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Economic Newsletter

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Agusto & Co. Economic Newsletter: Rethinking Nigeria's Models for Infrastructure Development

Nigeria has a huge infrastructural deficit and requires up to $3 trillion over the next 30 years to bridge this gap[1]. Putting this into perspective, the Federal government would need to spend the entire 2021 budget of ₦13.58 trillion continuously over the next century on capital expenditure to meet the target. The fact that less than ₦3 trillion was appropriated for capital expenditure reflects the urgency to increase infrastructure spending. Sadly, the dire fiscal position of the Federal Government of Nigeria (FGN) has left little room for investments in infrastructure, a vital expenditure for an emerging economy like Nigeria. With a dwindling revenue base projected at ₦8 trillion and a widening budget deficit of over ₦6 trillion, according to the 2021 budget, conversations around optimizing the country's underutilized assets are germane.

Over the next two years (between January 2021 and November 2022), the Nigerian government intends to sell or concession no fewer than 36 of its assets to raise funds to finance the 2021 budget and drive infrastructure development across the country. Different models have been deployed by the Nigerian government in the past, to resuscitate non-performing and under-performing assets, either through outright sales to private investors or some form of public-private partnerships (PPPs). While some projects have been successful, others have not been.

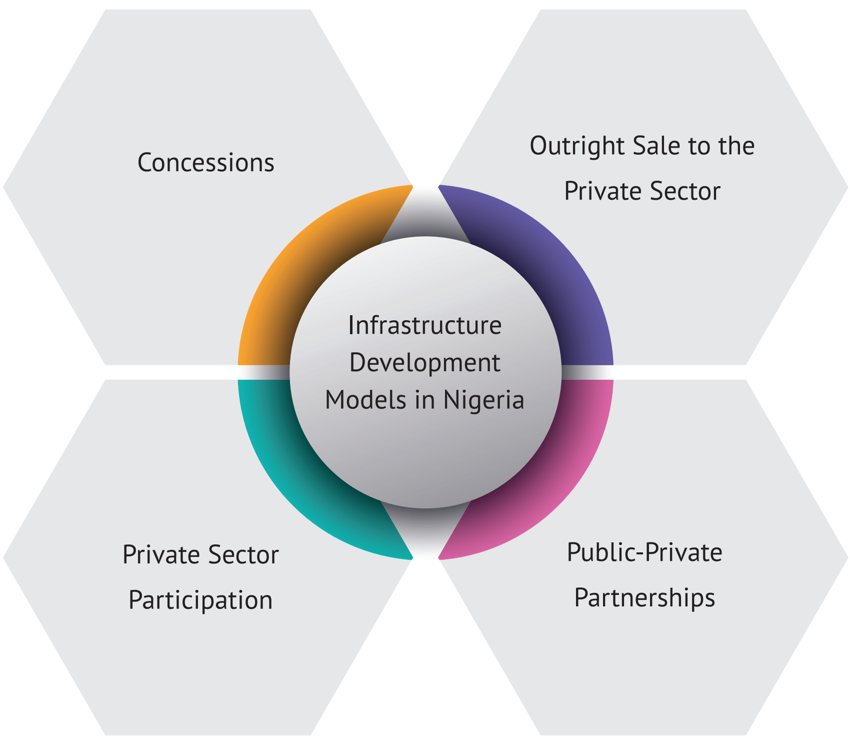
1 *The Bureau of Public Enterprises (BPE)*

Agusto & Co recognizes positively the role that the National Council on Privatization (NCP) through its secretariat the Bureau of Public Enterprises (BPE) plays in driving the Federal Government's programme of privatizing public enterprises, carrying out sector reforms and liberalizing key economic sectors especially the infrastructure sector. Some of the bills already passed into the Law in this respect are the Electric Power Sector Reform Act, the Telecommunications or NCC Act, the Pension Reform Act, the Debt Management Office (Cross Debt) Act and the Solid Minerals Act. These reforms have contributed notably to major breakthroughs in the telecommunications, power, oil and gas and financial sectors.

However, lessons learnt from the past suggest that in ascertaining what assets or projects would be successful going forward, there are two tests that must be passed: the political feasibility of the project and the commercial viability of the asset. Does the government have the political will to see a sale or concession of the asset through? Is the economics of the project strong enough? Will people be willing to pay competitive rates so that an effective investor can recover capital and returns on investments?

In this article, we analyse four major models that have been used historically by the Nigerian government, highlighting challenges and lessons learnt in operating each model.

Figure 1: Infrastructure Development Models in Nigeria



Source: Agusto & Co Research

Source: Shutterstock

Concessions

Nigeria concessions assets to private investors under the Build, Operate and Transfer (BOT) Model where the latter owns and manages the asset in question for a period of time after which it is returned to the government. In certain instances, owning and managing the assets may involve building from scratch or refurbishing. The private investor operates the asset for an agreed timeframe, recouping its capital outlay and returns while the government typically receives a signature fee abinitio.

Historically, Nigeria has partnered with some companies in concession agreements, many of which have had operational and commercial challenges. A few examples worthy of note are;

- the Bi-Courtney Limited and FAAN agreement for the development of the Domestic Terminal and General Aviation Terminal for the Murtala Muhammed Airport (MMA)
- the Federal Government and Bi-Courtney concession for the development of the Lagos-Ibadan Expressway
- the Lagos Trade Fair Complex concession between the Federal Government and Aulic Nigeria Limited
- the Lekki-Epe Expressway Concession between the Lagos State Government (LSG) and Lekki Construction Company Limited (LCC)

Identified issues with some of these agreements include breach of contracts, change in government and abandonment of projects due to protests and circumvention of court orders, among others. More recently, the stalling of the East-West Rail lines of the Nigeria Railways, which had General Electric (GE) as the concessionaire for over five years and a potential $2 billion investment by GE also reflects the absence of political will to move ahead with the deal.

[2] *https://punchng.com/airport-concession-icrc-initiates-faan-bi-courtney-settlement/*
[3] *https://www.thecable.ng/lagos-ibadan-road-way*
[4] *http://www.icrc.gov.ng/assets/uploads/2018/02/Annual-Report-2016-for-website.pdf Page 32 highlights the challenges with the contract*

Apart from a weak political will of the government to relinquish control of these assets, private investors are also skeptical about partnering with the government. Investors stand the risk of being unable to recoup invested capital and returns fully from projects due to price controls and associated subsidies that may not be remitted timely. On the other hand, issues such as over invoicing and other unethical practices by private investors discourage the government, forcing it to cut down on the owed subsidies as seen in the oil and gas downstream saga in 2018/2019. The outstanding debt of ₦168 billion owed to oil marketers in 2018 was paid using promissory notes in June 2020 and are only convertible to cash after three to four years[5]. More so, subsidizing payments for an entire population of both the rich and poor is not a sustainable approach given the government's volatile earnings. Private investors are also concerned about changes in government and the enforceability of existing contracts. While the investor could seek redress at the courts, the probability of a protracted legal battle is a disincentive to seeing the process through. If the contract entails a process that needs legislative approval or changes to the existing laws for instance, there may be bottlenecks that could stall the process.

Outright sale to the private sector

With an outright sale, the government completely transfers the asset to a private sector investor for a fee and has no control over the asset. The banking industry post 2000 is an example of a private sector driven operating model that has worked in Nigeria. Prior to the liberation of the banking industry, the government held majority equity stakes in banks such as First Bank of Nigeria Limited, Union Bank of Nigeria Plc and the United Bank for Africa. However, following the directive of the CBN for government to divest from banks, the Nigerian banking industry as at today is wholly owned by the private sector. This has spurred growth in capital, profitability, foreign and domestic investments, creating a much stronger industry with a collective capital base of over ₦4 trillion and a loan book of over ₦13 trillion.

On the other hand, the power sector that was unbundled into the generating, transmission and distribution segments has not quite fared well since its partial privatisation. The power distribution (DISCO) segment of the value chain was sold to private investors, many of whom continue to post losses over the years. One may attribute the underwhelming performance of the power sector to price controls by the government which has kept tariffs uncompetitive and cost unreflective. Other pertinent issues include gas supply constraints (given that gas to power in Nigeria is capped at a subsidized price of about 2.7/mmbtu, which is considerably lower than the international price of gas) and high ATC&C losses (Aggregate Technical, Commercial and Collection Losses). Though reasons for the near failure of the Industry are quite obvious, the government continues to battle push backs from labour unions and the poor Nigerian citizens with every tariff increase pronouncement, which subdues the political will of the government.

5 *https://www.vanguardngr.com/2020/06/fuel-subsidy-fg-clears-outstanding-n168bn-debt-to-oil-marketers-investigation/*

In addition, a critical link in the power sector, the Transmission Company of Nigeria (TCN) is still 100% owned by the government and has the potential to become a critical bottleneck in the entire power supply chain. As at 27 April 2021, the wheeling capacity of the grid stood at 8,100MW. Though sufficient to meet Nigeria's current average generation of circa 4,200MW and peak generation ever attained of 5,801MW, the wheeling capacity of the grid falls short of the nation's peak demand forecast of 28,850MW and installed generating capacity of 13,014MW. In addition, significant increases in generation capacity will result in the transmission infrastructure becoming a blockade in the growth electricity supply. This risk is heightened by the absence of an alternative wheeling route, which implies that grid supplied electricity will therefore be restricted to the transmission capacity of 8,100MW in the absence of a significant expansion of the current infrastructure.

The Port Harcourt Refining Company Limited, a subsidiary of NNPC and wholly owned by the government was once sold to some private investors towards the end of the Olusegun Obasanjo administration, but the sale was reversed by the Umaru Yar'Adua administration on the back of allegations on a lack of transparency. Agusto & Co is of the opinion that while private sector led projects have predominantly thrived over the years compared to government driven projects, private investors remain concerned about the Nigerian business environment particularly the policy and regulatory environment and the volatile macroeconomic fundamentals that are directly impacted by crude oil prices. Insecurity challenges, social uprisings and the weak legal framework are also deterrents to potential investors.

Figure 2: Identified challenges with Partnerships with the government

Source: Agusto & Co Research

Private Sector Participation

In the private sector participation model, the government does not sell off its assets, but opens up the Industry to private sector participation and competition. This model was successful in the telecommunications industry when NITEL (the government owned Telecommunications Company) was stripped of its monopoly and investors such as South Africa's MTN Nigerian Communications Limited entered into the Industry to compete with NITEL. The Nigerian government charged as much as $285 million to new telecommunications companies seeking to enter the Nigerian market to obtain an operating license as far back as 2001. No sooner than later, NITEL[6], which was expected to maintain its dominance in the Telecommunications space gradually faded out of the Industry. Subsequently more private sector led telecommunications companies have entered the Nigerian telecommunications market, changing the dynamics of the competitive landscape and growing in leaps and bounds. These companies are also known to pay to the government significant amount of taxes annually. In the last 19 years, MTN has paid over ₦2.3 trillion in government taxes and other levies[7].

Public-Private Partnerships

Public-Private Partnerships (PPPs) involve collaborations between the government and private sector companies to finance, build or operate large projects such as transport infrastructure (building rails, airports, roads and so on). The Nigeria Liquefied Natural Gas Limited (NLNG) is a Public-Private Partnership that exists between the government through the Nigerian National Petroleum Corporation (NNPC) and International Oil Companies (Total, Eni and Shell). This partnership seems to be so because the government is a minority shareholder with 49% equity stake in the company through the Nigerian National Petroleum Corporation (NNPC). The government gets paid dividend and royalty from NLNG annually. Since its reception, NLNG has paid dividends of over $36 billion, 49% of which went to the FGN courtesy of its shareholding in the Company via NNPC[8].

As part of the government's effort to create an environment for the implementation of PPP projects, a ₦15 billion Infrastructure Fund was created through the Central Bank of Nigeria (CBN), the Nigerian Sovereign Investment Authority (NSIA), African Finance Corporation (AFC) and other financial institutions to unlock local investments and attract foreign private investment in infrastructure development[9].

6 *The expansion of the telecommunication industry exposed NITEL's inability to compete in a private sector led industry. Thus, the Nigerian government eventually divested from NITEL in 2015.*
7 *MTN Nigeria Communications Limited 2019 annual report*
8 *Thttps://www.nigerialng.com/media/Publications/FACTS%20&%20FIGURES%202019%202nd%20Edition_.pdf*
9 *The Bureau of Public Enterprises (BPE)*

Our Recommendations and Conclusion

The current administration has less than two years left in power, which raises concerns about what can be achieved in the next 12 to 18 months, considering that the 2022 fiscal year will be politically dominated as the country prepares for another round of elections.

The benefits of relinquishing control to the private sector are glaring, but remain difficult to implement. The Federal government handing off certain critical assets of the country that have been dormant over the years will positively impact on the country's budgetary allocation. There is also the potential increase in taxes collected from these private sector companies in the medium term if they are sold off and run successfully by the private investors. Nigeria's non-oil taxes to nominal GDP has averaged about 3% over the last five years, comparing less favorably with Kenya's 15% and Ghana's 12% in the same period. Increased employment and improved service quality are also some identified benefits. More so, these private sector companies can be encouraged to list on the Nigerian Stock Exchange which is also good for our financial ecosystem. Savers will have more investment outlets to channels their funds, resulting in a deeper financial market.

Figure 3: Key benefits of private sector participation

Source: Agusto & Co Research

However, there are caveats and risks associated with operating models that involve private sector participation regardless of the levels of participation. First is the high level of corruption in the country and the lack of accountability by the country's leadership. There is the risk that the government may sign a bad contract skewed in favour of the private business, akin to the case of Process and Industrial Developments (P & ID) that threatened about a quarter of the country's external reserves, a case that remains in the British courts. This could result from inadequate due diligence in awarding the contract and inadequate understanding of the terms among other factors. Sanctity of contracts is also important for a private investor embarking on an agreement with the government as history has shown that this has been a major issue in Nigeria.

There is also the risk of underperformance or incompetence on the side of the awardee especially in a concession model. The government's persistent control over pricing may adversely affect the ability of a private sector investor to recoup capital within the projected timeframe. This can arise from inflationary pressures and not being able to transfer additional costs to customers. Another risk is the mindset of Nigerians who typically see models like concessions as a government project and are not willing to pay for services offered by the project.

Clearly, given the government's weakening revenue generation capacity, private sector involvement is a good approach to tackling Nigeria's infrastructural deficit and growing revenue. However, it is important that there is willingness from the government to relinquish ownership to some extent as well as price controls. While some may argue from the social implications of privatization given that the majority of the country's population is in abject poverty[10] and may become disenfranchised, it is vital to focus on improving the earning capacity of Nigerians by creating jobs. Thus, the business and legal environment must be receptive to private investors who are most concerned about the sanctity of contracts and their ability to recoup investments.

[10] *According to the Nigerian Bureau of Statistics (NBS), 40% of Nigerians (or 82.9 million) are classified as poor with real per capita expenditure below ₦137, 430 per year.*

Agusto & Co. Limited

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