ibid.

other components of financial infrastructure provide platforms for majority of other financial transactions.<sup>858</sup>

The objective of this segment is to interrogate the impact of collateral framework, credit information system, and payment and securities systems on access to credit for infrastructure financing.

## **7.7.2 Core components of financial infrastructure**

### **7.7.2.1 Lending infrastructure**

A lending infrastructure refers to the environment in which lending takes place in a country and it includes: the credit information environment; the legal and judicial system; the bankruptcy environment; and the tax and regulatory environment.

The existence of a sound framework for secured lending is a critical pre-requisite for a modern economy that is highly leveraged. Similarly, a sound collateral system provides information for lenders about prospective debtors about the existence of prior interests in collateral and give creditors who register assurance of priority in the collateral, thereby mitigating ‘risk to lenders and facilitating access to credit’.<sup>859</sup>

Spratt commenting on bank lending makes allusion to the recent empirical work which has proved ‘a link between the strength of property rights and their enforcement and the level of external finance used for investment purposes’. He concluded that the ‘countries that do not have these positive features, in contrast, tend to have a greater reliance on less efficient financing from development banks, the state or the informal sector’.<sup>860</sup>

However, there are two main sides to financial intermediation-payment system and the lending or credit system. A robust credit system is of critical importance for the soundness and growth of an economy. However, a robust credit system is not possible without a strong and reliable credit information sharing platform.<sup>861</sup> Existence of

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<sup>858</sup> Ibid.

<sup>859</sup> Djankov et al 9.

<sup>860</sup> Spratt 315.

<sup>861</sup> Popoola A ‘Challenges of financial infrastructure’ The Guardian 23 April 2012.

credit bureaus, collateral registries and sound judicial system are of critical imperatives for access to credit.<sup>862</sup>

### **i. Credit registries**

Credit registries and bureaus have been described as key enabler of financial infrastructure and lending in developing economies like Nigeria.<sup>863</sup> In emergent economies, lending is in large scale made possible by national credit bureaus which perform the crucial role of gathering, processing and distributing reliable and current credit information either in form of a public credit registry usually owned by the government through the Central Bank, or privately owned bureaus. The credit bureaus gather data from wide and varied sources on corporate entities or individuals, process it into credit profiles, and then make the information available on request to subscribers, including financial and non-financial institutions, as well as to regulatory authorities.<sup>864</sup>

The reports given by the credit registries and bureaus usually contain information about the payment behaviour of consumers and commercial entities, including data on timely fulfilment of or delinquency in financial obligations. Credit officers of banks and credit institutions will then use this information in making decisions as to the credit-worthiness or otherwise of a prospective debtor of credit or help to decide whether to approve an application for a credit facility and what interest rates to apply in the circumstance. This credit information may also be used for economic analysis and systemic risk evaluation by the regulators in the banking industry to supervise the financial intermediaries in a financial system.<sup>865</sup>

Therefore, as could be seen from the above, credit registries and bureaus are the core components of a country's financial infrastructure that provide critical lending infrastructure in that they, among other functions, increase access to credit; support prudent and responsible lending and reduce credit losses; and they also strengthen

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<sup>862</sup> Ibid.

<sup>863</sup> Baer T et al (2009) 4.

<sup>864</sup> Ibid.

<sup>865</sup> Ibid.

banking supervision in monitoring systemic risks in the highly leveraged banking sector of the economy.<sup>866</sup>

A study conducted in 2007 proved that the establishment ‘of credit registries is positively correlated with the depth of the financial market measured by private credit to GDP’. It was also estimated in the study ‘that the private credit to GDP ratio is higher three to five years after the establishment of a credit registry...’.<sup>867</sup>

High degree of asymmetric information has been identified as one critical factor that explains the reason why banks in Nigeria do not lend more to the private sector, because this creates difficulties in ascertaining borrowers' credit worthiness.

In Nigeria and elsewhere, credit information providers are classified into two categories: public credit registry and private credit bureaus.

#### **(a) Public credit registry**

The establishment of a public credit registry was a policy response and a remedial measure to the then prevailing environment of financial system distress in Nigeria. In pursuance of its regulatory and promotional role within Nigeria’s financial system, the apex bank, the Central Bank of Nigeria (CBN) runs a credit information system called the ‘Credit Risk Management System’ (CRMS).<sup>868</sup> The credit information system was set up against the backdrop of the upsurge in non-performing credit portfolios in banks during the 1980s and 1990s. Another prevailing factor that made its establishment imperative was the prevalence of “predatory debtors” in the banking system who abandoned debt obligations in some banks only to contract new debts in other banks’.<sup>869</sup> Also, the use of status enquiries on bilateral basis between banks was characterized by systemic weaknesses. As pointed out, status enquiries were regarded as business courtesies or a matter of routine to which some banks, in some instances, either did not respond to or gave unintelligible replies.<sup>870</sup>

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<sup>866</sup> Ibid.

<sup>867</sup> Djankov 9.

<sup>868</sup> World Bank Making finance work in Nigeria 58. See also Isern et al (2009) 25

<sup>869</sup> Ibid.

<sup>870</sup> Central Bank of Nigeria, ‘Credit Risk Management System’ last accessed on 11<sup>th</sup> April 2012 at: [www.cenbank.org/Supervision/crms.asp](http://www.cenbank.org/Supervision/crms.asp).

The decision to establish a Credit Bureau in Nigeria featured in the Presidential Budget Speech of 1990, and thereafter, it was given a legal backing by the Central Bank of Nigeria Act No.24 of 1991<sup>871</sup> as amended. The enabling law gave power to the CBN ‘to obtain from all banks, returns on all credits with a minimum outstanding balance of N100,000.00<sup>872</sup> for compilation and dissemination by way of status report to any interested party (i.e. operators or regulators)’<sup>873</sup>. It was also mandatory for all financial institutions to render returns to the CRMS in respect of all their customers with aggregate outstanding debit balance of N1,000,000.00 (One million naira) and above. It also required banks to update these credits on monthly basis as well as make status enquiry on any intending borrower to determine their eligibility or otherwise. Banks are penalized for non-compliance with the provisions of the Act.<sup>874</sup>

Banks are also required to make status enquiries on any intended borrower to determine their eligibility, and banks are penalized for non-compliance.

As it stands now, CRMS is a web-enabled database that provides the platform for banks and other stakeholders to conduct status inquiries on borrowers as a support mechanism for bank credit decision procedures.<sup>875</sup>

The CRMS generates a credit history<sup>876</sup> of borrowers in the system plus a profile on the total liabilities a debtor has acquired within the banking system. Information dating back to 1994 is maintained by CRMS. As of 31 December 2008, fewer than 30,000 borrowers were registered in the system.<sup>877</sup>

The CRMS’s effectiveness is assailed with two main weaknesses. First is the absence of loan classifications or any scoring mechanism limits the benefits that the system provides. As a result, a debtor may have different classifications in different banks with no sharing between them. Second weakness is the lack of a unique identifier for individuals which pose a significant challenge. In Nigeria there are various forms of

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<sup>871</sup> Sections 28 and 52.

<sup>872</sup> Now N1million and above of principal and interest.

<sup>873</sup> Section 28.

<sup>874</sup> Section 52.

<sup>875</sup> Central Bank of Nigeria, ‘Credit Risk Management System’ (n 870 above)

<sup>876</sup> Both positive and negative data is maintained as well as historical trends.

<sup>877</sup> World Bank Making finance work in Nigeria 58-9.

personal identification (including a national ID),<sup>878</sup> but all have limited coverage and none is fully reliable. When a bank enters a new borrower into CRMS, a new ID is generated, which becomes obligatory for use by all banks. However, duplicates sometimes get past the different filters. Besides, the database may have some identification errors.<sup>879</sup>

Banks are reportedly only required to list loans as non-performing 90 days after due. Consequently habitual late payers that pay their obligations within 90 days would have a “clean” credit history. Loan classifications are not a part of the information generated at this time, thus a debtor may have different classifications in different banks with no sharing between banks. The absence of loan classification, or any scoring mechanism, also limits the benefits that the system provides.<sup>880</sup>

However, efforts must be made to safeguard the CRMS system and make it even more efficient, particularly from a regulatory point of view. If the CRMS system is truly effective, the CBN should make CRMS information an integral part of its off-site supervision.<sup>881</sup>

### **(b) Private Credit bureaus**

Credit bureaus provide ‘the information needed for accurate and timely risk analysis, especially for consumer credit’.<sup>882</sup> They ‘promote deeper financial systems by helping to overcome adverse selection and moral hazard related to asymmetric information in credit markets’ The investigation reveals that ‘as a result of cost savings through more efficient and accurate credit analysis and lower expected losses, lenders can increase their credit extension’.<sup>883</sup>

According to the report, the ‘credit bureaus, by reducing information asymmetries and stimulating competition in the market, are also supporting improved access to finance

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<sup>878</sup> According to the 2008 EFINA survey reports, 39% of Nigerians have a national ID card, while 14% have passport. Making identification more problematic is also the widespread practice of altering names by use or habit, while birth dates and addresses tend to be unreliable.

<sup>879</sup> World Bank Making finance work in Nigeria 59.

<sup>880</sup> Ibid.

<sup>881</sup> Isern et al (2009) 26

<sup>882</sup> World Bank (2009) ‘Financial Infrastructure’ 2.

<sup>883</sup> Ibid. 8.

for good borrowers’. The report reveals that ‘firms report fewer obstacles to financing where credit bureaus are more developed’.<sup>884</sup> Citing two separate studies,<sup>885</sup> the report indicates ‘that firms have improved access to finance where credit information is available’.<sup>886</sup> The report also refers to another study which avers that the importance of credit information ‘as a predictor of the level of factoring in an economy (weighted for GDP) and much stronger than creditor rights’.<sup>887</sup>

Also cited is the study by Love and Mylenko<sup>888</sup> which ‘uses firm-level information to assess the correlations between the existence of credit registries and use of finance, and perceptions of financing constraints by borrowers’. The study, making use of ‘information on 5000 firms in 51 countries, finds that firms are less likely to report access to finance as a major problem in countries with credit bureaus. It ‘also finds that usage of credit is higher in countries with credit bureaus.’<sup>889</sup>

As pointed out at the outset, the credit bureaus are too critical to the lending infrastructure and without them, lenders are likely to lend in dark and ultimately dissuaded from lending which is not good for the health of business and the economy as a whole.<sup>890</sup> Thus, the decision to allow private investors to invest in credit information system by establishing credit bureaus in Nigeria was legally enabled by the Central Bank of Nigeria Act.<sup>891</sup> This enabling law empowers the apex bank, CBN, ‘to license, and regulate credit bureaus to collect, in such manner as the apex bank may deem fit, credit information on the customers of banks and other financial institutions’.<sup>892</sup> The Act also makes it mandatory for a bank, ‘before granting a loan, advance loan or credit facility to any customer, obtain from the Bank<sup>893</sup> credit information on that customer where the amount of the loan, advance or credit facility

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<sup>884</sup> Ibid.

<sup>885</sup> Galindo et al (2001).

<sup>886</sup> World Bank ‘Financial infrastructure’ 9.

<sup>887</sup> Klapper L (2006) ‘The Role of Factoring for Financing Small and Medium Enterprises.’ Journal of Banking and Finance. Volume 30:3111-3130 cited in Financial infrastructure et al. 9.

<sup>888</sup> Love I et al (2003) ‘Credit reporting and financing constraints’ Policy Research Working Paper Series 3142, World Bank, Washington, DC.

<sup>889</sup> Financial infrastructure et al 9.

<sup>890</sup> Popoola op. cit.

<sup>891</sup> No. 7 of 2007.

<sup>892</sup> See sub-section 1 of section 57 of the Act.

<sup>893</sup> In the context, the CBN.

is up to one million naira or such sum as may be set from time to time by the Bank'.<sup>894</sup>

Pursuant to this, in October 2008, the CBN issued Guidelines for the Licensing, Operations and Regulation of Credit Bureaus in Nigeria.<sup>895</sup> The guidelines limit bank ownership of a bureau to 10 percent of its total paid-up capital and shall not invest in more than one credit bureau.<sup>896</sup> A credit bureau is permitted to collect customer related information to determine such customer's "overall debt exposure and repayment behavior".<sup>897</sup> The ability to access credit bureau information is restricted only to lending entities or individuals and only for a "permissible purpose" such as to obtain credit scoring, information on borrower's existing loan facilities or opening a new account.<sup>898</sup> Banks and other financial institutions must obtain credit reports from at least two credit bureaus before extending credit.<sup>899</sup>

As opined by a cohort of researchers,<sup>900</sup> with increase in the number of private credit bureaus now operating in Nigeria, this requirement should be feasible in the short- to medium-term. Under the new Guidelines, a consumer has the right to inspect (at a credit bureau) his or her credit information and to request an investigation of any information such consumer considers inaccurate.<sup>901</sup>

As also rightly observed, the introduction of credit bureaus could help Nigeria develop a fully functioning, competitive credit reporting industry in the short term.<sup>902</sup>

This was further underscored by a key player<sup>903</sup> in the credit information industry when he opined that the credit bureaus:

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<sup>894</sup> See sub-section 3 of section 57 of the Act.

<sup>895</sup> Hereinafter "Credit Bureau Guidelines".

<sup>896</sup> Guidelines for the Licensing, Operations and Regulation of Credit Bureaus in Nigeria, October 2008, Section 3.1.

<sup>897</sup> Ibid. Section 5.2

<sup>898</sup> Ibid.

<sup>899</sup> Ibid. Section 5.4.3-4.

<sup>900</sup> Isern et al (2009) 26.

<sup>901</sup> Guidelines for the Licensing, Operations section 9.4.

<sup>902</sup> World Bank Making finance work in Nigeria 59.

<sup>903</sup> Popoola op. cit.

...should assist in enhancing character lending, boost retail banking and enable good customers to have access to credit without or with minimal tangible collateral or security. It should also be able to assist.....to crowd out serial defaulters and fraudsters to a minimal level.

These giant strides in the area of credit information system would place Nigeria in the enviable position of being able to have a fully functioning, competitive credit reporting industry in the very short term and this would enable Nigeria to reach respectable levels of database coverage much faster than other countries.<sup>904</sup>

## **ii. Mortgage registry**

Loans are often guaranteed by real estate, either the home of the owners, or the company's warehouse or offices. Mortgage financing is therefore normally an important component of financial infrastructure and a critical element of the lending infrastructure.<sup>905</sup>

Under the Nigerian the Land Use Act of 1978, ownership of all land in a federating state vests in the Governor of the federating who is empowered to allocate land for development for a lease of 99 years. The implication of this is that ownership of land is in reality a “right of occupancy” which is recognized through a certificate of occupancy. This right of occupancy is transferable, with the Governor's consent. By this, all transactions touching on the property, including sales, leases, mortgages and other charges, are subject to complex requirements and processes including the consent of the State Governor, which adds a significant amount of time to the registration process.<sup>906</sup>

Nigeria is said to be one of the most expensive nations for property registration globally and this is underscore by a survey<sup>907</sup> Nigeria is ranked number 180<sup>908</sup> for property registration with ‘13 procedures, duration of 82 days and costs of 21.9 percent of property value. The total fees are estimated at 20–30 percent of the

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<sup>904</sup> Isern et al 26.

<sup>905</sup> Ibid. 27.

<sup>906</sup> Ibid. 8.

<sup>907</sup> The 2012 World Bank Doing Business Report.

<sup>908</sup> Out of 181 comparator countries.

mortgage, although developers and others can negotiate waivers for particular developments or even defer payments'.<sup>909</sup>

As noted in the previous chapter and in line with the prevailing Nigeria's secured credit transaction law, mortgages must be registered at the lands registry of the state where the property is registered and, in the case of a corporate borrower, also at the Corporate Affairs Commission's registry.<sup>910</sup> However, it is worth noting that the land registries are not interconnected with the registry at the Corporate Affairs Commission, and conducting searches for details of security given is unreliable for many reasons. What this in effect implies is that there is a widespread practice of taking but not registering security over land (mortgages), especially for short-term borrowing. This practice leaves lenders completely unprotected from a legal viewpoint, but it has some "moral" value as the borrower has in fact agreed to give the real estate as security. Besides, as further argued by a group of researchers,<sup>911</sup> one reason for this common practice is that the cost of registration can easily negate any potential profit on the loan, or alternatively, if the cost is passed to the borrower, the cost of the loan would then be prohibitive (even exceeding informal market rates).<sup>912</sup> In practice, mortgages are only registered prior to legal action being required. Consequently, information held by land registries is often inaccurate and of little use to credit providers seeking to establish the credit-worthiness of potential borrowers. Given these complications, access to finance for infrastructure development is further contracted even if infrastructure development investors have real estate to offer as collateral.<sup>913</sup> Thus, in most cases, the information held by the land registries is inaccurate and serves no useful purposes.<sup>914</sup>

Given the above scenario, mortgage registration in Nigeria makes it difficult for investors to secure loans.<sup>915</sup> Thus, the collateral requirements coupled with the costs

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<sup>909</sup> Isern et al 28.

<sup>910</sup> Corporate Affairs Commission is the agency in charge of registering and regulating the formation and management of companies in Nigeria.

<sup>911</sup> Isern et al 28.

<sup>912</sup> World Bank Making finance work for Nigeria 55.

<sup>913</sup> Ibid. 29.

<sup>914</sup> World Bank Making finance work in Nigeria op. cit 59.

<sup>915</sup> Ibid. 60.

of property poses a serious hindrance to access to finance in Nigeria especially finance for infrastructure development in Nigeria.<sup>916</sup>

### iii. Lien registry

Generally, financial institutions rely heavily on collateral for lending<sup>917</sup> and the CBN regulations require that every loan of N10 million and above must be collateralized with land or buildings. Unsecured lending is generally not allowed except for small loans, and not all forms of collateral are equally accepted by financial institutions.<sup>918</sup> Most financial institutions only establish lines of credit, loans or overdraft facilities against the security of real estate, notwithstanding the difficulties explained above. The financial institutions' 'preference is determined by present and anticipated transaction costs in establishing and enforcing property rights, the ease of liquidation, and the position vis-a-vis other creditors in case of insolvency'.<sup>919</sup> As pointed out in the study, these various market preferences coupled with the CBN regulations limit credible investors' access to credit and they create incentive to investors that lack the preferred collateral to seek financing from informal credit markets with less stringent collateral requirement but with higher lending costs.<sup>920</sup>

It is also important to note that there is lack of a reliable lien registry for moveable assets which in turn makes equipment or asset financing for investing companies and individuals difficult, the only being leasing. This is because there is no method of establishing what, if any, claims exist on these assets.<sup>921</sup> As further observed,<sup>922</sup> the CAC runs a registry where claims against the assets of companies can be registered. But these are general claims on total assets of the company<sup>923</sup> and individual assets cannot be singled out.<sup>924</sup> Also, the registration is limited to companies while sole proprietorships, most partnerships and individuals are excluded. As noted in the recent World Bank Report on the Observance of Standards and Codes (ROSC) in

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<sup>916</sup> Ibid. 61.

<sup>917</sup> Isern et al 29

<sup>918</sup> World Bank (2009) 'Making finance work in Nigeria' 61

<sup>919</sup> Ibid.

<sup>920</sup> Ibid.

<sup>921</sup> Ibid.

<sup>922</sup> Ibid. 62.

<sup>923</sup> That is, debentures.

<sup>924</sup> World Bank Making finance work in Nigeria op. cit.

respect of Nigeria's insolvency and creditor rights (ICR) system, banks generally have a low level of confidence in this registry.<sup>925</sup>

By deploying 'a common (probably biometric) identity mechanism, the private bureaus could contribute to solving the identity problems of individuals and owners of firms'.<sup>926</sup>

Unfortunately, the inadequate and comatose socio-economic infrastructures have posed a great threat to a credible lending infrastructure and 'an important missing link' to Nigeria's 'economic transformation'.<sup>927</sup> The lack of uninterrupted power supply and cheap and unrestricted access to Internet technology incapacitate the credit information system. Besides, lack of credible means of national identification is another hindrance to information gathering for credit purposes. This challenge has necessitated 'some banks to deploy the use of biometric equipment to capture information to reduce the incidence of fraud and losses in the absence of a reliable means of identification'.<sup>928</sup>

As noted earlier on in the study, in Nigeria, industry-specific regulations require that loans should be collateralized while also limiting the kinds of collateral acceptable. Hence, there is urgent need for the collateral legal framework and the registries (especially for movables such as equipment) be modernized to promote their use in raising capital.<sup>929</sup>

In Nigeria, there is suggestion that there is need to develop asset-based lending which is hinged on movable business assets as security. As also observed in the study, 'while there is a workable system of registering floating claims on the assets of companies at the Corporate Affairs Commission, the registry does not identify individual assets, and only incorporated business can make use of the registry'.<sup>930</sup>

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<sup>925</sup> Ibid.

<sup>926</sup> Isern 62.

<sup>927</sup> Popoola op. cit.

<sup>928</sup> Isern op. cit.

<sup>929</sup> Ibid. 67

<sup>930</sup> Ibid.

Also, the apex bank's regulations and banks give preference to real estate as collateral and even when an investor or a company presents 'real estate collateral, the cost of registering such collateral is so prohibitive that, if registered, loans would be priced out of range'.<sup>931</sup> The effect of this is that mortgages are rarely registered (until required prior to a judicial process), which in turn constrain the effectiveness of the mortgage registry.<sup>932</sup>

As argued and in agreement with the CGAP and World Bank study-<sup>933</sup>

a well-functioning and competitive credit information system that incorporates positive and negative information and covers all sectors of the economy (not just financial institutions) is imperative for credit to continue to develop in Nigeria. Without access to reliable information on the financial condition of a debtor, and his willingness to pay as evidenced by historical payment patterns, creditors tend to limit the amount of credit by relying only on the value of security (collateral) available.

As wisely suggested, to modernize the credit and collateral system and widen access to finance in Nigeria, the laws should be reviewed and where appropriate, reform the legislation and regulations on collateral and registries in the medium term. The related legislation and regulations should be reformed to embrace the recent developments in the global credit information system and market, widen 'the definition of acceptable guarantees, and improve use of debtor credit history'.<sup>934</sup>

Though the CBN Credit Bureau Guidelines for the Licensing, Operations and Regulations allow a holder/data subject the right of unrestricted access to his or her credit information, it is only at the credit bureau's physical address. However, the danger there is the 'long distances and limited opening hours may effectively restrict' a holder/data subject's access to his or her credit information. As a result, it has been suggested that other means of provision of reliable credit information to appropriate users should also be explored. These should necessarily include: 'internet, mobile telephony, the postal system, offices of financial service providers where they have

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<sup>931</sup> Ibid.

<sup>932</sup> Ibid.

<sup>933</sup> Ibid.

<sup>934</sup> Ibid.

accounts, and/or a secure agent network'.<sup>935</sup> In order to obviate the possibility of 'undue burden on the credit bureaus, such alternative means may be limited in frequency or subject to a fee after an initial free annual copy'.<sup>936</sup> Additionally, it was also observed in the study that 'although the Credit Bureau Guidelines require credit bureaus to investigate data a consumer has disputed, this would only lead to a correction where the creditor agrees with the consumer that an error was made' and that 'in the event there is a genuine dispute between a creditor and consumer as to whether amounts reported as delinquent were actually due, the Credit Bureau Guidelines imply that only the creditor's view will be reflected in the consumer's credit report'.<sup>937</sup> As a remedial measure, it was suggested that 'provision should be made to require credit bureaus (or require creditors when reporting data to credit bureaus) to indicate on the credit report when items reported as delinquent are in fact disputed by the consumer'.<sup>938</sup>

Reforming the collateral infrastructure therefore entails putting in place 'a sound legal and regulatory framework' to support the collateral system and the establishment 'of a unified collateral registry system' in Nigeria. The legal framework which is part of the collateral infrastructure should necessarily make provision 'for the creation, perfection, and enforcement of security interests.' Particular 'these entail:

- creation of a security interest by simple agreement of the parties ('creation');
- establishment of priority of a security interest against third parties (commonly known as 'perfection');
- use of notice registration (also known as 'filing') and creation of a notice registration system; and
- simple and expeditious enforcement of a security interest upon default by the debtor ('enforcement').<sup>939</sup>

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<sup>935</sup> Ibid. 66.

<sup>936</sup> Ibid.

<sup>937</sup> Ibid.

<sup>938</sup> Ibid.

<sup>939</sup> World Bank 'Financial Infrastructure' 18.

It is however instructive to note that ‘a well-developed collateral framework also has synergies with important aspects of the legal framework such as contract enforcement and insolvency/bankruptcy. When creditor rights are clearly established, contracts are more easily enforced and disposition of assets of distressed borrowers can proceed more efficiently and systematically.’<sup>940</sup>

#### **iv. Payment and securities settlement**

Payment and securities settlement systems have a role to play in maintaining financial stability. A modern payments and securities settlement infrastructure can enhance ‘the ability of the financial system to mobilize savings and increase the pool of assets available for investment’. Additionally, new technologies like mobile banking create the platforms to rein-in ‘investible’ funds electronically which in turn can improve the monetary threshold in an economy.<sup>941</sup>

Similarly, a strong and reliable institutional infrastructure for securities settlement underscores the level of the capital market and broader economic development of a country.<sup>942</sup>

Also of critical importance ‘is the soundness of the legal framework, in particular as it concerns settlements finality and protection of collateral arrangement’. As rightly posited in the study, ‘when the payment system functions properly, risk sharing among agents is more equitable, financial resources are distributed more efficiently, and there is greater confidence in the financial system-and in the very use of money’.<sup>943</sup>

In the same vein, a payment system that is strong and modern can reduce the risks of financial crises by removing ‘settlement risks related to financial market transactions, in particular, credit, liquidity and operational risks’.<sup>944</sup>

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<sup>940</sup> Ibid.

<sup>941</sup> Ibid 8.

<sup>942</sup> Ibid.

<sup>943</sup> Ibid. 7.

<sup>944</sup> Ibid.

The World Bank Report also argues that improving the payments infrastructure can culminate in considerable ‘cost savings and efficiency improvement’. Using a sample of 12 European countries, Humprey et al.<sup>945</sup> ‘estimate that bank operating costs fell by about 24% between 1987 and 1999 due to payment system reforms’, the result of which was savings of US\$32 billion.<sup>946</sup>

Also, beaming the investigative search-light on the US market, Bauer and Hancock<sup>947</sup> and Bauer and Ferrier<sup>948</sup> estimate ‘that technological change was responsible for a reduction of about 10% per year in the cost of automatic clearing house (ACH) transfers since 1989 and for an annual reduction of about 8% for annual Fedwire processing costs in the early 1990s’.<sup>949</sup>

Above all, a strong and modern financial infrastructure ‘such as efficient bankruptcy and contract enforcement mechanisms and more available credit information, reduce intermediation costs, stimulate competition, and lead to narrowing interest spread.’<sup>950</sup>

However, to open up the financial sector for resource mobilization, new laws, re-jigged financial infrastructure and institutional changes in the areas of regulations and policy guidelines are imperative. An improved financial infrastructure could help modernize the financial sector considerably and lead to expansion of access to finance to be channelled into infrastructure project development.

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<sup>945</sup> (2003) “Cost savings from electronic payments and ATMs in Europe.” Federal Reserve Bank of Philadelphia. Working Paper No. 03-16 cited in Financial Infrastructure et al

<sup>946</sup> World Bank ‘Financial Infrastructure’ 9

<sup>947</sup> (1995) “Scale economies and technological change in Federal Reserve ACH payments processing”. Economic Review. Federal Reserve Bank of Cleveland, issue Q III: 14-29 cited in Financial Infrastructure 9.

<sup>948</sup> (1996) “Scale economies, cost efficiencies, and technological change in Federal Reserve payments processing”. Proceedings. Board of Governments of the Federal Reserve Systems (US):1004-1044 cited in Financial Infrastructure 9.

<sup>949</sup> World Bank ‘Financial Infrastructure’ 9.

## 7.8 Concluding remarks

In the chapter, the problem of the inability of Nigeria's financial system to effectively intermediate, by way of mobilizing and allocating financial surplus is discussed. It is argued that the failure indeed stemmed from the apparent weakness and shallowness of the financial system which has hindered economic growth especially in the infrastructure sector.

The discussion thus seeks to answer the poser: how could the financial system reforms and development generally improve access to market-driven long-term financing for public infrastructure development in Nigeria?

Besides, it is shown in the chapter how the weak and illiquid banking sector and shallow domestic capital market have failed in their roles in mobilizing and allocating financial resources and the impact on infrastructure financing in Nigeria. The chapter also explores the role of financial system reforms and development as a means to enhance the financial sector's capacity to fund infrastructure projects in Nigeria.

Obviously, the raging debate on the correlation between financial sector and economic growth and the need to develop sound and efficient financial system continues. As observed in the chapter, a well-functioning financial sector would facilitate the exchange of goods and services; mobilize savings and allocate resources for growth and productive investment which would in turn help to diversify risks.

As also indicated in the chapter, there is need for reforms of the financial system in general and the financial sector in particular. One of the suggestions made is that the reform and upgrading of each component of the financial infrastructure such as credit reporting, remittances, and payment systems, to meet international best practices and standards must be given an urgent attention.

## CHAPTER 8

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### **FINANCIAL RESOURCE MOBILIZATION FOR INFRASTRUCTURE: LEVERAGING INNOVATIVE FINANCING TECHNIQUES AND SOURCES**

#### 8.1 Introductory remarks

#### 8.2 Infrastructure investment requirements

#### 8.3 Infrastructure financing

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(b) Why project financing?

(c) Upside

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###### 8.4.1.2 Legal constraints

##### 8.4.2 Corporate financing

#### 8.5 Innovative sources

##### 8.5.1 Innovative source(s) already in use

###### 8.5.1.1 Sovereign wealth fund

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(a) Creative sources

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### 8.6 Risks and the mitigation instruments

#### 8.6.1 Types of risks

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(b) Export credit guarantees or insurance

(c) Political risk guarantees or insurance

### 8.7 Viability gaps in PPP infrastructure financing

### 8.8 Financial intermediary loan (FIL)

### 8.9 Sovereign credit ratings

### 8.10 Concluding remarks

## 8.1 Introductory remarks

In the two previous chapters, the conclusions were that with the suggested legal reforms and a re-jigged enabling financial system, the space would be opened for the development of innovative techniques and sources of finance and which would in turn serve as encouragement for greater private sector involvement in delivering functional public infrastructure assets and services.

The investigation in this chapter is aimed at answering the research question bothering on what are the innovative techniques and sources that could be used in bridging the huge financing gaps in Nigeria's infrastructure landscape.

Flowing from the above, the obvious task in this chapter is to challenge conventional thinking and generate fresh ideas as to market-driven innovative financing techniques and sources for infrastructure projects in Nigeria. It will investigate ways in which the infrastructure financing requirements can be met in an environment of budgetary constraints and explores how to leverage market-based innovative financial instruments, both domestic and foreign, including risk mitigation instruments and other foreign-based sources like oil for infrastructure deal. The chapter will also create a little space for some of the legal constraints that may hinder the leveraging on some of these innovative technique and sources.

In achieving the overarching objective of this chapter, the discussion shall be broadly divided into two: financing techniques and innovative sources. Financing techniques are in turn divided into structured and corporate financing. The discussion on the innovative sources shall be approached from three perspectives: innovative sources currently in use in Nigeria; those that can be used but not yet to be deployed; and those that require legal reforms before they can become operative in Nigeria.

## 8.2 Infrastructure investment requirements

The starting point is that Nigeria's infrastructure investment requirements have been put in the region of N2.25 trillion (about USD 15 billion) annually<sup>951</sup> and mobilizing additional resources to close the infrastructure investment gaps needs a blend of

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<sup>951</sup> See the ICRC 's website-[www.icrc.gov.org/](http://www.icrc.gov.org/) -accessed last on the 15<sup>th</sup> September, 2011.

domestic and external flows. So, then, increased private and public capital is urgently needed in Nigeria for investment in infrastructure and basic services for economic growth, human development, creation of jobs and general improvement in the livelihoods of the people.

In this regard, it has become imperative for the development of new and innovative financial models and sources of funding, private and public, domestic and external, to meet the urgent need for substantial additional capital. Deploying a mix of these types of financing techniques and sources will reasonably provide the required resources for financing the infrastructure investments in the country. Crucially, it requires reliance on consistent flow (and efficient intermediation and appropriate underpinning legal framework) of different sources of private finance to meet the unmet infrastructure financing requirements and also play facilitative role in the infrastructure development in Nigeria.

Obviously, evolving innovative new sources of financing for infrastructure development requires exploring the potential for the new market-based techniques of raising development finance; building appropriate legal and institutional structure including insolvency laws as said in the previous chapter; and creating legal templates to facilitate debt issuance using various innovative financing techniques.

It is however instructive to note at the outset that innovative financing is not restricted to financial engineering; it also involves risk mitigation and credit enhancement through the provision of collateral (either existing or future assets), spreading risk among many investors, and guarantees by higher-rated third parties. Really, these mechanisms permit lower-cost and longer-term borrowings in international capital markets.<sup>952</sup>

So, as pointed out in the introductory chapter, one constraining challenge that Nigeria is facing regarding infrastructure deficit is in the area of inadequate funding and lack of access to long term finance. Really, infrastructure investments are naturally

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<sup>952</sup> Ketkar S & Ratha D (eds.) (2009) Innovative financing for development The World Bank 20.

substantial with massive up front costs, long-term revenue streams and usually in fixed locations and reasonably unattractive to investors.

Though private investments in core infrastructure assets have improved over the years, it is still sub-optimal and scaled strongly in favour of few sectors. For example, the recent trend in private infrastructure investments is tilted towards the telecommunication sector.

Based on the Document on Vision 20: 2020,<sup>953</sup> the Federal Government's proposed expenditure in road rehabilitation, upgrade and expansion between 2011 and 2013, would cost the public sector N700 billion (about USD 47 million) to finance various construction and rehabilitation projects across the country within that time frame.<sup>954</sup>

Citing a report released by the Federal Ministry of Finance, it is estimated that fixing the infrastructure gap that is confronting Nigeria requires capital investments to the tune of US\$100 to US\$111 billion and this conservative estimate excludes the subsequent periodic maintenance and recurrent costs.<sup>955</sup>

According to the report, the deficit has made mockery of Nigeria's current expenditure on provision and maintenance of infrastructure assets. Transcending this, there is also the problem of effective allocation and disbursement of funds.<sup>956</sup>

Addressing this escalating infrastructure gap that obstructs Nigeria's march towards an exponential economic growth and development cannot be met by public sources of finance alone.

Therefore, to confront the poverty of infrastructure head-on in the face of shrinking fiscal space in the public sector finance in Nigeria which is as a result of poor regime of tax revenue collection, irresponsible wastages and corruption in a way and manner resources are managed, dwindling overseas development assistance coupled with

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<sup>953</sup> Published by the National Planning Commission-<http://www.npc.gov/ng/>-assessed on the 25<sup>th</sup> August 2011

<sup>954</sup> Ibid.

<sup>955</sup> Project appraisal (n 151 above).

<sup>956</sup> Ibid.

competing demands from other sectors of the economy, it has become imperative for the government to mobilize resources from more financially robust private sector to close the yawning financing gaps in the infrastructure market in Nigeria.

### **8.3 Infrastructure financing**

Generally by their nature and design, infrastructure projects require substantial or lumpy investment and longer gestation period for development, construction, start up and operation.<sup>957</sup>

As a preamble, infrastructure financing is a subset of project financing.<sup>958</sup> In general terms, it involves a mix of both equity and debt where the split between the two usually depends on the individual project and importantly on the risk profile of each project. By its nature, infrastructure financing requires finances with tenors raging from 7-25 years or in some cases, even longer maturity periods and has the characteristics of large investments, higher risks and fixed and low (but positive) real returns.<sup>959</sup>

Infrastructure project is naturally an attractive investment opportunity because of the relatively predictable long-term revenue streams which matches the long-term liabilities of institutional investors like pension funds.

The many challenges facing infrastructure financing in Nigeria have been identified and they include:

- inadequacy of appropriate infrastructure-related laws;<sup>960</sup>
- lack of long-term funds for infrastructure financing;
- uncertain political/economic environment;
- non-existence of risk sharing structures;
- lack of a refinancing facility to assist banks and other firms engaged in infrastructure financing to boost their liquidity;
- inadequate capacity building for stakeholders;

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<sup>957</sup> State Bank of Pakistan Guidelines for infrastructure project financing (2011)-www.sbp.org.pk.

<sup>958</sup> *Infra*, 268.

<sup>959</sup> Moghalu, Kingsley 2.

<sup>960</sup> See chapter 6 *supra*.

- fear of policy reversal by government as typical infrastructure projects span periods of 15-20 years which represents 4-5 regimes;
- the CBN prudential guidelines were too restrictive to allow for long-term lending;
- absence of developed bond market in the economy;
- absence of incentives for long term financing by the banks;
- paucity of commercially bankable projects; and
- the unavailability of equity capital.<sup>961</sup>

However, the key development challenge that Nigeria faces today is the mobilization of domestic and international resources to enhance infrastructure investments that will boost growth and reduce poverty. It is this development challenge that this study seeks to address in this chapter.

## **8.4 Financing techniques**

Financing techniques or financial models can be broadly classified as: structured finance and corporate finance.

### **8.4.1 Structured finance**

Structured finance is a very broad term and can be defined in so many ways depending on the context. It is a mechanism for risk transfers. But generally, structured finance is a financing technique or financial model where legal structures are deployed to isolate asset or entity risk, resulting in decreased risk for the originator; or monetization of any rights of payments by a party having the legal right to transfer those payments to others.<sup>962</sup> Examples of structured finance include: project finance; asset-backed securities and collateral debt obligations. Others include: the use of derivatives; complex leasing transactions and various other risk transfer

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<sup>961</sup> Ibid. 6.

<sup>962</sup> Davis, H (2005) The definition of structured finance: results from a survey The Journal of Structured Finance, Fall Vol. 11, No. 3 5-10-accessed at <http://www.ijournals.com/action/showLogin> on 2nd June 2012.

mechanisms.<sup>963</sup> Usually, a Special Project Vehicle (SPV) is created to raise the funding with its debt structured to fit the cash flow.<sup>964</sup>

There are however, three basic types of finance used in structured financing: equity, debt and mezzanine (or hybrid) finance. In equity, the shareholders own the project in question. They provide the risk capital for the project and receive their return basically through the dividends and potential capital appreciation. They indeed exercise right of control on the SPV through the exercise of their voting rights which in turn enable them to control the Board of Directors.<sup>965</sup>

Under debt financing, the lenders have a contractual relationship with the borrower through the loan agreement as against ownership interest in the case of the shareholder. The providers of debt financing for the project receive their returns from the project in the form of interest rather than dividends or capital appreciation. They lack voting rights and ownership. Nevertheless, they exercise some measure of control through contractual conditions as expressed in the loan agreement.<sup>966</sup>

Mezzanine capital is any form of finance that ranks below senior debt but above ordinary equity in seniority. It is a mix of features of the equity and debt and includes: preferred shares; subordinated debt; and convertible debt. Usually, it provides only a fraction of the funding for the project.

Under the structured finance, there are five types of techniques but the most prominent is the project finance which seems to be mostly in use in all jurisdictions and suited for infrastructure financing in Nigeria and elsewhere. Other innovative mechanisms or techniques include: asset-based finance, leasing, receivable financing and securitization. However, for the purposes of discussion in this section, the focus will be on project finance which is mostly used and well-suited as an innovative financing technique in infrastructure development.<sup>967</sup>

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<sup>963</sup> Ibid.

<sup>964</sup> Yescome, ES (2007) 119.

<sup>965</sup> Niehuss (2010) 107.

<sup>966</sup> Ibid. 108.

<sup>967</sup> Project finance and asset-based financed have many similar characteristics and academics believe they are two sides of the same coin. However, there exists a thin line of divergence between the two. This will be pointed out in the appropriate section below.

#### 8.4.1.1. Project finance

Project finance is an off-shoot of a large cluster of financial techniques referred to as structured finance. Project finance transactions are reputed for positive outcomes like job creation, infrastructure development, technological improvements, training a better-educated workforce, and gaining access to international capital.<sup>968</sup> John Niehuss<sup>969</sup> defines ‘project finance’ tersely as ‘a special method of raising funds for projects-primarily in the energy, mining and infrastructure sectors’. He pointed out that project finance ‘has been used in connection with public-private partnerships to fund projects where the private sector works with a governmental entity to provide public services traditionally financed by governments’.<sup>970</sup>

In Black’s Law Dictionary, ‘project finance’ is defined as ‘a method of funding in which the lender looks primarily to the money generated by a single project as security for the loan. This type of financing is usually used for large, complex and expensive single-purpose projects such as power plants, chemical processing plants, mines and toll roads’.<sup>971</sup>

Where the contract provides for the building of an entirely new infrastructure facility and the private contractor takes the burden of financing and the cost becomes the kernel of the contract, project financing is usually used in this circumstance. In this case, third party financiers like banks are invited to provide a substantial part of the funding. Project finance is therefore a form of financial engineering well-suited for financing PPP projects.

It must however be noted that project finance is different from asset – based finance, such as leasing, where the asset value or its residual value is of primary importance. As such, project finance is viable machinery for financing infrastructural needs of a country where the demand for infrastructure far outstrips the economic resources of the country.<sup>972</sup> Again, the need for enormous debt and capital, coupled with the risks involved in large project development, often make project financing one of the few

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<sup>968</sup> Sarka R (2003) 146.

<sup>969</sup> Niehuss (2010) 1.

<sup>970</sup> Ibid.

<sup>971</sup> Ninth edition, 663.

<sup>972</sup> Hoffman (2008) 7.

available financing alternatives in the energy, transportation, and other infrastructure industries.<sup>973</sup>

John Niehuss explains further that it becomes an international project financing where a project has foreign dimension involving participants and/or funding from more than one international jurisdiction.<sup>974</sup>

As a financial model, it is usually used to fund the investments required to build infrastructure for economic growth and development.<sup>975</sup> Typically, in a structured financing ‘revenue generating asset (or group of assets) is segregated in order to serve as the source of debt repayment and shift the repayment obligation away from the entity that created the asset to the revenue stream generated by the asset’. The cash flow is generated by a greenfield operating asset created by the project as against the position in majority of other kinds of structured finance where ‘the cash flows used to repay the debt are generated by pools of existing financial assets’.<sup>976</sup>

Typically when projects are sponsored by governments they rely on allocations from their capital budgets funded primarily by revenues from tax collections which are augmented by local and cross-border borrowings. Where a private entity undertakes a project, the funding is usually from its internal cash resources, borrowing and in some cases, augmented with new equity. In all these cases, the financing methods are straight-forward. In these two examples, borrowings are based on the overall financial condition and credit-worthiness of the government or the private company in question and its ability to generate cash from the public or corporate assets and activities. Where the public sector in this instance or private sponsors are creditworthy with significant cash reserves and borrowing capacity, these traditional options are the fastest and least complicated means of funding infrastructure projects.<sup>977</sup>

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<sup>973</sup> Hurstel, D & Carpenter, MA (1994) 13.

<sup>974</sup> Niehuss op. cit.

<sup>975</sup> Ibid.

<sup>976</sup> Ibid.

<sup>977</sup> Ibid. 3.

However, public sector and private investors are in most cases cash strapped and unwilling or sometimes unable to raise the required financing for infrastructure project in the markets for plethora of reasons. These may include: poor credit rating and ‘a desire to avoid excessive concentration of resources and risks in a single project’. In these instances, they usually turn to project financing in raising the debt needed for the project. This creates an alternative option in financing projects where there is reliance on the ‘cash flow generated by the project itself’ and depends not completely ‘on financial capacity or creditworthiness’ of the public sector or private sponsor.<sup>978</sup>

In other words and uniquely too, project finance ‘relies on the revenue and assets of a single project’ for ‘equity returns, debt service and security for loans’.

This is in contrast with the methods the public sector and private sector typically use to raise financing which are usually called ‘sovereign borrowing and corporate finance respectively and ‘which establish creditworthiness by relying on revenues from all of the borrower’s projects and activities and on all of its assets as security’.<sup>979</sup>

John Niehuss has identified the features common to all domestic and cross-border project finance which also adds to their legal complexity.

These are: First, a Special Project Vehicle (SPV)<sup>980</sup> - a new creation of the sponsor of the project. The SPV is created as the owner of the project assets; enters into contracts in its name as a legal corporate entity and usually act as the borrower of the debt funds raised for the project. As described by John Niehuss, “the entity starts its existence as a shell with no assets, no income and no previous operating history and acts as the focal point or hub for the contractual and other activities associated with the project’.<sup>981</sup>

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<sup>978</sup> Ibid.

<sup>979</sup> Ibid.

<sup>980</sup> It is sometimes called Special Purpose Vehicle; Special Purpose Company or simply as Project Entity

<sup>981</sup> Niehuss 4.

Second the revenue stream. Here, the main source of payment of debt service and dividends is the revenue stream generated by the new asset created by the project. This takes the asset and the debt off the balance-sheet for the originating sponsor.<sup>982</sup>

Third, it is non-recourse or limited recourse financing. This means that there is no recourse to a sponsor's credit beyond its equity in SPV. Here, because the project financing depends on the revenue and assets of the SPV rather than the overall credit-worthiness of the sponsor for the repayment of the debt, they are usually referred to as non-recourse financing. As pointed out by Niehuss, in reality, it is rare for a project financing to be completely non-recourse. In most cases, sponsors are usually asked to provide some credit support which means that there is some measure of limited recourse to the sponsor. This kind of transaction is referred to as a limited recourse financing.<sup>983</sup>

Fourth is risk identification and mitigation. In project financing, there is 'an intense focus on the risks that might negatively affect these assets and the revenue stream they generate and on the measures available' to mitigate these risks. This is simply because the assets of a single project are the only source of revenue.<sup>984</sup>

Fifth, it is a contract-based financing. Project financing involves a complicated inter-related contracts which are created between the SPV and others involved in the project in order to help allocate risks associated with the project and to create and give projection to the expected revenue stream to be generated by the project assets. Because of the existence of so many contracts, the project finance is sometimes referred to as contract-based financing.<sup>985</sup>

Sixth, it is highly leveraged capital structure. According to John Niehuss, 'project financings typically have a large amount of debt relative to equity, and it is common to have 70-80% in debt financing and 20-30% in equity finance. The exact amount of

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<sup>982</sup> Ibid.

<sup>983</sup> Ibid. 5.

<sup>984</sup> Ibid.

<sup>985</sup> Ibid.

leverage is highly dependent on the basic project economics and the strength of the off-take or user contracts that create the revenue stream for the project'.<sup>986</sup>

Seventh, there is diversity of lenders. In project financing especially the one with international elements, diverse group of lenders are generally involved. This holds true typically for transactions in emerging markets. Lenders may include commercial banks, multilateral development banks, export-credit agencies, specialized bilateral agencies and purchasers of bond issues.<sup>987</sup>

Eighth is third party credit support. Generally, lenders are always reluctant to rely solely on a project's revenue stream for debt service and require various forms of third party back-up credit support to give assurance that their debt will be serviced even if the revenue stream never materializes or is diminished or interrupted. Such supports include guarantees, insurance, letters of credit, warranties, surety bonds and derivatives.<sup>988</sup>

Ninth, the project accounts. Usually, trust, reserve and other accounts are created to collect, segregate and protect the revenues generated by the project assets; establish payment priorities and to channel funds to the lenders for debt service and other priority uses.<sup>989</sup>

Tenth is security over project assets. In giving an additional level or layer of assurance to lenders, security interest are created in favour of the lenders over all project assets, including the concession, the sponsor's shares in the SPV, all project contracts and project accounts.<sup>990</sup>

Eleventh is renegotiation and restructuring. Given its complexity and long tenor, many projects need to be renegotiated or restructured at some point to accommodate

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<sup>986</sup> Ibid.

<sup>987</sup> Ibid. 6.

<sup>988</sup> Ibid.

<sup>989</sup> Ibid.

<sup>990</sup> Ibid.

unforeseen developments in the project or the external environment.<sup>991</sup> This is also an element of project financing.

Then lastly is the dispute settlement-It is imperative to give special attention to dispute settlement procedures for projects with international elements due to the involvement of interested parties from different nations of the world which makes the arrangement subject to different laws and treaties and to the interconnected nature of the contractual relations amongst the interested parties.<sup>992</sup>

#### **(a) Parties to project finance**

There are several parties to project finance especially where some of the parties are from different nations of the earth with different legal systems and regimes. Usually, this brings with it a complicated legal work because all the vested interest must be captured in the preparatory legal work. Generally, there are four main parties-the host government; the sponsors, lenders and contractors. These are the main decision makers in most of the key issues and their decisions determine the overall structure and the course of the project whether local or international.

Other parties whose role may be critical to the success of the project because of their various roles in providing specific services and functions include: the engineers and other technical professionals; contractors, credit support providers or guarantors; purchasers and users; input suppliers; operators and advisors which include lawyers, engineers, financial advisors, risk and insurance consultants, environmental experts, human right and community relations advisors, market and demand consultants and country and political risk advisors.<sup>993</sup>

The implication of this to a typical project financing is that quite a number of differing and somewhat conflicting legal interests must be considered and factored in by the sponsor and its legal team.<sup>994</sup>

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<sup>991</sup> Ibid.

<sup>992</sup> Ibid. 7.

<sup>993</sup> Ibid. 8-11.

<sup>994</sup> Ibid.

### **(b) Why project financing?**

Naturally project finance is a complex and time-consuming method of raising funds compared to more straight-forward corporate or sovereign finance options to be discussed later. For an instance and as rightly remarked by Niehuss, the number of parties with wide and varied interests in a project finance transaction is the one of the main reasons why the associated legal work is typically complicated. Parties to a project finance transaction usually include: the host government, sponsor, lenders, technical experts, contractors, providers of credit supports, purchasers and users, input suppliers, operators and advisors.<sup>995</sup> In the area of documentations, the process is also very complex and it varies from project to project subject to a wide variety of factors, in particular, the sector, the nature and source of financing and the project sponsors.<sup>996</sup>

Then, the question is: why is project financing the preferred choice? This brings the discussion to the advantages and disadvantages of the use of project financing.

### **(c) Upside**

Project financing has three main strong-points which tend to over-shadow the downside.

First, the debt raised by the SPV is usually off the balance sheet of the sponsor and enables the sponsor to expand its debt capacity by avoiding restrictions on additional borrowing in its existing debt instruments. This could be useful for smaller or less credit-worthy sponsors or governments who would not be able to raise debt for the projects on their own balance sheets.<sup>997</sup>

Second, in project financing, the sponsor may likely succeed in sharing risks with other parties in the project and lower its exposure to risk 'that it would need to assume solely if the use of traditional corporate financing is adopted. The possibility of sharing risks may be crucial in large projects.'<sup>998</sup>

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<sup>995</sup> Ibid. 7-11.

<sup>996</sup> Ibid. 17-20.

<sup>997</sup> Ibid. 21.

<sup>998</sup> Ibid.

Third, diversity of lenders, especially international development banks and agencies in a project financing, impact positively on the project and assist in making a project bankable. This also reduces the possibility of adverse action from the host government.<sup>999</sup>

#### **(d) Downside**

At the other end the spectrum, there are downsides to project financing.

First, the processes are convoluted in the sense that so many parties are involved especially if there is an international dimension to it. Second, the time to prepare, negotiate and document all related financial arrangements may be long. Third, the somewhat prohibitive costs of preparation expenses and the interest rates and other financing costs may be one of the downsides to the project financing.

Fourth, the freedom of action of sponsor or SPV is sometimes restricted through the contractual control of the lender. Then lastly, there is so much of difficulty encountered in the course of renegotiation and restructuring.<sup>1000</sup>

Project finance appeared on the infrastructure project development landscape for the first time in the 1970s and 1980s during the time when lumpy investments were needed in the oil, gas and power sectors. Then the capital value of a project was usually higher than the value of the companies contracted to design, construct and operate the project. The banks were providing the huge capital needed for investment where the investors had limited or no recourse to the parent companies in the event of failure of the infrastructure project.<sup>1001</sup>

Project finance is a common platform used in a concession contract where the infrastructure requires a huge capital investment upfront to build the infrastructure assets like roads, water treatment plant, rail track, and other critical infrastructure from which the required public services are to be delivered.<sup>1002</sup>

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<sup>999</sup> Ibid.

<sup>1000</sup> Ibid. 20-21.

<sup>1001</sup> See the National Policy on Public Private Partnership et al. 68.

<sup>1002</sup> Ibid.

### (e) Legal constraint

Project finance as a financing technique is relatively new and under-developed in Nigeria and one main constraint to its development is the legal constraint which undermines its expected positive outcomes especially its use by the private investors in mobilizing funds for infrastructure financing in Nigeria.

Because of the lack of specific legislative structure for project finance transactions in Nigeria, such transactions are governed by the general law of contract in particular and commercial law in general.<sup>1003</sup> Unfortunately, these bodies of Nigerian law are derived substantially from the antiquated received English law that consists of the principles of common law, doctrines of equity and statutes of general application of law in force in England as at January 1, 1990. The implication of this is that project finance contracts are still subject to some laws and principles that were enacted over a century ago. More intriguing is the fact that all these laws have long been repealed or amended decades ago by the British parliament.

The immediate outcome of this is that many project finance transactions have ended up in fiasco due to the fact that they were based on poorly constructed legal framework<sup>1004</sup> coupled with the problem of enforceability of contracts and the general obstructive tendencies in the realm of commercial justice system in Nigeria.

So, then, Nigeria is in dire need of an adequate legal structure or a 'project finance legislation' which will provide substantive specific and general rules governing project finance transactions in Nigeria, setting forth the 'rules of the game' and

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<sup>1003</sup> Generally, the law of contract and commercial law in Nigeria comprise received English law consisting of common law principles, doctrines of equity, statutes of general application; Nigerian legislation and court decisions. See Nwogugu E 'The Law of Contract' Introduction to Nigerian Law (1980) (ed.) Okonkwo CO Sweet and Maxwell 271; Mwalimu C (2009) Volume II Peter Lang Publishing Inc 399-404.

<sup>1004</sup> The improvement of 105-kilometre Lagos-Ibadan highway awarded by way of concession to Bi-Courtney Highway Services Limited under the PPP framework in Nigeria coincidentally provides a classic example of this. Some months ago, after years of non-commencement of the improvement of the highway due to lack of the funds, the wearied Nigerian public was informed that at last, the concessionaire had secured funding from a South African financier, Rand Merchant Bank. However, this cheering news turned out to be short-spanned. A disconcerting report again came up not too long ago when the South African financier wrote the International Centre for Investigative Reporting, Abuja, informing the public that 'rather than being a financier, it was appointed a financier advisor to the project as part of the a wider team.'. Obviously, devil is in the details concerning the legal documentation of the project finance transaction; see Osun Defender, Monday, November 19, 2012-[www.osundefender.org/?p=62975](http://www.osundefender.org/?p=62975)-last accessed 19/11/2012.

thereby injecting legal certainty into project finance transactions and by extension, the infrastructure market in Nigeria.

Such legislative intervention through the proposed enactment of a legislative framework for project finance will also stimulate the private investors' appetite for infrastructure financing and development in Nigeria. The provisions of this proposed law should be drafted in a manner to address the concerns of private investors as to the attendant legal and political risks in project financing. These suggested provisions will go a long way in allaying the fears of private parties to the project finance transactions especially the foreign investors. Such risks include: the possibility of the host government waving the flag of sovereign immunity; problem of enforceability of project finance contracts, changes in the agreement, to mention a few.

Part of this legal reform is the possibility of developing standardized contracts to also infuse certainty in the transaction and encourage investors.<sup>1005</sup> Such developed contractual terms and procedures which will form part of the legal substratum of the project finance structure and may end up helping to reduce transaction costs in project finance transactions in Nigeria.

#### **8.4.2 Corporate finance**

Aside structured finance, the other class of financing technique or model is corporate finance. Corporate finance approach involves the funding of a project provided from the investor's own balance-sheet resources, that is, as a corporate loan. This is quite suitable alternative approach. It is also known as balance-sheet finance. Here, the investor's available cash and credit lines are used to pay for the project, or if necessary, new credit lines or even new equity capital are raised to finance the project's cost. Provided it can be supported by the investor's balance sheet and earning record, a corporate finance loan is usually simple, quick, and cheap to arrange. In a corporate finance structure for PPP projects, the Project Company is usually a wholly-owned subsidiary of the investor, or the investor may enter directly into a project agreement with the public authority.<sup>1006</sup>

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<sup>1005</sup> Hoffman 20.

<sup>1006</sup> Ibid.

## **8.5 Innovative sources**

As pointed out above, in financing infrastructure development in Nigeria, the infrastructure investment gaps need a blend of domestic and external flows; external resources should not, however, replace but complement domestic resources and in the circumstance, nothing should be taken off the plate.

There are many creative financing mechanisms that can be used to bridge the financing gaps in infrastructure development in Nigeria. However, the discussion on the innovative sources shall be approached from three perspectives: innovative sources currently in use in Nigeria; those that can be used but not yet to be explored; and those that require legal reforms before they can become operative in Nigeria.

### **8.5.1 Innovative source(s) already in use**

The sovereign wealth fund remains the only innovative source of financing for infrastructure that could be said to be already in use in Nigeria and shall be the focus in the discussion under this segment.

#### **8.5.1.1 Sovereign wealth fund**

A sovereign wealth fund (SWF) is a state-owned investment fund composed of financial assets such as stocks, bonds, property, precious metals or other financial instruments.<sup>1007</sup>

The SWF is not only a tool for strengthening the fiscal framework but also a vehicle for infrastructure development and wealth creation for the nation. Leveraging on SWF can unlock cash for investments in sound infrastructure projects.

The Nigeria Sovereign Investment Authority (Establishment etc) Act was signed into law in May 2011 with US\$ 1 billion seed capital for the Fund, to enable its operation and the expectation that it will be funded monthly from excesses of budgetary revenue from oil. The legislation established the Nigeria Sovereign Investment Authority with the mandate to receive, manage and invests in a diversified portfolio of medium and long-term revenue of all the three tiers of government in anticipation of the depletion

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<sup>1007</sup>See Wikipedia-[http://e.wikipedia.org/wiki/Sovereign\\_wealth\\_fund](http://e.wikipedia.org/wiki/Sovereign_wealth_fund)-accessed last 14<sup>th</sup> September, 2011.

of Nigeria's hydrocarbon resources in conjunction with other investors for the development of critical infrastructure in Nigeria that will attract and support foreign investment, economic diversification, growth and job creation among other noble ideals.<sup>1008</sup>

The Nigeria Sovereign Investment Authority is an integral part of the country's macroeconomic wealth management framework. According to the former Finance Minister, Olusegun Aganga, the operation of the Sovereign Wealth Funds would help reduce government's 'susceptibility to the unintended consequences volatile oil prices can bring about, such as high inflation and adverse impact on economic growth, real appreciation of the currency, weak export base, surge in import and the accompanied unsustainable balance of payments position'.<sup>1009</sup>

The SWF was established to help Nigeria to conserve a percentage of money due to the Federation Account from crude oil in excess of what is appropriated by National Assembly. The legislation provides for the fund to be split into Nigerian Infrastructure Fund to support infrastructure development, among others. The Sovereign Wealth Investment Authority is empowered to manage the funds to 'prepare for the eventual depletion of Nigeria's hydrocarbon resources'.<sup>1010</sup>

As part of the functions of the Authority, the Act specifically provides for the establishment of a 'a ring-fenced portfolio of investment related to and with the object of assisting the development of critical infrastructure in Nigeria that will attract and support foreign investment, economic diversification and growth'.<sup>1011</sup>

Other funds to be set up under the Act are: the Future Generations Fund and the Stabilization Fund.<sup>1012</sup> These funds will be funded monthly through a significant portion of oil and gas revenue above the budgeted revenue. Such funds were

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<sup>1008</sup> See the explanatory memorandum to the Nigeria Sovereign Investment Authority (Establishment etc.] Act, 2011.

<sup>1009</sup> 'Governors and Sovereign Wealth Fund'- Sun Newspapers, Monday, August 29 2011

<sup>1010</sup> Ibid.

<sup>1011</sup> See section 3 of the Nigeria Sovereign Investment Authority Act 2011

<sup>1012</sup> Future Generations Funds is a diversified portfolio of appropriate growth investments for the benefit of future generations of Nigerian citizens. Stabilization Fund is portfolio of investments to provide supplemented stabilization funding based upon specified criteria and at such time as other funds available to the federation for stabilization needs to be supplemented.

previously escrowed in the Excess Crude Account (ECA) to stabilize the budget and close the budget deficits as a result of oil price volatility. It was also designed to provide fund for domestic infrastructure investments. The Act establishes a sovereign wealth fund to manage excess profits from the country's sale of crude oil. The SWF Act also provides to the effect that the Fund can be invested in private equity and venture capital among other types of assets. Infrastructure assets are very perfect alternative.<sup>1013</sup>

However, unlocking fund is one thing, channelling those funds into the sector that requires cash is another. There are cases of targeted domestic and international investments and grants that were set aside yet not utilized for one reason or another. A typical example is the attempt of the Central Bank of Nigeria and Bankers' Association to stimulate the private equity and venture capital industry in Nigeria where a programme was initiated for banks to mandatorily set aside 10 per cent of their pre-tax profits for equity investment in small and medium-sized industries-Small and Medium Industry Equity Investment Scheme (SMEEIS).<sup>1014</sup> According to latest CBN reports on the scheme, as at June 2009, a total of N42,024,988.746 was set aside under the scheme and N13,820,910.454 (over 32 percent was unspent). Lessons learned from this experience are that private equity does not exist in a vacuum. The provision of investment capital, through SMEEIS, pension funds or the SWF is only one part of the equation and a more holistic approach is needed if the intervention is to have the desired effect of growing businesses and creating jobs.<sup>1015</sup>

### **8.5.2 Other possible innovative sources yet to be explored**

These are innovative sources that have great potentials in being used to bridge the financing gaps in infrastructure development but yet to be used due to lack of political will on the part of the executive arm of government. These sources are in turn divided into two: long-term funds and bond instruments. Under the long-term funds, there are: pension funds and remittances; while under the bond instruments, there are: Islamic, lottery and Diaspora bonds.

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<sup>1013</sup> See 'Developing private equity and venture capital' ThisDay Newspaper, August 30 2011.

<sup>1014</sup> Ibid.

<sup>1015</sup> Moghalu op. cit.

### 8.5.2.1 Funds

#### (a) Pension funds

As argued in chapter 6, there is the need to expand the investment space for pension funds,<sup>1016</sup> and one of the outlets is the investment in infrastructure. Part of the pension funds may be put in the banks especially the Development Financing Institutions (DFIs) to make them more liquid and promote savings to be directed to infrastructure projects financing.<sup>1017</sup> Funds from this source may also be dedicated to debt financing of infrastructure projects through some selected banks under a very strict supervision. Besides, pension assets may also be invested in infrastructure projects through special purpose vehicle or infrastructure bond in the capital market. However, to accomplish this, pension law and regulations need to be amended accordingly.

The growing interest in pension funds as part of the broader infrastructure development strategy in Nigeria has been linked to the following factors like good investment match. Infrastructure assets such as toll roads, airports and electric utilities and others can yield long term and predictable revenue streams which match the long term liabilities of a pension fund covering the same period thereby making a good fit.<sup>1018</sup>

Then, infrastructure serves as alternative investment classes for pension funds looking to expand and balance out volatile equity investments with more secure asset classes thereby giving the platform for diversification. It may also be argued that there is this incentive about low investment risks, though this is debatable. Infrastructure investments are usually closely regulated and most times enjoy a monopoly within the society. Examples are transport infrastructure and power. This eliminates or reduces to a minimal level competition risks making them attractive to pension funds. Pension funds also find infrastructure projects attractive as their ‘public goods<sup>1019</sup> status’ which makes them socially responsive investments.<sup>1020</sup>

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<sup>1016</sup> Ibid.

<sup>1017</sup> Ibid.

<sup>1018</sup> World Bank Making finance work for Nigeria 16.

<sup>1019</sup> ‘Public good’ is an economics concept that means if a person consumes the good, there is no less for everyone else; example is the air we breathe. This concept also includes the requirement that no one can be excluded from using it, that is no corporation can gain control of it and sell it as a commodity. See Grigg, N (2011) Water finance, Wiley & Sons, Inc. 188.

<sup>1020</sup> World Bank ‘Making finance work for Nigeria’ (2009) op. cit.

Deploying the pension funds involves development of other credit instruments, reduce risk, increase transparency and standardize the processes and clarify regulations.

The regulatory authorities must be proactive in its oversight and regulatory functions and must also leverage on the reforms in the banking and non-banking financial sector to promote growth of pension fund assets and ensure reasonable returns on pension fund investment. The National Pension Commission (PenCom) expanded its investment guideline in December, 2010 to include new asset classes, where pension funds can be invested in and they include private equities.<sup>1021</sup>

Nigeria can mobilize an increasing pool of capital to fund its long-term infrastructure requirements<sup>1022</sup> and create a sound foundation for availability of functional infrastructure.

The pension industry in Nigeria has undergone transformative reforms in recent years and the newly-established, fully-funded pension funds are accumulating considerable amounts of capital that can be productively channelled into investment in the economy. Based on their medium to longer term investment horizon, pension funds provide natural sources of funding for Nigeria's considerable infrastructure investment needs.<sup>1023</sup>

The nation's huge infrastructure deficits present enormous opportunities for pension funds investment in the area of enhancement of the safety of the pension fund assets via diversification of the pension fund portfolios and income streams as well as contributing to procurement of critical infrastructure that would create jobs and deliver services to the public.<sup>1024</sup> This is however not without its risks as pointed out above.

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<sup>1021</sup> Ibid.

<sup>1022</sup> As cited in Chapter, the Debt Management Office has established that Nigeria's current infrastructure deficit requires capital investments to the tune of US\$100 to US\$111 billion. The magnitude of financing required to bridge the country's infrastructure deficit currently outstrips the supply of capital available from the public sector.

<sup>1023</sup> World Bank 'Making finance work for Nigeria' (2009) op. cit.

<sup>1024</sup> PENCOM to monitor investments et al.

Leveraging the growing pool of pension funds into PPP projects will go a long way in addressing the perennial infrastructure deficits and lack of finance. This will however not happen without some challenges.<sup>1025</sup>

Pension funds under administration in Nigeria are expected to quadruple in next few years. The issue is how to explore the means to bring this class of investors more directly into PPP financings. This has the benefit of diversifying the funding pools away from commercial bank finance by tapping into other domestic savings pool.<sup>1026</sup>

Without doubt, the capital market remains an important investment platform for the growing pension funds. Pension fund business is a long-term one and not speculative, hence, infrastructure investment remains a very sensible outlet for portfolio investments. As a long-term investment, factors such as bonuses, dividends and rights issues are more important than short-run price moment.

Under the pension funds regulations, Pension Fund Administrators (PFAs) are expected to maintain a maximum exposure if not more than 25% of the total portfolio rate to ordinary shares. The implication of this is that at each point in time, 75% of the total pension fund investments are not exposed to ordinary shares.<sup>1027</sup>

Pension Fund Administrators (PFAs) under the regulation of the National Pension Commission increased their investment in the stock market from N36.70 billion in 2009 to N60.07 billion in 2010.<sup>1028</sup>

The huge idle funds are lying in the vaults without the investors' access to it. Hence, the call for the amendment of the relevant laws to grant the PPP investors access to the idle funds.

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<sup>1025</sup> Vella, Julian (2010) 'Pension savings could be put to work for infrastructure development' 143.

<sup>1026</sup> Ibid.

<sup>1027</sup> "Pension fund investments in stocks hit N60 billion" ThisDay Newspaper, Thursday, 8 Sept, 2011.

<sup>1028</sup> Ibid.

In response to this well-intentioned call, the Commission embarked on an extensive process of reviewing the investment regulation with a view to open up new opportunities for pension fund investments. This came to limelight through the investment regulation which came into effect in December 2010. Under the regulations, pension funds are now allowed to be invested in infrastructure bonds that are registered by the Securities and Exchange Commission.

To ensure that only bankable projects are invested in, the Commission has also come up with the revised investment regulation stating the requirements to be fulfilled by issuers of infrastructure bonds and managers of specialist infrastructure funds.<sup>1029</sup> Section 5.2.3 of the Regulation on Investment of Pension Fund Assets<sup>1030</sup> provides to the effect that Pension Fund Assets can be invested in infrastructure projects through eligible bonds or debt securities, subject to some specific requirements.

According to the section, the infrastructure project shall be:

- awarded to a concessionaire through an open and transparent bidding process;
- not less than N5 billion in value;
- managed by concessionaire with good track record;
- in accordance with and meet due process requirements of the Public Private Partnership (PPP) Policy, as certified by the Infrastructure Concession and Regulatory Commission (ICRC) and approved by the Federal Executive Council (FEC);
- of the nature of core infrastructure, which include roads, railways, airports, ports, power and gas pipelines (and related facilities), and other infrastructure projects that may be approved by the Commission, from time to time.

Moreover, the bonds or debt instruments issued to finance the infrastructure project shall in addition to the other requirements relating to Pension Fund Assets' investment in bonds, debentures, redeemable/convertible preference shares and other debt

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<sup>1030</sup> Issued on the 16<sup>th</sup> day of December, 2010.

instruments issued by corporate entities,<sup>1031</sup> have robust credit enhancements like guarantees by the Federal Government or eligible bank/development finance institutions; have a maturity date that is prior to the expiration of the concession; and have a redemption procedure in the event of project suspension or cancellation.<sup>1032</sup>

However, where infrastructure projects are financed through Specialist Infrastructure Funds, pension fund investments shall be subject to the following additional requirements:

- the Infrastructure Fund shall have well defined and publicized investment objectives and strategy as well as disclosures of pricing of underlying assets; annual financial statements audited by reputable firms of chartered accountants; and any other necessary information;
- the Infrastructure Fund shall have satisfactory pre-defined liquidity/exit routes;
- the Funds shall be managed by experienced Fund Managers, versed in infrastructure financing and registered with the Securities and Exchange Commission as fund managers;
- the key management officers of the Fund Manager shall have at least ten (10) years relevant experience in infrastructure financing; and shall not exit the Fund without the prior notice to the Commission through the Pension Fund Administrators;<sup>1033</sup>
- the Fund Manager shall retain a minimum of 5% of the Infrastructure Fund;
- the Fund have reputable development finance institutions or multilateral development finance organizations as co-investors. Alternatively, the Fund Manager shall have a minimum Investment Manager rating of 'BBB' issued by a rating company registered or recognized by Securities and Exchange Commission;
- a minimum of 75% of the Infrastructure Fund shall be invested in projects within Nigeria;

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<sup>1031</sup> See section 5.2.2 of Regulation on Investment of Pension Fund Assets issued by the National Pension Commission.

<sup>1032</sup> See section 5.2.3, *ibid.*

<sup>1033</sup> This 'exit clause' shall be expressly stated as a condition in the investment agreement/covenant between Pension Fund Administrator and Fund Manager.

- the Fund shall have an Advisory Board with independent representatives of institutional investors being in majority.<sup>1034</sup>

With Infrastructure Funds, many may typically invest in equities of companies that are involved in developing infrastructure.

Though the value of the pension funds assets under the management of Pension Fund Administrators stood at N2.2 trillion as at end of May, 2011, no investment has yet been made on such securities because the instruments or products are not available at the Nigerian stock.<sup>1035</sup>

Through the pension funds, Nigeria can mobilize an increasing pool of capital to fund its long-term infrastructure requirements<sup>1036</sup> and create a sound foundation for availability of functional infrastructure.

### **(b) Remittances**

Remittances are a large and stable source of external financing that can potentially be creatively leveraged for infrastructure development priorities in Nigeria. Remittances can improve capital markets access of banks and government in poor countries by improving ratings. Hard currency remittances that are properly accounted for can improve a country's risk rating.<sup>1037</sup>

However, the Central Bank of Nigeria needs to exercise its regulatory powers over liquidity management of the Nigerian monetary policies and its development

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<sup>1034</sup> See section 5.2.3 of the Regulation on Investment of Pension Fund Assets, *ibid*.

<sup>1035</sup> Pension funds can be invested in infrastructure-PENCOM-The Punch Thursday, 15 September, 2011. This is as a result of lack of needed infrastructure in the capital market. This shall form the fulcrum of the discussion of this study when the need to reform the financial sector of the Nigerian economy comes under focus in the next chapter.

<sup>1036</sup> PENCOM to monitor et al.

<sup>1037</sup> As cited somewhere else earlier on in the study, the Debt Management Office<sup>1036</sup> has established that Nigeria's current infrastructure deficit requires capital investments to the tune of US\$100 to US\$111 billion. The magnitude of financing required to bridge the country's infrastructure deficit currently outstrips the supply of capital available from the public sector.

functions pursuant to the enabling provision of the Act to ensure that the currency remittances are accounted for and are well managed and channelled appropriately into Nigeria's infrastructure development programmes in tandem with the nation's development priorities.<sup>1038</sup> With an appropriate policy framework from the side of the apex bank, the perennial shortage of funds within the financial system which undermines the lending capacities of some of the infrastructure participating banks, especially the Development Banks, may become a thing of the past and the difficulty in borrowing by serious private investors for infrastructure financing will improve considerably.

Generally, remittances from migrants are a market-based external source of development finance<sup>1039</sup> and though they are seen as an instrument of global redistribution-an international mechanism of social protection, they are also a source of finance for capital formation, financing infrastructure development in a community and also providing start-up capital for new business enterprises.<sup>1040</sup>

AB Atkinson identified several reasons for remittance. According to him, 'transfers may be made: because the migrant desire to assist family members at home country; as a form of savings; to provide for a later return home; and repayment of loans that allowed migrant to study and travel abroad. Sometimes, emigration may be part of a co-insurance strategy, with remittances being made when the migrant is successful and the family home at home guaranteeing support in the case of failure'.<sup>1041</sup>

Over the years, remittances have been higher than ODA flows and FDI in some of the sub-Saharan African nations. Remittances through unofficial channels are believed to be even higher than the recorded flows.<sup>1042</sup> Remittances are the second largest source

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<sup>1038</sup> Sections 30 & 31 of Central Bank of Nigeria Act, 2007 empower the apex bank to take some actions that are critical to the liquidity management issues within the economy and its developmental functions which are needful 'for the purpose of promoting the development of money or capital markets in Nigeria or of stimulating financial or economic development'.

<sup>1039</sup> 'Market-based' in the sense the rates of remittances are determined by the law of supply and demand rather than by the government.

<sup>1040</sup> Atkinson AB (2004) 14.

<sup>1041</sup> Ibid. 20.

<sup>1042</sup> Ratha et al 154.

of foreign capital after FDIs<sup>1043</sup> and are currently the most important source of external finance to developing countries. They are more than foreign aid and have the feature of being more stable than volatile capital flows like portfolio investment and international bank credit. They are generally an international redistribution from low income migrants to their families in the home country.<sup>1044</sup>

There are various mechanisms for leveraging remittances for the purposes of infrastructure development. Governments and local financial institutions can issue infrastructure bonds for emigrants,<sup>1045</sup> who would earn an interest rate, creating a more attractive instrument of channelling remittances.<sup>1046</sup> It may also be channelled into banks for debt financing thereby giving liquidity to the banks.<sup>1047</sup>

Through these mechanisms, remittances can support infrastructure development in Nigeria. Also banks in Nigeria can leverage remittances and raise funds by securitizing remittance receivables and then use the proceeds to increase lending. Remittance securitization typically involves a bank pledging its future remittance receivables to an offshore special purpose vehicle (SPV). The SPV issues the debt. Designated correspondent banks are directed to channel remittance flows of the borrowing bank through an offshore collection account managed by a trustee. The collection agent makes principal and interest payments to the investors and sends excess collections to the borrowing bank. Since remittances do not enter the issuer's home country, the rating agencies believe that the structure mitigates the usual sovereign transfer and convertibility risks. Such transactions also often resort to excess coverage to mitigate the risk of volatility and seasonality in remittances.<sup>1048</sup>

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<sup>1043</sup> 'World Bank, ADB propose Diaspora Bond for Nigeria, Others' THISDAY, Thursday 30<sup>th</sup> March 2011.

<sup>1044</sup> Solimano, A (2003) Remittances by Emigrants, Discussion Paper No. 2003/89 United Nations University-WIDER 11.

<sup>1045</sup> 'Infrastructure bond for emigrants' is a subset of 'diaspora bonds', while 'infrastructure bond for emigrants' is a fixed-interest instrument designed to creatively raise funds from a country's emigrants to finance infrastructure development in particular, 'diaspora bonds' are long term securities to be redeemed only upon maturity used as innovative instruments for financing development of a country in general. In this sense, infrastructure development is one of the components of development as a whole.

<sup>1046</sup> Ibid.

<sup>1047</sup> Ibid.

<sup>1048</sup> Ketkar at la (2009) Innovative financing for development 39.

By mitigating currency convertibility risk, a key component of sovereign risk, the future-flow securitization structure allows securities to be rated better than the sovereign credit rating.<sup>1049</sup>

Another possibility is for domestic banks to offer foreign currency accounts for migrants free of exchange rate taxes and other regulations. In addition, housing and accounts can be created to channel remittances to various productive uses in the home country such investment in durables (housing) and education (investment in human capital).<sup>1050</sup>

Remittances open foreign exchange flow, complement national savings and is a source of financing for capital formation.<sup>1051</sup>

Remittances have become a very significant source of development finance for several developing countries:<sup>1052</sup> they are a source of foreign exchange; they support consumption levels of low-to-middle-income families and constitute a direct source for funding small community-oriented investment project finance tied to migrants associations that send home donations to fund these types of projects. From a social point view, remittances can have a positive poverty-reducing effect, as many families of the migrants who receive remittances are low-income people, although the syndrome of dependence from remittances' income by recipients should be avoided.<sup>1053</sup>

Properly mobilized remittances could contribute to increase investment in basic infrastructure such as water, roads, low-income housing, school-buildings, and investment in human capital (education) and help to finance micro and small-scale firms. For remittance-sending countries, remittances represent a market-based

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<sup>1049</sup> Ibid.

<sup>1050</sup> Ibid.

<sup>1051</sup> Solimano, 11

<sup>1052</sup> Countries like: India, China, Mexico, Philippines, Egypt, Pakistan, Bangladesh, Nigeria, Vietnam and Lebanon are reported to be top 10 recipients of remittances among developing countries in the year 2011. See Migration and Development Brief 18, Remittances Flows in 2011 The World Bank – last accessed at <http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-onthe1110315015165/MigrationandDevelopmentBrief18.pdf> on the 26<sup>th</sup> August 2012

<sup>1053</sup> Solimano, 7.

international transfer<sup>1054</sup> to developing countries that, indirectly, reduce the demand for official development assistance.<sup>1055</sup>

The costs of remittances should be reduced, and the flows increased through banking channels and constructively leverage these flows to improve capital market access of banks and governments by improving ratings and securitization structures. Shifting remittances from informal to formal channels may require eliminating parallel market premiums, improving access to formal finance for poor households, and reducing regulating barriers to entry of new operators.

However, there have been concerns about the stability of remittances, the incentives the governments may have to divert remittance flows from banks involved in securitization, and the ability of banks to securitize remittances that don't belong to them.<sup>1056</sup>

But it must be said that earning foreign exchange through remittances entail an implicit trade-off with the outflow of skilled national and manpower from the sending countries. Presently, the potential development impact of remittances is in part impaired by the existence of a costly, concentrated and poorly competitive international market for remittances.<sup>1057</sup>

Although the involvement of commercial banks in the remittances business is still low, the evidence shows that the costs of sending remittances tend to be lower if sent through banks rather than through international money operators.<sup>1058</sup>

On the recipient side, the issuance of remittance bonds, opening of foreign currency accounts for migrant workers in the home country, the creation of facilities for voluntary donations for projects are all measures to leverage remittances for development. In turn, the creation of education and housing accounts at home for migrants could help to encourage the productive and social use of remittances

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<sup>1054</sup> The international transfer is market-based in the sense that such transfer is determined by the law of supply and demand rather than by the government.

<sup>1055</sup> Solimano op.cit.

<sup>1056</sup> Ibid.

<sup>1057</sup> Ibid.

<sup>1058</sup> Ibid. 11.

proceeds. Also attracting the return of emigrants that can bring fresh capital, new ideas and international contacts can be a promising way to attract remittances for growth and development in receiving countries.<sup>1059</sup>

The major challenge however, facing international market for remittances is the high cost of intermediation. Most money transmitter operators that dominate the market charge high fees and use over valued exchange rates. The development potential of remittances will be greatly enhanced if the international money transfers were conducted at lower cost.<sup>1060</sup>

It has also been suggested that the most obvious means to increase the scale of remittances is via policies to reduce the transaction cost of remittances. It has been observed that many migrants face obstacles in accessing bank services in the sense that the bank intermediation is well tailored to their needs.<sup>1061</sup> Therefore, as observed by A.B. Atkinson, competition could increase bank receptiveness to the requirements of migrants, and measures can be taken to facilitate entry into the money transfer business, such as reducing licence costs.<sup>1062</sup>

It should however be noted there are no legal barriers that prevent receipt of remittances in Nigeria by licensed institutions. Here like in cases of the Islamic, lottery and diaspora bonds, the need for industry-specific or general legislation does not present itself, rather the apex bank, the Central Bank and Securities and Exchange Commission which is the apex regulatory authority for the Nigerian capital market, may only need to exercise their wide regulatory powers to make rules and regulations and develop remittance products as financial vehicles for attracting remittances from Nigerian emigrants which will then be channelled into infrastructure development in the country.

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<sup>1059</sup> Ibid.

<sup>1060</sup> Ibid. 6-7

<sup>1061</sup> Atkinson AB 20.

<sup>1062</sup> Ibid.

### 8.5.2.2 Bond instruments

Under this group, this study will take a look at the potential uses of bond instruments in financing infrastructure project development. It should be reiterated here again that the critical importance of a sound and effective capital market that is well-regulated and supervised in bridging the huge financing deficit in infrastructure project development cannot be over-emphasized. Opportunities abound in Nigeria for different kinds of bond instruments to be floated and leveraged on in financing critical infrastructure projects for growth and development.

#### (a) Bonds

##### i. Islamic bond

Bridging the huge financing requirement in infrastructure procurement and service delivery in Nigeria requires creativity. Hence, the idea has been mooted for the creation of Islamic bond as another innovative financing instrument well-suited for the scaling up of the nation's infrastructure level.<sup>1063</sup>

The Islamic bond option otherwise known as 'sukuk' has become an important platform for funding of large scale infrastructure projects around the world. On the side of the investors, the Islamic bond market provides greater potential and platform for diversification into new asset classes. As pointed out by Mansur Ahmed,<sup>1064</sup> sukuk has matured into a diversified internationally acceptable financial instrument to raise corporate finance for acquisitions or working capital purposes, or used in the transportation sector, real estate, building of infrastructure and petrol-chemical projects in many nations around the globe.<sup>1065</sup>

'Sukuk'<sup>1066</sup> are certificates that represent a proportional, undivided ownership right in tangible assets or pools that comply with the principles of Islamic finance. Sukuk

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<sup>1063</sup> Islamic banking: Federal Government inaugurates committee on infrastructural financing-The Punch, Tuesday, 12 July 2011.

<sup>1064</sup> Ibid.

<sup>1065</sup> Ibid.

<sup>1066</sup> Sukuk (a plural noun in Arabic)-literally means "certificates", refers to an arrangement where holders acquire a beneficial interest in the assets in proportion to the value of the Certificates that they hold. Sukuk are investment certificates designed to be in compliance with the shariah. The Accounting Auditing Organization of Islamic Financial Institutions defines sukuk as certificates of equal value

market is a potential source of funding of infrastructure projects. The market is fast growing which is reflective of investor's interest in the instrument. Sukuk has been deployed extensively for infrastructure projects in the oil and gas sector, water, power and transport. It has served as an alternative to government funding or private debts for private concessionaire.<sup>1067</sup>

The Islamic bond indeed has a very great potential in Nigeria against the backdrop of the large population of Muslims in this most populous black nation in the world. The government can leverage on sukuk, if properly harnessed, to raise funds from international markets and diversify sources of funding for infrastructure projects critical to national development.<sup>1068</sup>

Successes have been recorded in the use of Islamic financing instrument in infrastructure development in some parts of the world. However, as argued by Mansur Ahmed, the critical imperatives for the successful issuance of Islamic bonds in Nigeria will include the right regulatory and taxation framework, transparent transaction structure, credit rating, marketing, risk and mitigating measures, appropriate technical capacity and guarantees.<sup>1069</sup>

Islamic bond or sukuk is one of the Islamic capital market securities. It is the most common form of Islamic financial instrument. Islamic bonds or sukuk 'are wholesale asset-based capital market securities. Issuance of this shariah-compliant financing instrument by corporate and public sector entities has witnessed a surge in the Islamic world amidst the increasing demand for alternative investments. Though Islamic bonds are stable in a manner similar to the conventional asset-based securities (ABS), they mostly have a considerable different underpinning structures and priorities.<sup>1070</sup>

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representing undivided shares in the ownership of tangible assets, usufruct (i.e, usage) and services or in the ownership of assets of a particular project or investment activity-See Development of an Islamic bond market in Hong Kong what are the tax implications? KPMG, 4.

<sup>1067</sup> Ibid.

<sup>1068</sup> Sanusi L 'Islamic bond for infrastructure financing'-[www.cenbank.org/](http://www.cenbank.org/)-accessed on 12<sup>th</sup> January, 2012.

<sup>1069</sup> See the ICRC website-<http://www.icrc.gov/>-last accessed 15<sup>th</sup> September 2011.

<sup>1070</sup> Jobst A, Kunzel K, Mills P & Amadou Sy, (2008) Islamic Bond Issuance-What Sovereign Debt Managers Need to Know, IMF Policy Discussion Paper, 3-4

1071 Ibid.

Importantly, Islamic bonds like other Islamic financial products need to be shariah compliant, which generally prohibits the receipt and payment of interest and provides that income must be derived from an underlying real business risk rather than as a guaranteed return from a loan. This means that Islamic bonds or sukuk do not provide an explicit return guarantee or investment protection. Investors only own the underlying asset (s) via a special purpose vehicle (SPV), which funds unsecured payments to investors from direct investment in real religiously-sanctioned economic activity.<sup>1071</sup>

Under this financial transaction, ‘sukuk commoditize the proceeds from asset transfers between capital providers and users of different Islamic finance contracts’. The issuers of sukuk substitute capital market investors for traditional lenders as source of funding by converting the expected proceeds from bilateral risk-sharing between borrowers and lenders in shariah-compliant finance contracts-such as lending transactions (instalment sale) or trust-based investments in existing or future assets-into marketable securities,. Hence, Islamic bonds usually refinance the assets of one (or a combination) of three basic forms of Islamic finance-synthetic loans (marabaha), sale-lease backs (ijara), or profit-sharing arrangement (musharaka or mudharabah)<sup>1072</sup>

It is needful to note that though global issuance of Islamic bond still remains a fraction of the issuance of conventional bonds, the Islamic bonds market has been developing despite the global financial crises triggered by the collapse of the United States sub-prime market.<sup>1073</sup>

Historically, the issuance of Islamic bonds or sukuk has usually been denominated in US dollars, domestic currencies may also be the currency of choice and its issuance is concentrated in parts of Asia and the nations of the Gulf Cooperation Council.<sup>1074</sup>

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<sup>1072</sup> Iqbal Z & Murakur A (2006) *An Introduction to Islamic Finance-Theory and Practice*” Wiley Finance Editions, New Jersey cited in Jobst, A, Peter Kunzel, Paul Mills, and Amadou Sy, (2008) *Islamic Bond Issuance-What Sovereign Debt Managers Need to Know*, IMF Policy Discussion Paper, 3-4.

<sup>1073</sup> Ibid.

<sup>1074</sup> Ibid.

Though the Islamic bonds or sukuk are still evolving, there is preponderance of a select few in the market. For example, musharaka contracts continue to be the largest sukuk. In a musharaka, both the financier and borrowing enterprise (and possibly others) jointly contribute funds to an existing or future projects in form of capital or in kind, and ownership is shared according to each party's financial contribution.<sup>1075</sup>

This type of Islamic bond or sukuk will be well-suited for infrastructure financing in Nigeria through the Special Project Vehicle,<sup>1076</sup> although lease-based transactions are the commonest.<sup>1077</sup>

The issuance of Ijara sukuk (which fund the gainful long term transfer of an asset or service for a specified rent and term, frequently conditional on the future purchase of the assets for an agreed lawful consideration comes second in issuance. However, in terms of overall market-share, the issuance of trustee-type mudarabah structures (to fund a project or asset, which is then exclusively managed by the entrepreneur in accordance with agreed business objectives between financier and debtor) comes third in issuance.<sup>1078</sup>

The growing Islamic bonds market reflects the increasing need for long term funding instruments in Islamic finance which can be leveraged on for infrastructure development and service delivery.<sup>1079</sup>

The Islamic bonds market is not without challenges especially in the areas of laws and regulations.

First, Islamic jurisprudence is neither definite nor bound by precedent and rulings in one jurisdiction may not be uniformly enforced in others.<sup>1080</sup> As a result, the absence

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<sup>1075</sup> Ibid.

<sup>1076</sup> This is a new entity created by the sponsor of the project and usually called SPV. The SPV is typically created to own the project assets, enter into contracts and normally act as the borrower of the debt funds raised for the project. The entity starts its existence as a shell with no assets, no income and no previous operating history and acts as the focal point or hub for the contractual and other activities associated with the project.

<sup>1077</sup> Jobst et al op. cit.

<sup>1078</sup> Ibid

<sup>1079</sup> Ibid. 8.

of widely recognized standards for shariah compliance may challenge the legal status and restitution interest of investors.<sup>1081</sup>

Second, in the same vein, regulatory standards pertaining to shariah compliance vary considerably. Greater standardization would improve the valuation and efficient pricing of sukuk and enhance the development of secondary market liquidity within the regulatory environment that are cast in a way to be flexible enough to adapt to the characteristics of new Islamic capital market securities while preserving universal standards of market supervision and financial surveillance.<sup>1082</sup>

Islamic finance is driven by the general precept of extending the tenets of the religious beliefs in the shariah to financial agreements and transactions. Shariah law bans the sale and purchase of debt contracts, profit taking without real economic activity as well as activities that are not considered halal (shariah compliant). Only interest-free forms of finance associated with investment that do not involve any association with pork, alcohol, fire arms, adult-entertainment or gambling are considered permissible in Islamic finance.<sup>1083</sup>

Nigeria too is in a bid to establish Islamic bonds issuance. This is several months after Islamic Halal Fund was introduced for listing on the Nigeria Stock Exchange, the country's shariah compliant investment instrument. The ethical investment fund is managed by Lotus Capital, a full-fledged ethical financial institution structured along the Islamic legal code which is committed to providing innovative asset management, private wealth management and general financial advisory services.<sup>1084</sup>

With the coming on stream of Islamic capital market products, many believe that Nigeria will be able to attract huge Islamic funds in global financial institutions said to be worth US\$1.3 trillion. Another advantage, it is noted, is that the nation's

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<sup>1080</sup> Presently, the shariah approval process is adhoc and beset by legal uncertainty from the heterogeneous assessment of shariah compliance across different jurisdictions and Islamic schools of thought.

<sup>1081</sup> Since Islamic law itself is divided in different juristic schools of thought (madhahib), there is no consistent ruling of Islamic courts on religious compliance of the eligibility of certain assets and transaction structures. That said, some progress has been made to establish general applicability of shariah standards.

<sup>1082</sup> Jobst et al op. cit. 10.

<sup>1083</sup> Ibid.

<sup>1084</sup> Nigeria: CBN partners DMO for Islamic bonds-Daily Independent-21 June 2011.

financial system will benefit from the Islamic financial market estimated to be US\$ 230 billion in size, with an annual growth rate of between 12 and 15 percent.<sup>1085</sup>

With the introduction of Islamic capital market securities, it has been argued by some experts that it will help Nigeria's capital market attract some of the huge funds packaged in Islam compliant instruments and not invest in activities that conflict with Islamic principles. It is also believed that it will represent "an assertion of religious law in capital market transactions where the market is free from prohibited activities and elements such as *riba* (usury), *maisor* (gambling) and *ghurer* (ambiguity)"<sup>1086</sup>

Islamic finance considers money to have no intrinsic value in itself. It is mainly a store of wealth and a medium of exchange and, as such, it is unjust to increase its value merely by lending it to another person. Therefore, financial instruments such as bonds, debt securities and deposits involving the receipt and payment of interest (*riba*) are not acceptable to Islamic communities.<sup>1087</sup>

A company wishing to raise finance through *sukuk* will usually issue certificates to investors for cash, and identify assets that are then ring-fenced in some way-typically, but not necessarily, the company will make a declaration that it holds these assets on trust for the certificate holders. The assets are used to generate income, which is periodically distributed to the certificate holders. These periodic distribution are frequently benchmarked to a rate of interest, so that-for example-investors may receive quarterly distributions equal to London-Inter-Bank Offered Rate (LIBOR) plus a margin, calculated based on the capital they have subscribed.<sup>1088</sup>

The concept of *sukuk* is similar to the securitization of assets. It is a process under which assets are pooled together, repackaged as tradable certificates of investments and transferred to a large number of investors. Typically, the ownership of the assets is transferred to a special purpose vehicle (SPV). The SPV funds the purchase of assets by issuing participation certificates (i.e *sukuk*) to investors. During the life of

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<sup>1085</sup> Daily Independent-Nigeria: CBN partners DMO for Islamic bonds-21 June 2011

<sup>1086</sup> Ibid.

<sup>1087</sup> Development of an Islamic bond market in Hong Kong what are the tax implications? KPMG op. cit, 3.

<sup>1088</sup> Ibid.

sukuk, the investors earn revenue generated from the underlying assets. Similar to conventional bonds, sukuk have a defined period of investment and give the investors relatively predictable stream of income or return. However, sukuk are distinguished from conventional bonds in that they represent the beneficial ownership of tangible assets rather than being a debt instrument. Sukuk holders bear the risk and liability of the underlying assets rather than the risk of insolvency of debtors. Further, the returns to sukuk holders are linked to the performance or the operation/management of the underlying asset which are not fixed ex-ante.<sup>1089</sup>

It should be noted that sukuk are similar to regular bonds in that they provide a cash flow to investors and help raise capital to finance long term projects.

## **ii. Lottery bond**

Another locally-based innovative financial instrument is the lottery bond. Lottery bonds are a genre of government bond in which some randomly selected bonds within the issue are redeemed at a higher value than the face value of the bond. They are typically issued only by a government. Lottery bonds are in use in France, Belgium and other major nations of Europe.<sup>1090</sup>

The lottery payout structure entails a method of random draws. Every issued bond is similar to a lottery ticket with an equal opportunity at winning payments in monthly draws for cash prizes. The prizes are typically larger than coupon payments on regular payout bonds. However, there exists the likelihood that a bondholder will not win any of the cash prizes during the life of the bond.<sup>1091</sup>

The lottery bonds can be creatively used to finance critical infrastructure in Nigeria. Lottery bonds are usually issued in a period where investor's zeal is at the lowest ebb and government may see an issue failing to sell. In order to encourage the sale of bonds, bonuses other than interest and early sale premium can be given.

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<sup>1089</sup> Ibid.

<sup>1090</sup> See [http://en.wikipedia.org/wiki/Lottery\\_Bond-Last](http://en.wikipedia.org/wiki/Lottery_Bond-Last) accessed 1st September, 2011. See also <http://www.investopedia.com/terms/l/lotterybond.asp>.

<sup>1091</sup> <http://www.investopedia.com/terms/l/lotterybond.asp-Last> accessed 1st September, 2011.

The Nigeria's National Lottery Act 2005 was signed into law on the 30<sup>th</sup> day of March, 2005. The Act, in the main, provides for the operation of the national lottery and the establishment of the National Lottery Regulatory Commission saddled with the responsibility for regulation of the national lottery business in Nigeria. It also provides for the establishment of a National Lottery Trust Fund.<sup>1092</sup> The Act also provides for the establishment of the National Lottery Fund which is expected to be funded through a percentage of the bet proceeds of a national lottery.<sup>1093</sup>

Section 40 of the Act in particular states that the proceeds of the Trust Fund shall be applied to finance projects and these projects must 'be in the interest of the Nigerian community and such projects shall include but not limited to projects for the advancement, upliftment and promotion of sports development, education, social services, public welfare and relief, and management of natural disasters in Nigeria.'

Though the lottery fund provided for under this legislation takes a semblance with the lottery bond suggested in this study, the lottery fund seems to have a wider application than the lottery bond which is proposed in this study to be strictly for infrastructure financing. Aside this, since the Act was signed into law in 2005, it has remained a lame duck with nothing to show for the efforts involved in proposing the bill and passing it into law.

### **iii. Diaspora bond**

A diaspora bond is a debt instrument issued by a company-or potentially, by a sub-sovereign entity or by a private corporation to raise financing from its overseas diasporas. It is an open-ended instrument issued for sale to the Diaspora for the development of its home country. India and Israel have successfully raised US\$ 11 billion and US\$25 billion, respectively, from their Diaspora abroad.<sup>1094</sup>

Diaspora bond issue entails appealing to the patriotism of a country's diasporas abroad. Mostly, these bonds are issued in times of crisis and often at a "patriotic" discount. The diasporas tend to be less averse to convertibility risk unlike

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<sup>1092</sup> See the explanatory memorandum to the National Lottery Act 2005.

<sup>1093</sup> Section 35 (1) of the National Lottery Act 2005.

<sup>1094</sup> Ketkar, S & Ratha D 'Development Finance via Diaspora Bonds' in Innovative financing for development (2009) 59-76.

international investors. The reason is that they are likely to have present and contingent liabilities in their home country and are therefore more inclined to buy diaspora bonds. Additionally, diaspora investors are expected to show a greater degree of forbearance than dollar-based investors if the issuer were to encounter financial difficulties. As a result, it is possible to sell diaspora bonds at a significant price premium (yield discount). Nigeria has a significant percentage of her migrants in the Organization for Economic Cooperation and Development (OECD) countries because of the larger income differentials.<sup>1095</sup>

The government and private companies with appetite for infrastructure investments could potentially tap into the huge savings and wealth of Nigeria's diasporas abroad by issuing diaspora bonds to finance infrastructure investments in the country.

However, there are challenges in issuing diaspora bonds. These challenges include weak and opaque legal system for contract enforcement; lack of unity on regulations in the host countries that allow or constrain diaspora members from investing in these bonds.<sup>1096</sup>

In pursuit of the government's desire to tap into this huge source of financing, the Federal Government of Nigeria has indicated the intention to float Diaspora bond as part of the strategies to unleash capital for investment in critical sectors of the economy such as infrastructure.<sup>1097</sup>

Undoubtedly, there is enough capital within and outside the country to drive development especially the procurement of infrastructure. According to World Bank, about US\$18.6 billion was remitted to the country by Nigerians in Diaspora in 2009.<sup>1098</sup>

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<sup>1095</sup> Ibid.

<sup>1096</sup> Ibid. 160.

<sup>1097</sup> See 'Aganga: FG plans Diaspora Fund to unlock Capital' ThisDay Newspaper, Monday, 1<sup>st</sup> August, 2011.

<sup>1098</sup> World Bank, ABD propose Diaspora Bond for Nigeria, Others-ThisDay 31<sup>st</sup> March 2011.

According to the Federal Government of Nigeria, the fund would be managed by a private sector fund manager who will provide holders periodic reports on the performance of the fund, and it will be listed to improve its tradability and transparency. The proceeds from the fund will be invested in flagship infrastructure projects in the country.<sup>1099</sup>

### **(b) Legal constraint**

To effectively mobilize infrastructure funds through fixed income securities in Nigeria, one crucial pre-condition is that appropriate regulatory agencies must strive to develop the bond market by improving, among other things, its legal and regulatory environment. Besides, another way to achieve the development of the fixed income securities market is to provide ‘fiscal space’ for innovative bond instruments like: Islamic bonds; Lottery Bonds; and Diapora bonds.

Regarding the floating of the Islamic, lottery and Diaspora bonds in Nigeria, the need for industry-specific or general legislation does not present itself, rather the Securities and Exchange Commission which is the apex regulatory authority for the Nigerian capital market, only needs to invoke its wide regulatory powers to make rules and regulations pursuant to Section 313 (6) of the Investment and Securities Act, 2007 as it did regarding Islamic fund management under Rule 249C: Rules on Islamic Fund Management of January, 2011.

### **8.5.3 Innovative sources requiring legal reforms to become operative**

Under this segment, the innovative sources are divided into two broad groups. Under the first group, these are domestic innovative sources that are fiscal-based and they include: currency transaction tax; financial transactions tax; and fuel tax. The second group are foreign-based innovative sources and they include: securitization of future-

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<sup>1099</sup> See ‘FG targets \$2 billion Diaspora Fund’ The Punch Newspaper, 26 July 2011.

flows; receivable stolen assets; use of foreign reserves; and oil-for-infrastructure deals.

### **8.5.3.1 Fiscal-based innovative sources**

#### **(a) Proposed taxes**

##### **i. Currency transaction tax**

Currency Transaction Tax (CTT) is defined as ‘one of the new mechanisms being considered by governments, international institutions, and others to raise large amount of independent, global, and stable monies’.<sup>1100</sup>

It is also referred to as Tobin Tax named after James Tobin, the first proponent of the idea for a currency transactions tax as a means of combating financial volatility.

Initial proposal for Tobin tax was for enhancing the efficacy of national macroeconomic policy and the operation of international monetary system by reducing short-term speculative currency flows. The renewed interests in the tax in recent years is as a result of the dramatic surge in cross-border financial flows in the post Bretton Woods era has been linked with the unprecedented rise in financial instability and crisis.<sup>1101</sup> The potential of this tax as a revenue raiser came up as a by product of the idea of using the tax as a means of combating financial volatility. Its use in the context of the subject matter of this study is not to combat ‘financial volatility’ but to generate additional finance for infrastructure development. Some proponents have suggested tax rate as high as 0.25 on a transaction which they described as 25 basis points, to discourage excess currency speculation, but in contrast, A.B. Atkinson<sup>1102</sup> is of the opinion that a rate of 1 or 2 basis points could be adopted for revenue-raising purposes. This study like to align with the later suggestion since it is in tandem with the trend of thought earlier expressed in this study that the tax should be used as a platform to raise financing for infrastructure

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<sup>1100</sup>Schmidt R (2008) The currency transaction tax: rate and revenue estimates UNU Press: Tokyo Japan 5, e-book-i.unu.edu/media/publication/000/002/177/currency\_transaction\_tax\_web.pdf

<sup>1101</sup>Nissanke M (2003) Revenue potential of the currency transaction tax for development finance A critical appraisal Discussion paper no. 2003/81, United Nations University WIDER 1

<sup>1102</sup>Atkinson AB (2004) New sources of development finance: funding the millennium development goals, Policy Brief No. 10, United Nations University WIDER 14.

<sup>1103</sup>Ibid.

<sup>1104</sup>Baker, D (2008) The Benefits of a Financial Transactions Tax, Centre for Economic and Policy Research-<http://www.cepr.net>-Last accessed 15<sup>th</sup> September 2011.

development in the country and not to discourage ‘excess currency speculation’ that may lead to financial volatility. Without doubt, this suggested tax will have an impact on the remittances as a source of infrastructure financing, but at 1 or 2 basis point, the impact on the remittance flow might be negligible.<sup>1103</sup>

## **ii. Financial transaction Tax**

The global economic recession has inspired renewed interest in a financial transaction tax (FTT). Though vigorously derided and opposed by the financial industry, it offers a very attractive mechanism for raising revenue that is arguably efficiency-enhancing. Financial transaction tax (or Robin Hood tax) is a levy on financial transactions like equities or shares, debt instruments or bonds and their related derivatives. It applies to trading in a broad range of financial assets and could raise huge funding for infrastructure development. Such a tax, though arguably, is efficiency-enhancing since it would substantially reduce the resources used by the financial sector without reducing its effectiveness in allocating capital.<sup>1104</sup>

The proposed levy is as low as 0.005-0.1% of each transaction. Though the main objective is to raise revenue, it could also discourage ‘dangerous financial speculation and high frequency trading’.<sup>1105</sup>

According to Oxfam, it could be levied on three types of transactions: equities/shares, debt/bonds and foreign exchange. It has been suggested that the coverage could be restored to the basic financial transactions, or ‘extended to two types of derivatives, future and options’. Oxfam argues that the transactions in these derivatives outstrip transactions in the actual asset. Hence ‘covering derivatives would massively increase the FTT revenue’.<sup>1106</sup>

This class of taxes were initially mooted ‘as a means of curtailing short term speculation, thereby reducing wasted resources, market volatility and asset mispricing. However, ‘concerns have been raised that the taxes might reduce assets prices

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<sup>1105</sup> Financial Transaction Tax briefing for South Africa Government, (2011) Oxfam publication.

<sup>1106</sup> Ibid.

and returns to savings, increase cost of capital for business, reduce liquidity and increase price volatility, and increase tax evasion by movement of transactions to offshore centres', and the belief generally now is that such taxes at the rate of 0.005-0.01% would not do any damage and exert a reasonable pressure on speculation. Other advantage of the class of taxes is that it would be a predictable revenue source.<sup>1107</sup>

Financial transactions tax or the Robin Hood Tax as a modest set of taxes on a stock purchase or sale and on the sale or purchase of a future, option, or credit default swap, are proportional to the actual transaction costs in the industry. It could raise substantial sum of revenue to be ploughed in infrastructure and 'skims the fat off of a sector of the economy that can afford to pay it. Secondly, the taxes would probably encourage longer-term productive investment. It has been argued that by reducing the volume and profitability of short-term trading that serves no productive purpose, the tax would encourage the Stock Exchange to find new ways to make money of longer-term productive investments. Thirdly, it would likely reduce dangerous financial market speculation. Since the tax would hit high-volume, high-speed trading the hardest, it would serve to discourage short-term speculation in financial markets as well as the proliferation of ever more complex derivative instruments. More complex derivatives could be subject to the tax many times over, substantially reducing the potential profits from complexity.<sup>1108</sup>

Though the global opposition to this kind of tax that it would increase the volatility of stock prices is ever on the increase, it is contended here that it could creatively raise huge revenue and the revenue raised can be used to rev up infrastructure financing in Nigeria.

It is instructive to note that the currency transaction tax or Tobin tax and the financial transaction tax or Robin Hood tax seem to overlap. However, for the purposes of this study, the difference between currency transaction tax and the financial transaction tax is that while the currency transaction tax is a levy on transactions in the foreign

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<sup>1107</sup> Ibid.

<sup>1108</sup> Facts and myths about financial speculation tax (2010) Centre for Economic and Policy Research-[www.cepr.net](http://www.cepr.net)-Last accessed 15<sup>th</sup> September, 2011.

exchange market, the financial transaction tax is a levy imposed on the dealings in the capital market.

### iii. Fuel tax

This is another levy that can be leveraged to fund infrastructure development in Nigeria especially in the area of rehabilitation and maintenance of road infrastructure networks.

A fuel tax is simply a levy imposed on fuel consumption especially the ones for transportation. The fuel for cooking by households like kerosene should be exempted for this tax.

The rate could be as little as 0.1 per litter and the fuel tax receipts should be channelled into an ‘Infrastructure Intervention Fund’ for the development, rehabilitation and maintenance of transport infrastructure in the country.

The dedicated ‘Infrastructure Intervention Fund’ can be managed by the apex bank, the Central Bank of Nigeria or seasoned private sector fund managers within the framework of a sound regulatory environment.

### (b) Legal constraint

Tax is a monetary charge imposed by the government on persons, entities, transactions, or property to yield public revenue. The term embraces all governmental impositions on the person, property, privileges, occupations and enjoyment of the people, and includes duties, imposts, and excises.<sup>1109</sup> Some of the purposes of taxation among others include: re-distribution of wealth, stimulating economic growth and development and enhancement of the social services delivery. **Justice Latham** of the United States’ Supreme Court<sup>1110</sup> underscored this when he described ‘taxation’ as: “...the one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as the air he breathes to the natural man. It is not only power to destroy; it is also the power to keep alive”.

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<sup>1109</sup> See Black Law Dictionary, 8<sup>th</sup> Edition, 1996.

<sup>1110</sup> See the case of *Nicholas v. Ames* (1989) 173 U.S. 505, 509.

Just as in the power to maintain law and order, the power to tax is inherent in sovereignty. It is an incidence or attribute of sovereignty, each being essential to the existence of independent government. In Nigerian state where federalism operates, the power to levy taxes or duties comes under the concurrent list and the implication of this is that both the National Assembly and State Houses of Assembly can make laws on taxation or collection of duties based on the subjects of the taxation or imposition of duties.<sup>1111</sup>

So, the constitution in extant allocates the power to tax the subjects between the three tiers of government and the body of tax law is purely statutory and the tax system is made up of plethora of statutes by which various levels of government in the country seek to charge and collect revenue for public expenditure.

Levying the proposed currency transaction tax, financial transaction tax and fuel tax obviously fall under the exclusive legislative competence of the National Assembly and to levy these taxes, it is legally imperative for the National Assembly to enact such laws that will facilitate the levying, collection and the use of these taxes to fund critical public infrastructure assets in the country.

### **8.5.3.2 Foreign-based innovative sources**

Under this group, there are four potentially innovative sources of funding for Nigeria's infrastructure development.

#### **(a) Creative sources**

##### **i. Recovered stolen assets**

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<sup>1111</sup> Section 4 of the Constitution of the Federal Republic of Nigeria, 1999 as amended.

Receiving of flight capital and stolen assets is another innovative way of using existing resources to finance infrastructure financing requirements. The cross-border flow of the global proceeds from criminal activities, corruption, and tax evasion are estimated to be more than US\$1 trillion annually.<sup>1112</sup>

It is believed that some US\$20 billion to US\$40 billion in assets acquired by corrupt leaders of the poor countries, mostly in Africa, are kept overseas. The World Bank and the United Nations' office on Drugs and Crime have launched the Stolen Assets Recovery initiative to help countries recover their stolen assets. These recovered assets could provide financing for social programmes and infrastructure in particular.<sup>1113</sup>

It must however be added here that recovering stolen assets has its legal complications especially from the sending country. No country can send back stolen wealth stashed in her banks without an appropriate law enabling the executive arm or appropriate agency of the government to repatriate such stolen wealth to the country where it was stolen from. Also on the side of the recipient country, there is the need for an appropriate legislation to ensure the judicious use of such repatriated wealth.

## **ii. Foreign exchange reserves**

Another creative means of financing for infrastructure in Nigeria is the use of part of the country's foreign reserves. A remarkable feature of international financial system in recent times is 'the rapid and vast accumulation of foreign exchange reserves by the developing countries'. The developing countries as a whole is said to account for more than 80% of global reserves accumulation in the recent times and their current

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<sup>1112</sup> Ratha, D, Mohapatra S & Plaza S Beyond aid: new sources and innovative mechanisms for financing development in Sub-Saharan Africa in Ketkar et al (2009) Innovative financing for development 169. The quartet noted that the United Nations Office in Drugs and Crime (UNODC) and the World Bank (2007) reported that 25% of GDP of African States is estimated to be lost to corruption every year, with corrupt actions encompassing petty bribe-taking done by low-level government officials to inflated public procurement contracts, kickbacks, and raiding of the public treasury as part of public asset theft by political leaders.

<sup>1113</sup> Ibid. As also acknowledged in the footnote, the quartet cited the example of Nigeria that successfully recovered half a billion dollars in stolen wealth from Swiss sources with the cooperation of the World Bank, civil society, and the Swiss authorities. The bulk of the recovered ill-gotten wealth under reference were assets stashed in Switzerland by the Sanni Abacha, the maximum leader that reigned in Nigeria between 1993 and 1998 when he died in a mysterious circumstance.

level of reserve are approaching USD 5 trillion. Africa, Nigeria inclusive, too has been amassing international assets at a remarkable pace. This pool of reserves surpasses developing countries' immediate liquidity needs leading to increased creation of Sovereign Wealth Funds which have an additional level of assets of more than USD 3 trillion.<sup>1114</sup>

Although economic growth and poverty reduction in many developing countries has been impressive in recent years, a significant increase in investment in areas such as infrastructure is required to sustain such growth in the future. The argument is that a very small portion of developing countries' total foreign exchange reserves-say, 10%-be channelled to investment in infrastructure development. Infrastructure is recognized as a key ingredient in sustaining and accelerating growth. However, there is a large financing gap.<sup>1115</sup>

High expectations for private-sector financing of infrastructure have gone largely unmet due to lack of access to finance. Private investment remains limited and concentrated by both country and sector. National government still account for the large majority of financing. ODA and multilateral bank lending, though valuable, remains insufficient. In particular, there are large gaps in the provision of crucial cross-border investments, for example, in energy and roads.<sup>1116</sup>

It hereby proposed in this study that a fraction of Nigeria's foreign exchange reserves be set aside annually to be channelled to serious infrastructure investors through the commercial banks. Such fund could also be used directly by the government to fund infrastructure assets that are not naturally appealing to private investors for investment into.

These reserves, while providing a buffer against adverse external developments, contribute nothing directly to the real sector, as they are invested in foreign currency

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<sup>1114</sup> Griffith-Jones, Stephany, Jose Antonio Ocampo and Pietro Calice, 'Self-Financing Development' BusinessDay, Monday, September 15, 2008, back-page.

<sup>1115</sup> Ibid. As at the 31<sup>st</sup> of December, 2011 Nigeria's foreign reserve denominated in USD stood at USD 38.8 billion. If a fraction of this was invested in infrastructure development, one could imagine what the effect could be. See Central Intelligence Agency The World Fact Book-<https://www.cia.gov/library/publications/the-world-factbook/geos/ni.htm>-accessed last 19<sup>th</sup> July 2012

<sup>1116</sup> Ibid.

assets such as government bonds. Recognizing that the reserves are in excess of what is needed for ‘liquidity purposes and cushions against external shocks’ and idling away, such money can be leveraged into infrastructure investment in the country.

Expectedly, there is a constitutional impediment to the use of the foreign reserves. Nigeria’s foreign reserves consist of three components namely: federation, the federal government and the Central Bank of Nigeria (CBN). The CBN portion then consists of funds that have been monetized and shared. This arises as the CBN receives foreign exchange inflows from crude oil sales and other oil revenues on behalf of the government. Such proceeds are purchased by the Bank and the Naira equivalent credited to the Federation Account and shared, each month, in accordance with the constitution and the existing revenue sharing formula.<sup>1117</sup>

So, the use of part of the country’s foreign reserves as a creative means of financing for infrastructure in Nigeria, aside the fact that it goes against the grains of doctrine of fiscal federalism as practised in Nigeria, will be in violation of the 1999 Nigeria’s constitution. Importantly, section 162 (1) of the constitution provides that all revenues kept in the Federation Account must be shared between the Federal Government, the states and the local governments in accordance with the revenue allocation formula to be determined by the National Assembly. Section 162 (3) states that any amount standing to the credit of the Federation Account shall be distributed among the Federal and State Governments and the local government councils in each state and any amount standing to the credit of the states in the Federation Account shall be distributed among the states.<sup>1118</sup>

The implication of these provisions is that each tier of government has the right to spend its own portion of the revenue within the remit of the constitution. So, the use of the foreign reserves by a tier of government, in this case, the Federal Government, for infrastructure development may impair this constitutional right and the doctrine of fiscal federalism. To overcome this constitutional impediment, the constitution may need to be amended accordingly.

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<sup>1117</sup> CBN ‘Reserve Management’ at <http://www.cenbank.org/IntOps/ReserveMgmt.asp>].

<sup>1118</sup> Section 162 (4) of the Constitution.

In conclusion, it is believed that a case could be made for similar initiative in Nigeria too. However, the model has to be tailor-made for the Nigeria's specific constraints and infrastructure development priorities.

### iii. **Future-flow securitization**

This is a method of tapping into international capital markets in times of determining risk perception and low risk appetite among investors. The securitization structure allows sovereign, sub-sovereign, and private sector entities in developing countries to pierce the sovereign credit ceiling and obtain financing at significant lower interest costs and for longer duration.<sup>1119</sup>

Nigeria can raise reasonable bond financing by using securitization of future flows, such as remittances, export receivable as a potential way of improving the country's access to international capital markets. In a typical future-flow of transaction, the borrower pledges its future foreign-currency receivables, for example, oil, as collateral to a special-purpose vehicle.<sup>1120</sup>

The special purpose vehicle issues the debt. Though a legal arrangement between the borrowing entity and major international customers or correspondent banks, the future receivables are deposited directly in an offshore collection amount managed by a trustee. The debt is served from the account, and excess collections are forwarded to the borrowing entity in the developing country.<sup>1121</sup>

Banks can also improve their access to international capital markets by issuing bonds that are securitized by future remittance inflows through the issuing of remittance-backed bonds. Future-flow securitization mitigates sovereign transfer and convertibility risks and allows the securities to be rated better than the sovereign credit rating.<sup>1122</sup>

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<sup>1119</sup> Ketkar et al (eds.) (2009) Innovative financing for development: overview in Innovative financing for development 7.

<sup>1120</sup> Ibid. 166.

<sup>1121</sup> Ibid.

<sup>1122</sup> Ibid.

There are however constraints to future-flow securitization. One is a low level of domestic financial development; lack of banking relationships with banks abroad; and high fixed costs of legal, investment-banking, and credit-rating services. Absence of an appropriate legal instruments, weak protection of creditors' rights (including inadequate or poorly enforced bankruptcy laws), and a volatile macro-economic environment can also pose disincentives. Besides, extensive use of informal channels can reduce the flows through the formal financial system and by extension, the size of potential securitization.<sup>1123</sup>

It also carries significant risks-currency devaluation and, in the case of flexible rate debt, unexpected increases in interest rates-that are associated with market-based foreign currency debt.<sup>1124</sup>

Securitization backed by future flows of receivables as an asset class can provide useful access to international capital markets for infrastructure financing. A wide variety of future receivables may be securitized, while heavy crude oil receipts are the best receivables to securitize, diversified payment rights (DPRs) are not far behind.<sup>1125</sup>

Securitization of DPRs, which include all hard currencies receivables that come through the Society for Worldwide Interbank Financial Telecommunication

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<sup>1123</sup> Ibid. 168.

<sup>1124</sup> Ibid.

<sup>1125</sup> Ibid. Diversified payment rights are 'the future cash flows result from payment orders or electronic messages requested by offshore obligors instructing a bank to make a payment to a beneficiary other than the bank. This may take the form of payments to local exporters, foreign direct investments, tourism-related payments to travel agencies, personal wire transfers or workers' remittances, and payments to local service providers'. See Asian Development Bank (2005) Report and Recommendation of the President to the Board of Directors 3-4-last accessed 18<sup>th</sup> July 2012 @ [www2.adb-Org/Documents/RRPs/KAZ/40937-KAZ-RRP,pdk](http://www2.adb-Org/Documents/RRPs/KAZ/40937-KAZ-RRP,pdk).

System,<sup>1126</sup> is a more recent innovation. DPRs are deemed attractive collateral because the diversification of their source of origin makes such flows stable.<sup>1127</sup>

Many sovereign, sub-sovereign, and private sector borrowers have used future-flow securitization to raise billions of dollars since the first securitization of net international telephone receivables by Mexico's Telmex in 1987.<sup>1128</sup>

Developing-country issuers have found market placements backed by hard currency receivables particularly useful in times of financial stress because their structure allows issuers to escape the sovereign credit ceiling.<sup>1129</sup>

Typically, a future-flow structure entails the borrowing entity (or originator) selling its future product (receivable) directly or indirectly to an offshore special purpose vehicle (SPV). The SPV issues the debt instrument and designated international customers (or obligors) are directed to pay for exports from the originating entity directly to an off-shore collection account managed by a trustee. The collection agents allocate these receivables to the SPV, which in turn makes principal and interest payments to the investors. Excess collections are then directed to the originator.<sup>1130</sup>

Looking at it from the perspective of investors, the attractiveness of future-flow securities lies in their good credit rating and their stellar performance in good as well as bad times.<sup>1131</sup> Additionally, apart from providing lower-cost funding, securitization allows issuers to extend maturity of their debt and improve risk management as well as balance-sheet performance.<sup>1132</sup>

Securitization as a financing technique provides potential new capital to finance critical infrastructure and other project finance needs.

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<sup>1126</sup> The Society for Worldwide Inter-bank Financial Telecommunication (SWIFT) is the global provider of secure financial messaging services. See Ketkar, Suhas and Dilip Ratha (2009) 'Future-flow securitization for development finance' in Ketkar, Suhas and Dilip Ratha (eds.) *Innovative financing for development* et al.

<sup>1127</sup> *Ibid.* 7.

<sup>1128</sup> Ketkar et al 26.

<sup>1129</sup> *Ibid.*

<sup>1130</sup> *Ibid.*

<sup>1131</sup> *Ibid.* 29.

<sup>1132</sup> *Ibid.* 33.

#### **iv. Oil-for-infrastructure deals (Angola Mode)**

This is an emerging vehicle for infrastructure financing to bridge infrastructure deficit and its related funding gaps in Nigeria. Nigeria is one of the countries of Sub-Saharan Africa involved with China on infrastructure deals. ‘The finance is primarily channelled through the China Export-Import (Ex-Im) Bank on terms that are marginally concessional, though significantly less than those associated with Official Development Assistance’.<sup>1133</sup>

In some instances, the infrastructure finance is designed with a package linked to natural resource development through the platform of a mechanism called the ‘oil-for-infrastructure deal’ or the ‘Angola mode’. The phrase ‘oil-for-infrastructure’ or ‘Angola mode’ come under the generic phrase ‘resources for infrastructure’ deals. Generally, this is a deal structure whereby payment of the loan for infrastructure development is made in terms of natural resources.<sup>1134</sup> This approach is by no means novel or unique and follows a long history of natural resource-based transactions in the oil industry.<sup>1135</sup>

For China’s Ex-Im Bank, the arrangement is used for countries that lack adequate financial guarantees to support their loan commitments and gives them the opportunity to leverage natural resource exploitation for infrastructure development. The bank’s terms and conditions are agreed on a bilateral basis with the degree of concessionality that depends on the nature of the project.<sup>1136</sup>

Typically, the financial flows involve projects implemented by Chinese contractors that are funded through bilateral loans from China Ex-Im Bank to the government of the beneficiary country.<sup>1137</sup>

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<sup>1133</sup> Ibid.

<sup>1134</sup> Foster V, Butterfield W, Chen C & Pushak N (2009) Building bridges China’s growing role as infrastructure financier for Sub-Saharan Africa xvii. Simply put, ‘Angola Mode’ is an infrastructure financing scheme in which the repayment of a loan is linked to natural resource exports.

<sup>1135</sup> Ibid.

<sup>1136</sup> Ibid.

<sup>1137</sup> Ibid.

Aside China, India has also been deploying its Ex-Im Bank to support development of power projects in Nigeria. The Indian infrastructure deals in Nigeria are also associated with significant natural resource investments.<sup>1138</sup>

China's engagement in Nigeria amounts to total financing commitment of US\$5.4 billion. The initial engagement started in 2002 with the agreement on the first phase of the National Rural Telephony Project (NRPT), in which the China's telecommunication giants, ZTE and Huawei got involved in equipment supply and network rollout projects for both fixed and wireless services in the country.<sup>1139</sup>

The first loan Nigeria obtained from the China's Ex-Im Bank was in 2005 to support the construction of power stations at Papalanto (335 MW), Omotosho (335 MW), and Geregu (138 MW) in Ogun, Ondo, and Kogi States. The construction of Papalanto plant and the financing commitments were undertaken by a Chinese firm, Shandong Electric Power Construction Corporation (SEPCO) while the China Ex-Im Bank agreed to provide US\$300 million of the US\$400 million construction cost. This transaction was oil-backed such that in return a firm, PetroChina secured a deal to purchase 30,000 barrels of crude oil a day from the Nigerian National Petroleum Corporation (NNPC) for a period of one year, but however, renewable.<sup>1140</sup>

It instructive to note that this innovative financing source should not be an alternative but complementary to other innovative sources of infrastructure financing discussed in this enquiry.

However, in 2006, there was a significant scale-up in China Ex-Im Bank financing with almost US\$5 billion of projects agreed on. Included in this financing agreement are contributions of US\$2.5 billion to a major Lagos-Kano railway upgrading project; contribution of US\$1 billion to Abuja Rail Mass Transit project, which involves the construction of a high-speed rail link between Lagos and Abuja, as well as a light railway system connecting Murtala Mohammed International Airport and Nnamdi

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<sup>1138</sup> Ibid.

<sup>1139</sup> Ibid. 25.

<sup>1140</sup> Ibid. 25-26.

Azikwe International Airport with the Lagos and Abuja city centres respectively; and a contribution of US\$1 billion to the 2,600 MW Mambilla Hydropower projects.<sup>1141</sup>

Unfortunately, policy summersaults as a result of change of administration in Nigeria, crude politics, greed on the part of the cash hungry political class who sought to profit from the deals and purpose-less leadership ‘killed’ a deal that could probably have changed the infrastructure landscape in the country.

As summed up in a Chatham House Report,<sup>1142</sup> ‘while Nigeria was playing politics with the Asian partners in the ‘oil-for-infrastructure’ deals, Angola was driven by economic necessity to quickly access funds to finance its post-war recovery. Nigeria simply lacked the imperative. As a result, the oil-for-infrastructure concept worked in Angola but not in Nigeria’.<sup>1143</sup>

#### **(b) Legal constraints**

To leverage on these sources for maximum outcomes, efforts must be made to overcome the apparent legal impediments. All these sources need an effective legal and regulatory framework if the benefits are to be tapped through their uses as financial conduit pipes for infrastructure financing and development in Nigeria. For an instance, some billions of dollars of the collective wealth of Nigerians stashed in bank vaults in Switzerland by the late Nigerian maximum ruler Sanni Abacha was eventually repatriated to Nigeria but unfortunately, nobody could account for the way the recovered stolen wealth was used.

Second is the use of the Nigeria’s huge foreign reserves. Such cannot become operative now except an appropriate legislative framework is put in place. Apart from bringing about certainty regarding its uses, an appropriate legislative framework will prevent its abuses by the bureaucrats and politicians as was the case the Excess Crude Account which was abused largely because it was not backed by a legal and regulatory framework and hence no accountability.

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<sup>1141</sup> Ibid.

<sup>1142</sup> Vines, Alex, Lillian Wong, Markus Weimer and Indira Campos (2009) Thirst for African oil Asian national oil companies in Nigeria and Angola A Chartam House Report.

<sup>1143</sup> Ibid. 3.

The oil-for-Infrastructure-deal is another viable source of financing infrastructure development in Nigeria. From observation, apart from being unconstitutional and based on the constitutional federalism that operates in Nigeria, it failed to deliver the expected outcomes because it lacked the adequate legal and regulatory framework. It was the lack of appropriate legal and regulatory framework that in the main undermined its success in Nigeria. The apparent failure of the government of the day to give the ‘deal’ the required legislative teeth opened the entire process up to corrupt officials to manipulate and denied the Nigerian public of positive outcomes that might probably have turned Nigeria into foreign investment destination.

As could be seen, future flow securitization also offers opportunities for new capital in funding critical infrastructure needs in Nigeria. However, one of the challenges to its operation in Nigeria is the lack of clear rules and in this context, there is need for securitization law to be developed and added to the provisions of the Nigerian Investment and Securities Act, 2007. Besides, the capital market apex regulatory body must start by invoking its regulatory powers under section 313 (6) of the Investments and Securities Act, 2007, and make rules and regulations as one of the ways to encourage and develop securitization in the Nigeria’s capital market.

### **8.6 Risks and the mitigation instruments for infrastructure financing**

As it has been demonstrated earlier on in the study, raising debt and equity capital to fund public assets development is quite a challenge in Nigeria like other developing countries.<sup>1144</sup> ‘Lacking credit history, and given the perception by investors that investments.....can be risky’ Nigeria is in urgent need of creative sources of financing to be able to fund the needed infrastructure development. In view of this challenge, there is a compelling need to leverage on risk mitigation instruments to assist in the quest to mobilize private resources in funding infrastructure assets development in the face of the budgetary constraints and the apparent constriction in public resources.

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<sup>1144</sup> Matsukawa, Tomoko and Odo Habeck (2007) Review of risk mitigation instruments for infrastructure financing and recent trends and developments, Trends and Policy Options, No. 4 The World Bank/PPIAF xi.

Generally, risk mitigation instruments for infrastructure financing in Nigeria are yet to be explored as innovative financing mechanisms in Nigeria. This explains the slow pace of development of the PPP financing technique and the reluctance of the foreign investors in investing in Nigeria's infrastructure development. This may also explain the reason for the many failed PPP structured projects littering in entire infrastructure project development landscape in Nigeria.

Obviously, the PPP projects are vulnerable to a range of risks regarding the completion, exchange rates and management of these risks is an important integral part of the entire design.

Risk mitigation instruments can be explained as 'financial instruments that transfer certain defined risks from project financiers (lenders and equity investors) to credit-worthy third parties (guarantors and insurers) that have a better capacity to accept such risks'.<sup>1145</sup>

These instruments are especially useful for developing countries governments and local infrastructure entities that are not sufficiently credit-worthy or do not have a proven track record in the eyes of private financiers to be able to borrow debt or attract private investments without support.<sup>1146</sup>

Risk mitigation instruments for infrastructure project development have many benefits. First, it makes possible for a country to mobilize resources both domestic and foreign capital (debt and equity) for infrastructure procurement to supplement the limited resources available to the government. Second, investors and banks will be well disposed to financing projects that are commercially viable when the related risks that are perceived as excessive are covered by instruments for risk guarantee. Third, risks associated with infrastructure development can be shared between the government and private investors when the government leverages on limited resources more efficiently by attracting private investors rather than having to finance the projects solely and undertaking the entire development, construction, and operating risk. The government can also upgrade their credit as borrowers, or as the

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<sup>1145</sup> Ibid.

<sup>1146</sup> Ibid.

guarantor for public and private projects, by using risk guarantees of more credit-worthy institutions or entities, which in turn, can lower their funding costs for infrastructure development. Also, multilateral and bilateral institutions are able to leverage their financial resources through the use of risk guarantee instruments as opposed to lending or granting funds thus expanding the impact of their support. Lastly, risk guarantee instruments allow the flow of local and cross-border private capital; support the creation of commercial and sustainable funding methods for infrastructure procurement, and promote provision thereof.<sup>1147</sup>

## **8.6.1 Types of risks**

### **8.6.1.1 Regulatory risk**

Regulatory risk is one of the problems usually faced by private investors in infrastructure in implementing tariff increases agreed upon due to regulatory action or inaction. Regulations for infrastructure projects are usually captured in the concession or other key contracts between a procuring public entity and a private company. This is called ‘regulation by contract’. In countries with huge regulatory deficit which is as a result of weak regulatory framework, the government may opt to provide contractual certainty to regulations to attract private investment. When these regulations are defined contractually, the regulatory risk may be mitigated using a partial risk guarantee (PRG), which could cover the government’s contractual obligations, or by a breach of contract policy under political risk insurance (PRI).<sup>1148</sup>

As argued by Matsukawa and Habeck, it is difficult for guarantors or insurers to assess and cover the risk of an untested regulatory regime, including the risk of unanticipated action by the new regulatory agency, without clear government undertakings, if not explicit recourse to the government, to provide coverage for regulatory risk. Some financiers may want to explore arbitration award default coverage offered by PRI providers to obtain a degree of comfort against such regulatory uncertainty.<sup>1149</sup>

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<sup>1147</sup> Ibid.

<sup>1148</sup> Ibid.

<sup>1149</sup> Ibid

### **8.6.1.2 Devaluation risk**

Devaluation risk came to the fore since the massive currency devaluations took place in late 1990s to early 2000s in a number of developing countries in East Asia and Latin America and has remained a controversial issue in infrastructure project financing since that time. Public and private utilities were unable to adequately pass through increased costs to users due to government action and inaction and suffered serious financial problems and, in some cases, loan default. This issue is common in countries without well-established and liquid long-term debt markets and without market-based currency hedge products (cross-currency swaps, for instance). Where local financial markets and market-based hedging mechanisms exist, local lenders as well as foreign lenders (including multilateral and bilateral agencies) can extend loans in local currency loans, or intermediate cross-currency swaps, to minimize the devaluation risk for infrastructure projects.<sup>1150</sup>

Devaluation risk has been contractually mitigated chiefly by allowing for tariff indexation of foreign currency cost components (for example, foreign currency debt and equity costs, dollar-denominated fuel costs) to foreign exchange rates. PRGs or certain breach of contract policies of PRI providers have also been used to cover a government's or public counterparty's contractual performance, indirectly covering the devaluation risk for the project.<sup>1151</sup>

### **8.6.1.3 Sub-sovereign risk**

Sub-sovereign risk chiefly refers to the credit or payment risk of lower-level (state, provincial, municipal) government entities. The trend is to decentralize government functions; therefore sub-sovereign governments are increasingly responsible for provision of infrastructure. For example, under the Constitution of the Federal Republic on Nigeria 1999, three tiers of government are recognized: federal, state and local governments and all the three tiers are constitutionally empowered to provide infrastructure assets and services to the public within their jurisdictions. Private investors have been asked to evaluate the quality of these sub-sovereign borrowers, the concession grantor, the contractual counterparty, the guarantor of municipal utilities, and the local regulator. Some products can mitigate certain sub-sovereign

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<sup>1150</sup> Ibid.  
<sup>1151</sup> Ibid.

risks. In investment-grade developing countries, private monoline insurers provide wrap guarantees for municipal bonds of sufficiently creditworthy municipalities. Multilateral development banks have traditionally lent to sub-sovereign governments either through or with the guarantee of the relevant sovereign government. The European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC) have created municipal finance units and provided loan and partial credit guarantee support (including local currency) to selected sub-sovereign governments and entities based on their own credit. Other multilaterals, such as the Inter-American Development Bank and the Multilateral Investment Guarantee Agency (MIGA) provide PRGs and PRI for municipal concession projects. It should be noted that PRI providers, which specialize in covering a country's political risks, generally require "legal links" to the sovereign government to cover sub-sovereign risk.<sup>1152</sup>

### **8.6.2 Kinds of risk mitigation instruments**

Risk guarantee or mitigation instruments have a wide and varied names often applied to instruments giving similar risk coverage for private investors. The focus of this study will be on guarantees and insurance covers with a medium to long term of contract which is typically used in infrastructure projects financing to act as catalyst to commercial debt and equity financing, from offshore or domestic sources.<sup>1153</sup>

#### **8.6.1.1 Guarantees and insurance**

Guarantees refer to financial guarantees of debt that cover the timely payment of debt service. Procedures to call on these guarantees in the event of a debt service default are usually relatively straight-forward. In contrast, insurance typically requires a specified period during which claims filed by the insured are to be evaluated, before payment by the insurer.

As explained by Matsukawa and Habeck,<sup>1154</sup> in infrastructure financing, private equity investors and lenders are driven by return on investment considerations, which must be adequate to compensate them for the risks they assume by making an

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<sup>1152</sup> Ibid.

<sup>1153</sup> Ibid. 1

<sup>1154</sup> Ibid.

investment. Their return requirements are determined by specific project risks and the type and structure of the financing. On one hand, in the case of lending to a government or a sovereign entity (which finance infrastructure projects), the lenders evaluate the likelihood of the borrower making timely debt service payments and, if they are willing to lend, then determine the maturity and pricing (credit spread) to be adequately compensated for the borrower credit risk to be taken. Bond investors typically rely on the analysis of established rating agencies, while bank lenders traditionally conduct such analyses in house. On the other hand, additional risk analysis is necessary to evaluate a single-asset, Greenfield private infrastructure project. Project sponsors and lenders investigate the details of a project's financial feasibility and commercial viability, including the risk allocation and mitigation measures. Project risks may include construction risks (engineering feasibility, cost overruns, costs of delay, for example) operating risks (demand or revenue risks, tariff mechanisms, operating cost overruns, equipment performance), macroeconomic risks, legal and regulatory risks for investments in the country generally and with respect to the specific infrastructure sector, the credit-worthiness of contractual counterparties, the sovereign government support offered, as well as other credit enhancements available to the lenders.<sup>1155</sup>

Usually, lenders lend to a sponsor(s) of private infrastructure projects company on a limited recourse basis contingent on the quality of the project's cash flows, which are supported by its security package (a security package normally include an assignment of all of the sponsors' rights under the project contracts) or with recourse to a creditworthy equity sponsor company; or land on a corporate finance basis backed by the borrower's multiple revenue sources and strong balance sheet.<sup>1156</sup>

The risks faced by private infrastructure investors are classified into three broad categories and they are: the risk of losses faced by debt providers in lending to the government or its public entity (risks associated with sovereign or public debt); the risk of losses faced by debt providers in lending to a private entity either on a corporate finance basis or on a limited recourse project finance basis (risks associated with various types of private corporate debt); and the risk of losses faced by equity

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<sup>1155</sup> Ibid. 2.

<sup>1156</sup> Ibid.

investors in investing in a private entity as above (risks associated with equity investments).<sup>1157</sup>

Specifically, risk mitigation instruments that are accessible to lenders and equity sponsors can be classified into broad categories. This classification will now be examined.

### **(a) Credit guarantees**

Under this category, there are partial credit guarantees (PCGs) and full credit or wrap guarantees.

#### **i. Partial credit guarantees (PCGs)**

They cover part of the debt service of a debt instrument regardless of the cause of default. They are typically offered by multilaterals and a few bilateral agencies. These guarantees are designed to improve both the borrower's market access and the terms of its commercial debt (that is, to extend the maturity and reduce interest rate costs) through the sharing of the borrower's credit risk between the lenders and the guarantor.<sup>1158</sup>

Traditionally, these guaranties have been used by developing country governments or public entities (state-owned utilities, for instance) to borrow in the international money market or support a bond offering in the international capital markets. PCGs typically have provided coverage for late maturity payments. For example, a PCG may cover the final principal repayment (a bullet principal payment) on the final maturity date or the last few principal and interest payments. PCGs have recently been used by sub-national governments and other sub-national entities, such as municipal utilities, as well as by private companies, to borrow domestically from commercial banks or issue bonds in the domestic capital market in local currency.<sup>1159</sup>

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<sup>1157</sup> Ibid.

<sup>1158</sup> Ibid. 3.

<sup>1159</sup> Ibid.

Naturally, PGCs are flexible and can be structured to meet the needs of specific debt instruments and market condition, including determining the right balance of risk sharing of the borrower's credit. For example, risk sharing between the guarantor and the lender can be pro rata or at certain percentages (50-50 risk sharing where each would take 50 percent of losses, for instance) or up to a certain amount of debt service losses. The guaranteed coverage level may be set to achieve a target bond rating to facilitate bond issuance or at a level required to encourage commercial bank lenders to participate. PGCs may be provided for a specific debt or for a loan portfolio, for example, when individual loans are small.<sup>1160</sup>

## **ii. Full credit guarantees or wrap guarantees**

They give cover to the entire amount of the debt service in the event of a default. They are often used by bond issuers to achieve a higher credit rating to meet the investment requirements of investors in the capital markets. In selected developing countries, private monoline insurers have been active in issuing wrap guarantees for bonds issued by infrastructure projects companies (toll road companies, for instance). Monoline insurers, however, generally require the underlying borrower or security to have a 'standalone' investment-grade rating on international scale to consider offering their guarantees.<sup>1161</sup>

### **(b) Export credit guarantees or insurance**

Another broad category of risk mitigating instrument is the export credit guarantees or insurance. These cover losses for exporters or lenders financing projects tied to the export of goods and services.

Export credit guarantees or insurance cover some percentages of both political risk and commercial risk (together, termed comprehensive risk guarantee or insurance). Commercial risks, in the context of purely export transactions at export credit agencies (ECAs) are defined as bankruptcy or insolvency of the borrower or buyer, failure of the buyer to effect payment, failure or refusal of the buyer to accept goods, termination of purchase contract, and so on. Export credit guarantees or insurance are normally 'tied' to the nationality of exporters or suppliers, and sometimes to the

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<sup>1160</sup> Ibid.

<sup>1161</sup> Ibid. 4.

project sponsors or lenders. As noted by Matsukawa and Habeck, export credit agencies may have project finance programmes where the insurance can cover all commercial risks associated with the construction and operation of a facility.<sup>1162</sup>

### **(c) Political risk guarantees or insurance**

Then, there are also Political Risk Guarantees or Insurance Cover losses covered by specified political risk events. They are typically termed Partial Risk Guarantees (PRGs), which may be termed as Political Risk Guarantees (PRGs), or Political Risk Insurance (PRI) depending on the provider. They cover commercial lenders in private projects. They typically cover the full amount of debt as well as accrued interest or full interest payments. Payment is made only if the debt default is caused by risks specified under the guarantee. Such risks are political in nature and are defined on a case-by-case basis. PRGs are offered by multilateral development banks and some bilateral agencies.<sup>1163</sup>

PRI, (on the other hand) or investment insurance can insure equity investors or lenders. PRI can cover the default by a sovereign or corporate entity but only if the reason for a loss is due to political risks. Coverage is generally limited to less than 100% of the investment or loan. Providers of investment insurance include export credit agencies, investment insurers, private political risk insurers, and multilateral insurers.<sup>1164</sup>

The wide range of risks covered by the insurance industry for traditional political risks includes:

- currency inconvertibility and transfer restriction- losses arising from the inability to convert local currency into foreign exchange, or to transfer funds outside the host country;
- expropriation- losses as a result of actions taken by the host government that may reduce or eliminate ownership of, control over, or rights to the insured investment: and

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<sup>1162</sup> Ibid.

<sup>1163</sup> Ibid.

<sup>1164</sup> Ibid.

- war and civil disturbance- losses from damage to, or the destruction or disappearance of tangible assets caused by politically motivated acts of war or civil disturbance in the host country.<sup>1165</sup>

In the recent times, newer political risks that are now covered include:

- breach of contract: losses arising from the host government's breach or repudiation of a contract;
- arbitration award default: losses arising from a government's non-payment when a binding decision or award by the arbitral or judicial forum cannot be enforced.<sup>1166</sup>

Without controversy, risk mitigation instruments facilitate the mobilization of private debt and equity capital. However, the borrower or project must be sufficiently "bankable" to enable the providers of such instruments to properly assess the risks, identify recourse measures as needed, and offer defined risk coverage. So, risk mitigation instruments are not an end in themselves. They cannot transform poorly structured projects, or borrowers with unpredictable future prospects, bankable.<sup>1167</sup>

Most of the risks that private infrastructure financiers are often confronted with usually relate to actions and inactions of government which are outside of the private party's control and they include:

- regulatory risk- the risk or losses as a result of adverse regulatory actions by the host government and its agencies (for example, a regulatory agency);
- devaluation risk of local currency-the risk or losses arising from unfavourable movement of foreign exchange rates, for example, devaluation of local currency for infrastructure projects that earn revenues in local currency while expenses, costs, and financing are largely denominated in foreign or hard currency;
- sub-sovereign risk-the risk or losses as a result of breach or repudiation of contracts or non-performance by the sub-national host government or sub-

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<sup>1165</sup> Ibid.

<sup>1166</sup> Ibid. 5.

<sup>1167</sup> Ibid. 6.

national; contractual counterparties, or both; action or inaction by the local host government having a material adverse impact on the project; and similar situations.<sup>1168</sup>

These risks do not readily fall under the established political risk categories and are difficult to define. However, some risk mitigation instruments have covered these risks, if not in full, in part, and indirectly.

The discussion below illustrates how these instruments have mitigated those risks that the private sector was unwilling to take with tangibles examples.

### **8.7 Viability gaps in the PPP infrastructure project financing**

Based on the magnitude demand estimates, and willingness and ability to pay assessments across many of the infrastructure sectors in emerging and developing markets, it is anticipated that with the exception of telecommunications, much of the country's critical infrastructure will continue to require substantial public sector investment over the coming phase of development.<sup>1169</sup>

The capital cost and revenue structures of many infrastructure developments will preclude wholly commercial financing solutions, but do not need to exclude private sector investment and expertise, provided the commercial "viability gap" can be closed. The balancing of social and economic considerations often results in tariff rates for different infrastructure sectors (power, water, transport) that are not cost recovering. This can be done to limited traffic-for instance on key road networks-that would imply exorbitant tariff rates for the investment to be viable with private finance. In other instances, where the end-user has become used to low prices and poor service-for instance in Nigerian power sector-there may be widespread consumer (that is, voter/political) resistance to an abrupt move to higher tariffs, particularly before there is any credible evidence of improved service.<sup>1170</sup>

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<sup>1168</sup> Ibid. 6.

<sup>1169</sup> Project Appraisal Document on a Proposed Credit to the Federal Republic of Nigeria (2011) Document of the World Bank 61.

<sup>1170</sup> Ibid. 61-2.

Where this is the case, private investment is not going to be forthcoming. The government has two policy routes from which to choose. It can decide that the investment has sufficiently high social and longer term economic value to make it a priority for full public procurement. Alternatively, it can decide to consider a PPP that would require a public contribution-in the form of an upfront capital investment subsidy and/or transfers over the life of the prospective PPP contract. In both cases, the objective is to close a “viability gap” and provide a potential profit margin to the transaction sufficient to crowd-in private investors.<sup>1171</sup>

Determining first whether an investment is justified from an economic viewpoint and then assessing whether it is suitable for a PPP structure are the key assessments that the government would need to undertake. Under the Nigeria PPP policy<sup>1172</sup> this assessment is contained in an “Outline Business Case” (OBC). The OBC would entail first the standard cost-benefit analysis (CBC) to determine the overall economic merits. Then a “value-for-money” (vfm) exercise to determine if there is a PPP arrangement that could deliver the investment at an overall lower cost and better service quality through the involvement of private operators and financiers versus a strictly public procurement arrangement. The CBC will also identify any key environmental and social safeguards that will be triggered in the Environmental Impact Assessment. The OBC is a fundamental first step in determining the public merit of an investment, the PPP rationale and to lay the foundation for the detailed PPP project development, structuring and financing that would then follow.<sup>1173</sup>

The Viability Gap Facility (VGF) ‘provides public financing to fill capital investment funding gaps required to make infrastructure PPP projects commercially viable’.<sup>1174</sup> It is a capital investment vital for the PPP projects to take-off, becomes operational and revenue-earning but cannot be financed by the private sector without undermining required levels of commercial rates of return. It might play a strategic ‘crowding in’ role for private sector investment. The premise for VGF is hinged on given the fact that Nigeria’s core infrastructure requires substantial investment, the capital cost and revenue structure of many infrastructure assets development will make wholly

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<sup>1171</sup> Ibid. 62.

<sup>1172</sup> See generally the National Policy on Public Private Partnership et al.

<sup>1173</sup> Project Appraisal Document 62

<sup>1174</sup> Ibid. 67.

commercial financing solutions almost improbable, private sector investment and expertise may still be involved provided the commercial viability gap is closed.<sup>1175</sup> One challenge is to determine the way in which the government provides the viability gap funding (VGF). One option is to allow individual line ministries to provide the VGF from its own annual budget allocation on a project –by-project basis. This can work, but it has disadvantages. In the first instance, line ministry budgets in Nigeria are allocated in a lapsing year-on –year basis.<sup>1176</sup> The funds are also to a significant extent fungible both within year and certainly from one fiscal year to the next. This presents a number of risks to the private sector. Firstly, within a budget year, they would have to weigh the political risks that the line ministry, whatever its commitment to the PPP, finds other priorities that lay claim to funds at critical points when government obligations to PPP expenditures is required. This could have significant negative consequences to the cash flow and overall viability of the PPP. On the other hand, the particular ministry budget may be revised in succeeding years eliminating the fiscal space it originally had to provide the VGF. All these risks come with a price that the private sector sponsor must factor into the bid. The result is, at minimum, a higher cost PPP; at worst, the private interests-especially higher quality international PPP sponsors/investors –may simply withdraw from the opportunity. This in turn will be a function of the certitude of its financing over the life of the PPP it will be supporting and the predictability and clarity of allocation and disbursement procedures and practices. This suggests something more structured than a simple year-on-year line ministry commitment.<sup>1177</sup>

The Federal Government is developing a VGF facility along the lines of the India Mode. A centralized VGF mechanism has three key comparative advantages. First, by managing it out of the Federal Ministry of Finance, it provides an additional degree of government authority relative to line ministries and comfort to the private sector that this funding is reliable. Second, it enables the government as a whole to ensure closer alignment to National PPP policies and practices and mitigate the challenges in ensuring coordination across the different MDAs to conform to the PPP guidelines set

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<sup>1175</sup> Ibid. 66.

<sup>1176</sup> Budget allocation on ‘a lapsing year-on –year basis’ means that budgets allocated to a line ministry in a year lapses on the 31<sup>st</sup> of December of that particular year and the unspent funds, if any, are expected to be returned to the treasury and cannot be transferred to the new year for use.

<sup>1177</sup> Project Appraisal Document 66.

out in the National Policy. Third, it provides in clear mechanism with its own governance and reporting requirements that can attract other international and donor funding looking to target measurable contributions to PPP infrastructure financing. Rough estimates on the initial amount needed for the VGF based on the “first-mover” projects listed in the Appendix is US\$335 million.<sup>1178</sup>

### **8.8 Financial intermediary loan (FIL) facility**

Another financing instrument for infrastructure financing is the Financial Intermediary Loan Facility (FIL Facility) which is designed to ‘provide long-term debt financing for eligible financial intermediaries’. This provision will encompass both domestic and foreign long-term loans of between 15-25 years with both fixed and variable interest rate options.<sup>1179</sup> ‘The price for the domestic lending is expected to be benchmarked to a moving average of the longer term 10 and 20 year government bond prices. While for foreign currency-denominated loans, the price benchmark will be US\$ 30 year treasury bond’.<sup>1180</sup> A risk premium of 3 percent will be added to the benchmark rate to account for commercial and foreign exchange risk (over and above what is already captured in the interest rate on the domestic bond benchmark). This according to the World Bank will be subject to ongoing review and revision based on market information and FIL uptake rates.<sup>1181</sup>

Recently, the World Bank pledged ‘to provide \$200 Million as a seed fund to set up FIL scheme under the PPP initiative’ in Nigeria ‘to help address the huge infrastructure gaps in the country’.<sup>1182</sup> Under the scheme, eligible participating financial intermediaries, particularly financial commercial banks with the African Finance Corporation (AFC) as the lead, will lend to qualifying private sector partners in a PPP project at the financial intermediaries’ risk. This is aimed at providing long term financing for Nigeria’s quest for infrastructure development.<sup>1183</sup>

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<sup>1178</sup> Ibid. 63.

<sup>1179</sup> Ibid. 16-7.

<sup>1180</sup> Ibid.

<sup>1181</sup> Ibid.

<sup>1182</sup> ‘World Bank Extends \$200m Infrastructure Loan to Nigeria’ Thisday Newspaper, 9 August, 2012-<http://www.thisdaylive.com/articles/world-bank-extends-200m-infrastructure-loan-to-nigeria>.

<sup>1183</sup> Ibid.

## 8.9 Sovereign credit ratings

Another suggested financial instrument that can be of immense use in infrastructure financing in Nigeria is the sovereign credit ratings. Sovereign risk ratings do not only affect investment decisions in the international bond and loan markets, they also affect allocation of foreign direct investment and portfolio equity flows<sup>1184</sup>.

The allocation of performance-based official aid is also increasingly being linked to sovereign rating. The foreign currency rating of the sovereign typically acts as a ceiling for the foreign currency rating of sub-sovereign entries. Even when the sovereign is not issuing bonds, a sovereign rating provides a bench-mark for the capital market activities of the private sector.<sup>1185</sup>

Borrowing costs rise exponentially with a lowering of the credit-rating. Nigeria with a large volume of remittance inflows can leverage those flows to raise the sovereign rating.<sup>1186</sup>

There is also a threshold effect when borrowing spreads jumps up as the rating slides below the investment grade. A borrowing entity with a low credit rating, therefore can significantly improve borrowing terms (that is, lower interest spread and increase maturity) by paying up-front for a better credit rating.<sup>1187</sup>

It should be noted that low or absent credit ratings impede not only sovereign but also private sector efforts to raise financing in the capital markets.

Establishing sovereign rating benchmarks and credit enhancement through guarantee instruments provided by multilateral and bilateral agencies would facilitate market access.<sup>1188</sup>

There is therefore the need for the Act to provide for the establishment of Viability Gap Fund (VGF) and Financial Intermediary Loan (FIL).<sup>1189</sup>

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<sup>1184</sup> Ratha, D, Prabal De and Mohapatra S (2009) Shadow sovereign ratings for unrated developing countries in 'Innovative Financing for Development' Ketkar and Ratha (eds.) The World Bank 99

<sup>1185</sup> Ibid. 109.

<sup>1186</sup> Ibid. 171.

<sup>1187</sup> Ibid. 170.

<sup>1188</sup> Ibid.

## 8.10 Concluding remarks

In the chapter, an extensive menu of innovative, cost effective and largely market-based financing techniques and sources suited for financial resource mobilization in closing the infrastructure financing gaps are examined. These financial products present a mix of flexible and complementary options that can be used to drive the financing of infrastructure in Nigeria. They can also be adapted to suit the financing needs of particular infrastructure assets development programme.

It is argued that closing the infrastructure financing gaps would need a mix of domestic and external resources, though the external resources should not replace but complement domestic resources, and in the circumstance, nothing should be taken off the table!

Also mentioned in the discussion is the use of risk mitigation instruments like risk guarantees to mitigate specific risks and allay fears of would-be investors, be it local or foreign, and stimulate flows of the required domestic resources and private foreign capital into infrastructure development landscape in Nigeria. It is however instructive to note that in the contemporary global economy, infrastructure project financing is often possible in emerging markets only when guarantees and credit subsidies from governments, multilaterals and bilateral organizations are available.

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<sup>1189</sup> Ibid. The Viability Gap Facility (VGF) ‘provides public financing to fill capital investment funding gaps required to make infrastructure PPP projects commercially viable’.<sup>1189</sup> It is a capital investment vital for the PPP projects to take-off, becomes operational and revenue-earning but cannot be financed by the private sector without undermining required levels of commercial rates of return. It might play a strategic ‘crowding in’ role for private sector investment. The premise for VGF is hinged on given the fact that Nigeria’s core infrastructure requires substantial investment, the capital cost and revenue structure of many infrastructure assets development will make wholly commercial financing solutions almost improbable, private sector investment and expertise may still be involved provided the commercial viability gap is closed.

Financial Intermediary Loan Facility (FIL Facility) is another financing instrument for infrastructure financing which is designed to ‘provide long-term debt financing for eligible financial intermediaries’. The provision will encompass both domestic and foreign long-term loans of between 15-25 years with both fixed and variable interest rate options.

Importantly too, finding new sources require building appropriate legal, financial and institutional structures as argued in the previous chapter. Creation of an appropriate legal template in particular, will facilitate the use of the wide and varied innovative financing techniques suggested in this chapter.

Needless to say is that these financial products will only thrive in an environment of appropriate legislative and regulatory frameworks and sound legal infrastructure where there is respect for contractual obligations and access to the judicial system for remedies for breach of contract.

## **CHAPTER 9**

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### **FINAL CONCLUSION**

- 9.1 Why this investigation
- 9.2 Synopsis of the findings
- 9.3 Concluding observations
- 9.4 Recommendations

## 9.1 Why this investigation?

As a recap, public infrastructure assets across the entire Nigerian state has remained terribly inadequate and in a parlous state. No thanks to decades of sub-optimal investment and poor maintenance culture which contributed immensely to the nation's infrastructure deficit. Thus, the demand for basic infrastructure services has grown out-stripping the supply capacity of the existing ones.

So, up-scaling the nation's infrastructure level and therefore opening up the country's potentials for rapid economic growth and development remains the main task for governments at all the three levels in Nigeria, and to reverse this untoward situation, massive investments must be made in the provision and expansion of infrastructure assets and services. Unfortunately, these financing requirements are well beyond the resources and capacity of the three tiers of government. Thus, mobilizing these huge infrastructure requirements therefore from internal sources has remained a daunting task for the governments at all levels.

Consequently, the Nigerian government is drawing on private initiatives and capital to tackle the menace of infrastructure deficits and lack of long-term financing. This entails leveraging on private sector resources and capacity for provision of infrastructure assets and services to the public through the public private partnerships to bridge the widening infrastructure finance gap and open up the country's vast economic potentials and fast-track development process.

Flowing from the above, the research problem then was that despite all its potentials, the public private partnership mode of financing in Nigeria has not made an appreciable impact in closing the infrastructure gaps due to lack of access to long-term financing. It is believed that an easy access to finance will increase the appetite for private investment in the nation's infrastructure market. However, central to the mobilization of domestic and foreign financial resources is the imperatives for legal reforms and development of a sound and wide-ranging financial sector, which means, a diversified, well regulated and inclusive financial system that will promote savings, deepen domestic capital market and channel the resources to sound infrastructure projects and initiatives.

It is against this back-drop that this study sought to investigate how reforms of the legal and financial infrastructure could be used for innovative financial resource mobilization to scale-up investments in procurement of public assets and service delivery to the teeming Nigeria population.

Specifically, this thesis sought to answer the following questions:

- i. what does the legal environment for the private sector participation in the provision of infrastructure and service delivery look like in Nigeria and what are its problems and challenges ;
- ii. how has the legal environment constrained access to adequate financing for infrastructure development;
- iii. how the country's legal infrastructure can be creatively reformed to encourage innovative financial resource mobilization to fund the nation's critical infrastructure;
- iv. how to leverage financial system's reform and development to unleash resources and broaden access to infrastructure funding; and
- v. what are the innovative techniques and sources that could be used in bridging the financing gaps?

In the main, the central thesis of this research is that the inadequacy of appropriate laws and inefficient financial system are partly responsible for the huge financing gaps in the Nigeria's infrastructure market and with the legal and financial reforms, an enabling legal and financial environment that would create space for resource mobilization through innovative financing techniques and sources thereby widen access to long-term financing and increase the appetite for private investment in the nation's public infrastructure assets and services.

## **9.2 Synopsis of findings**

Chapter 2 approached the discussion from multi-disciplinary perspectives and identified the fundamental legal assumption and the sub-set non-legal assumptions with their supporting theoretical constructs that underpin the entire investigation. The first and dominant assumption is that with appropriate legal and institutional reforms,

whether in reforming the existing laws and legal institutions or enacting or putting up new ones, the untapped domestic financial resources can be mobilized and cross-border capital attracted for infrastructure development in Nigeria. The supportive theory here is that which underscores the role of law and legal institutions in development or social change. Its main thesis is the idea of ‘legal liberalism’ that sees law as a means of social engineering and as a tool for achieving developmental objectives.

The second assumption which is non-legal is that private sector management in a competitive environment is intrinsically more efficient than the public sector, consequently private sector involvement in procurement, management and maintenance of public assets will improve the public allocation of resources, efficient maintenance and management of infrastructure assets for quality service delivery to the public. The theoretical construct that supports this assumption is the one whose core thesis is the emphasis on efficiency of markets and free competition and the primary role of individuals in determining optimal economic outcomes.

The third assumption which is also non-legal is that the development of a sound and wide-ranging financial system that is modern, diversified, well-regulated and inclusive will promote domestic savings, deepen capital market and broaden access to domestic and foreign capital for infrastructure investments in Nigeria. This assumption enjoy the backing of dominant financial theory that postulates that ‘the market, rather than the state is the best performer of the role of intermediary between those who possess surplus funds and those who wish to borrow’ as expressed in the Efficient Market Hypothesis (EMH) which underlines many fundamental assumptions about how markets operate, financial market, in particular.<sup>1190</sup>

It was pointed out in the chapter that the theoretical currents that underpin these fundamental assumptions provided a logical constructs and analytical framework in support of the central thesis of this study and which in turn provided a guide, the intellectual muscle and sinews needed to tread through the complex mazes of reality

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<sup>1190</sup> Spratt 11.

involved in this field of study which in itself represents a stew of many complex issues on infrastructure development landscape in Nigeria.

Chapter 3 was factual in content and in particular, interrogated the correlation between provision of infrastructure and development in an emergent economy like Nigeria. It also presented a contextual overview through a sector-level analysis of the current state of public infrastructure and the level of infrastructure deficit and the gaps in the financing in the country by beaming the investigative searchlight on three critical sectors that enable the Nigerian economy: power, transport and telecommunications. It set the stage by defining the term ‘infrastructure’, unpacked the reasons for the dilapidated state of infrastructure assets and perennial failure of service delivery in Nigeria. It also discussed the various strides that have been made by the successive administrations in their quest to raise the bar in procurement of critical infrastructure and service delivery to the Nigerian public. The chapter also identified four types of infrastructure: hard economic, soft economic; hard social; and soft social.

In the chapter, it was established that infrastructure remains an enabler and acts as catalyst and critical to human and economic development and also the general functioning of every modern society. It also defines a country’s business competitiveness and creates jobs and this explains why in every nation, provision of infrastructure assets has always remained in the front-burner of governments’ agenda for development and policy thrust.

Chapter 4 investigated the policy environment of private capital investment in procurement, maintenance and operation of critical public infrastructure assets in Nigeria. It explored the historical overview of the public private partnership as a policy framework and went on to enumerate the core principles of public private partnership driven by the ICPC as the main regulatory agency and these principles include: value for money; public interest; output requirements; transparency; risk allocation; competition; and capacity to deliver.

Reasons for the adoption of PPP as a policy thrust were also examined. It was the growth of the economy, among other reasons, which necessitated a continuous

investment in infrastructure facilities that could not be accommodated within the fiscal space that made the government to seek to mobilize private capital investment in infrastructure development.

Benefits the use of PPP as a financing technique were explained and the different manifestations of private participation in public infrastructure development and service delivery were also discussed; starting with privatization, concessions with all its variants and other ways by which the capital and expertise of private entrepreneurs are engaged.

In Chapter 5, the legal framework for private investment in public infrastructure assets came under review. The chapter appraised all the related laws touching on engagement of private capital in the financing, maintenance and operation of public infrastructure and service delivery. It outlined how official policy could be translated into written laws and policy becoming law through the law-making process and how laws outlined and defined principles, procedures, mechanisms and actions to be taken in order to achieve a predetermined policy goal.

Essentially, the chapter presented an overview of the legal regimes that translated this policy prescription-the private participation in infrastructure financing, procurement, maintenance and operation-into law and made it a financing technique in Nigeria. This presentation covered the regulatory system as subset of the legal framework; the institutional framework and the legal rubric or the legal agreements for the concession like contract formation, enforcement, and interpretation.

Under the institutional framework, it was argued that a sound institutional mechanism was crucial to facilitating an evolution of effective framework for the PPP market in Nigeria. It was also observed in the chapter that out of all the federating states in Nigeria, only Lagos State has leveraged PPP in infrastructure development.

Chapter 6 interrogated the imperatives for reforms of legal infrastructure for public assets financing in Nigeria. It argued that appropriate and effective legal infrastructure is a critical imperative to creating an environment that promotes private investment in

infrastructure and reviewing the existing infrastructure development-related laws is crucial to this vision.

This chapter took a critical look at the entire legal infrastructure of Nigerian infrastructure sector and concluded that there are gaps in the related laws and that the inadequacy and ineffectiveness of relevant laws and legal institutions are significantly responsible for the huge financing gaps in the Nigeria's infrastructure market and that with appropriate reforms of the legal infrastructure, the untapped domestic resources will be mobilized and adequate foreign capital attracted for procurement of public infrastructure and service delivery.

It was posited in the chapter that by reviewing and improving the relevant laws as appropriate in those areas of immediate relevance for private investment in public infrastructure, Nigeria government would have made a vital impact in securing a positive legal environment for attracting private capital in infrastructure development.

In the review under the chapter, some general and industry-specific legislative frameworks came under appraisal. The chapter also made case for the amendment of other related fields of Nigerian legal system like foreign investment protection laws, property law, contract law, law of secured credit transactions, and insolvency law, which are very pertinent to private investment in public infrastructure.

It was also observed in the chapter though Nigeria has a relatively developed legal and judicial system, the legal framework for the Nigeria's financial sector remains antiquated and unsophisticated. This is because the legal framework has not been updated for many years and does not provide adequate foundation for a modern financial system. As opined, it apparently suffers from a number of weaknesses affecting many developing countries, such as antiquated concepts, absence of laws for new developments, non-consolidation of laws and overlap in laws.

In Chapter 7, it was noted that one key development challenge that Nigeria faces today is the problem of weakness and shallowness of the financial system which has stunted growth especially in the non-oil sector of the economy and mobilizing domestic and international resources to enhance infrastructure investments that will

boost growth and reduce poverty is a must if Nigeria's desperate quest to become one of the top 20 most industrialized economies in the world by the year 2020 is to be realized. In that regard, a well-functioning, diversified and strong financial system which will allocate resources in an efficient, competitive, sound and stable manner and also ensure that risks in the economy are well spread out among the various sectors, remains a critical imperative.

The contention in the chapter was that financial system reforms could facilitate the drive for resource mobilization through development of the financial sector and the upgrading the outdated and moribund financial infrastructure and effecting institutional changes in the areas of regulations and policy guidelines. An improved financial infrastructure would in turn help modernize the financial sector considerably and lead to expansion of access to finance to be channelled into infrastructure project development. The existence of a modern financial infrastructure enables the continuing smooth functioning of the financial system intermediation process. A stable financial system contributes to broader economic growth and rising living standards. Overall, the chapter examined the financial sector reforms and development as a means of enhancing the financial sector's capacity to fund infrastructure projects development in Nigeria.

In chapter 8, there was discussion on how to mobilize financial resources for infrastructure financing through different market-driven innovative techniques and sources. Basically, the absence of financial intermediation was said to be evidenced by the mismatch between savings and investment. However, the imperative for investment cannot be over-emphasized.

The chapter challenged the conventional thinking and generated fresh ideas as to market-based creative financing of infrastructure projects in Nigeria. In financing techniques or models for infrastructure projects, the use of structured finance like project finance is critical. It was observed that there exist several sources of financing of infrastructure projects. Bridging the huge financing requirement in infrastructure procurement and service delivery in Nigeria simply requires creativity.

There was also discussion on diverse credit enhancement instruments which are potential creative means for infrastructure financing. Private investors have been hesitant to invest unless supported by host governments through tax incentives, direct finance and guarantees intended to improve the project's cash flow or reduce risk.

### **9.3 Concluding observations**

Flowing from the analysis above, it is conclusive that the state of a country's public infrastructure is a key index for measuring its economic development and growth, and an efficient and reliable infrastructure is critical to attracting long-term FDI, expanding international trade and catalysing growth. Like other countries in the South, Nigeria's infrastructure has been in a bad shape for decades plagued by several challenges which include: under-investment, population explosion and urbanization, corruption, non-maintenance and neglect. Thus, it has become a critical imperative for the government to engage private capital for provision, maintenance and operation of public infrastructure through public private partnership financing technique.

However, as observed in the study, the major challenge confronting infrastructure financing through the PPP structure in Nigeria include non-availability of long term fund for infrastructure financing.

As observed in the study, to move the PPP process forward as a policy prescription and unleash financial resources to bridge the financing gaps, it is important for the government to implement more critical changes in the appropriate PPP related laws. Without effecting those changes in the legal environment, achieving reasonable success in that regard may become a mirage! Though a PPP law, the ICRC Act, has been enacted setting out how the PPP programme can be driven within the framework of law and supplemented by the general guidelines on technical issues, it still leaves a lot to be desired. The review or reforms of the enabling legal regulatory and institutional framework must capture four critical issues as suggested by the UNCITRAL Legislative Guide. First is transparency. This means making the legal, regulatory and institutional framework clear as much as possible, with efficient and simple procedural applications and also readily accessible to make for predictability, openness, and act as a bulwark against arbitrariness. Second, there should be fairness.

Fairness in this context means that the legal framework balances the entire wide and varied interests of all the stakeholders in the infrastructure landscape-the public sector, private entrepreneurs and end-users as well.<sup>1191</sup>

The legal framework must provide for effective mechanism for settlement of commercial disputes, certainty of underlying contracts, autonomy of parties or freedom of contract, reasonable compensation to private sector, and commitment on the side of the host government to sanctity of contract. Unfortunately, the Federal Government of Nigeria is notorious for failing to uphold the sanctity of contracts. From recent experience, the Federal Airports Authority of Nigeria (FAAN)<sup>1192</sup> has been accused of flagrant flouting important clauses of the underlying concession agreement signed before the commencement of the MMA2 project. In this instance, during the negotiation, the agreement was that the terminal would process four million and charge N3, 000 as service fee. On completion, the government reneged and the concessionaire was then forced to charge N1, 000 as service fee. Also, the agreement was that all domestic operations would emanate from MMA2. This has not been so in that the government refused to uphold the sanctity of the contract. The implication of these is that the company cash flow has been seriously impaired which also led to inability of the concessionaire company from fulfilling its financial obligations toward the creditor banks.<sup>1193</sup>

Then, the law should be used to institute a robust regulatory authority with the requisite autonomy for effective regulatory oversight functions.

On the secured transactions regime, the enforcement proceedings are lengthy, costly and uncertain for all parties. Secured creditors do not feel that they would get swift, cost-efficient treatment in the courts or that they will be able to reliably enforce security in the event of default.<sup>1194</sup>

Regarding the registration of securities, the requirement of Governor's Consent and the high registration fees and stamp duties are a disincentive to granting security and

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<sup>1191</sup> UNCITRAL Legislative Guide 23.

<sup>1192</sup> One of the aviation industry's regulatory agencies of the Federal Government of Nigeria.

<sup>1193</sup> (n 13 above).

encourage reliance on unregistered security and ‘upstamping’.<sup>1195</sup> Under the charges over movables, the Bills of Sale regime is antiquated and requires complete overhaul.

Based on the findings in this study, the laws relating to insolvency and reorganization of businesses are obsolete and need to be completely overhauled and reformed. In undertaking this task, issues to be attended to should necessarily include creditors’ rights; debtors’ relief from creditor’s pressure; director and officers’ liability; fraudulent trading; insolvency procedures; role of courts; judicial resources; and creditor’s risk. The relevant law as it stands now do not return value to creditors who, as a result, are reluctant to use it.

The law in force in Nigeria do not prevent asset-stripping from financially troubled companies and hence, it should be replaced with more modern, workable provisions. There is also no law requiring insolvency practitioners appointed to act as trustee or liquidator to be qualified, licensed or regulated. This is improper in a system that its integrity relies heavily on the impartiality, competence and integrity of the insolvency practitioners. Expectedly, in this kind of environment, supervision of these practitioners in this industry is lacking.<sup>1196</sup>

Thus, the legal, institutional and regulatory framework for creditors’ rights and insolvency matters in Nigeria has failed to support the financial sector due to the unacceptable delays and subsequent cost consequences.

It was also observed in the study that improved access to domestic funds within the domestic financial sector will help support efforts toward resource mobilization for infrastructure development in Nigeria. This has brought to the fore the imperative for the development of capital market in Nigeria.

The Nigerian capital market generally still suffers from the problem of regulatory deficit. The framework for enforcement of listing rules is fragile and that for protection of investors is very weak. Usually, certain post-listing requirements are not complied with and this contributes the weakened investor protection mechanism.

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There are also institutional problem which relates to the poor operational competence of Nigerian Stock Exchange. This has led to inefficient settlement system and allows traders to engage in unethical practices. The slow settlement system exposes the flaks of the investors leaving them vulnerable with little control over their stocks and opening the space for traders to engage in unethical practices.

The role of pension funds in mobilizing domestic resources for infrastructure financing that cannot be over-emphasized. The pension funds are accumulating considerable amounts of capital that can be productively channelled into investment in the economy. Given their medium to longer term investment horizon, pension funds provide natural sources of funding for Nigeria's considerable infrastructure investment needs.

However, to open up the financial sector for resource mobilization, new laws, re-jigged financial infrastructure and institutional changes in the areas of regulations and policy guidelines are imperative. An improved financial infrastructure could help modernize the financial sector considerably and lead to expansion o access to finance to be channelled into infrastructure project development.

The conclusion drawn from Nigerian experience with the telecommunications industry and the MMA2 PPP project is that the task of up-scaling the infrastructure service delivery in Nigeria must, as a matter of necessity, be private-sector driven.

#### **9.4 Recommendations**

There are several issues involved in solving myriads of problems confronting Nigeria's infrastructure market; hence, the recommendations that are made in this section will be restricted to two main factors that impede flow of financial resources into Nigeria's infrastructure market. These problematic issues identified earlier on in the introductory chapter are: the inadequacy of appropriate laws and the failure of the Nigerian financial system to effectively intermediate financial surplus and help mobilize funds for infrastructure financing in Nigeria.

First and foremost, there is the urgent need to re-jig and modernize the Nigerian legal system.

Flowing from above, the legal framework for private investment in public infrastructure should be improved upon. Central to this is putting in place an efficient mechanism for contract enforcement and establishment of sound and stable regulatory framework.

Efforts must also be made to upgrade and modernize the credit infrastructure including credit reporting systems and collateral registry by leveraging on current technologies. As to the credit risk management, it is observed that the effective tools and techniques for credit risk management and credit information system are not in use in Nigeria. As a policy recommendation, it has become imperative to strengthen the creditor rights and insolvency regimes in Nigeria, embracing both the legal and institutional frameworks.

It is also important to mention that it is needful to review and where necessary reform legislation and regulation on collateral and registries. This will entail the improvement of the registry and legal system for liens on moveable assets.

On the secured transactions regime, the financial infrastructure is capable of modernization and improvement by centralizing the land registries and making that online information available. Obviously, there are so many shortcomings in the manner of its operation and in matters of enforcement. Attention should however be given to these critical areas: registration of securities; charges over immovable; and enforcement procedures.

On judicial reforms, it is also recommended that the means of enforcing the rights of unsecured creditors and of security should be made simple and the court procedures made more accessible, timely and cost efficient to encourage their use. The civil procedures should also be strengthened to avoid overlapping jurisdictions as between the federal, state and local levels. There also an urgent need to introduce a fast track channels to handle commercial matters more urgently and reduce drastically the

number of adjournments. It should also be mentioned that there exists, so is the urgent need to review and modernize Nigerian commercial laws.

The use of alternative dispute mechanisms must also be promoted to reduce the pressure on the court system and not to be seen as a competing system by the judiciary.

On the issue of the use of the capital market for resource mobilization for infrastructure financing and to indeed serve as a barometer of the economy, all companies that matter in within the economy like those in steel, power, energy and telecommunications industries must be encouraged to publicly quoted. This would go a long way in improving the depth of the market.

Also, sizeable chunk of the sovereign wealth funds should be invested in the Nigerian capital market. The reason is that equities market is naturally for long-term investments and this fit into the requirement for long-term fund for infrastructure financing and development. The low value of these stocks with the inherent opportunities in the majority of the listed companies, make such investment viable for the sovereign wealth fund's investment portfolios as against investing outside the country.

It is also of critical importance to return secondary market trading in the Federal Government bonds to the trading platforms of registered stock exchanges to serve as a viable investment window for retail investors.

The creation of a deep and robust capital market is a key to making available long term debt instruments for infrastructure. In deepening the domestic debt capital market, it is needful to develop corporate bonds and securitization market.

Also, there is need for consolidation of all regulations pertaining to issuance of corporate debt securities; reduce the incidence of multiplicity of regulators. This is because multiplicity of regulators adds to the existing problems relating to effective supervision. Reduction in the cost of placements, tax relief or exemptions obviates the problem of multiplicity of taxes. Reduction and uniformity in stamp duty on issuance

of debt instruments and on securitization transactions should be part of the strategies aimed at deepening the domestic debt capital market.

For an instance, the stamp duty payable on debt instruments is not only prohibitive in comparison with developed markets but also different across various states.

Reasonably, since stamp duty impacts heavily on the cost of issue of the debt instrument, it makes debt less attractive compared to loans. Also, high variability in stamp duties across various states inhibits the development of a more broad-based market.

Lastly, also needful is development of the capital markets for long-term debt. Part of this is to step up the issuance of sovereign bonds at the international capital market. The secondary bond market too should be enhanced along with the establishment of market makers. All these will in turn create a positive credit-rating for Nigeria as a nation.

With all these in place, the stage will be set to leverage the huge potentials of innovative techniques and sources of finance to transform the infrastructure landscape by promoting more robust involvement of the private sector in delivery of functional public infrastructure assets and services in Nigeria.

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