

# **SOCIAL INFRASTRUCTURE DEVELOPMENT IN NIGERIA (THE ROLES OF THE PUBLIC AND PRIVATE SECTORS.)**

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## **ABSTRACT.**

*This paper discussed some of the contemporary issues on social infrastructure in relation to the roles of the public and private sectors in infrastructure deliveries in Nigeria. It explained the effort being put in place directly and indirectly to achieve one of the three aims of the Millennium Development Goals (MDGs) which call for improvement in infrastructure deliveries by 2015 in order to conform with international ethos where multi-national exploit the gains of decentralization, privatization, globalization and sustainability of public infrastructure, to the disadvantage of developing countries. It further pointed out that the financial responsibility undertaken by the Nigerian government to execute social infrastructure could be lessen if the private sectors are encouraged to participate in the infrastructure development.*

*In order to achieve this, it was suggested that appropriate policy should be instituted at Federal, State, and local government level which could be assessed on four criteria:- (i) access to the infrastructure services (ii) quality of the infrastructure services, (iii) affordability of the infrastructure services (iv) financial sustainability of infrastructure services. The Nigeria government's political and logistic supports will be necessary to shore-up the efforts of the emerging private sector participation.*

**Keywords:** *Multinational finance privatization, affordability, infrastructure*

## INTRODUCTION

Infrastructure services are essential for growth and poverty reduction and achieving the Millennium Development Goals, yet in many developing countries, there continues to be an unmet demand for such services. To respond to this situation, there has been increasing interest in sub-sovereign infrastructure financing by developing country governments and their stakeholders, the donor community and the private sector. In recent years, political and fiscal devolution has shifted much of the decision-making and financial responsibilities for providing infrastructure services to sub-sovereign levels of government. Given the limited public financing resources available and foreign exchange risks associated with typical donor support, there is growing recognition that mobilizing capital from local financial markets to tap domestic saving is essential in developing sustainable infrastructure financing at this level.

Governments and citizens alike are concerned with satisfying the developing world's enormous unmet need for infrastructure. Over the last 40 years, recognizing that grant and subsidy funding is not sufficient, international financial institutions (IFIs) have lent large sums of money to meet local government needs in the developing world. This support recognizes the important role decentralized sub-sovereign governments can play in providing urban and local infrastructure services, and acknowledges that such projects can be self-financing. This lending has often been accomplished via specialized municipal development funds, yet, the record of these funds over the years in terms of repayment rates and other performance measures has been decidedly mixed. Meanwhile the unmet need for resources to finance infrastructure has grown - 3 apace.

There is also a growing recognition that mobilizing capital from private domestic sources is essential to develop sustainable infrastructure finance at the sub-sovereign level. As a result, stakeholders have increasingly looked for ways to tap resources from local financial markets, through bank loans or bond issuances. While sub-sovereign finance is yet in a nascent stage, the risks (actual and perceived) associated with lending to local governments and entities are high. In several countries, innovative local credit enhancement entities or programs have played a role in helping mobilize domestic resources for sub-sovereign infrastructure finance by mitigating those risks. (Kehew et al, 2005).

### **INFRASTRUCTURE SERVICE DELIVERY**

Mogbo (2002) explained that the global construction industry is estimated to be worth \$3.2 trillion and accounts for 10% to 15% of GDP. Construction consume more than one third of total energy used in OECD countries. The scale of infrastructure service makes it a powerful factor in the global environment. The construction industry creates the building that business and society needs and sets the framework for their operation. Transport networks form a key factor in developing and sustaining successful communities and economics worldwide.

All nations share the problem of developing and maintaining an effective infrastructure service that is socially, economically and environmentally sustainable, and which ensures accessibility to as wide a proportion of the population as possible. Transport infrastructure alone accounts for between 2% and 2.5% of GDP, with the figure rising to 3.5% in countries modernizing outdated transport infrastructure or building new transport systems (RICS, 2001). Given scarce resources, and the importance of transport infrastructure for economic performance, governments have an interest in involving the private sector in financing transport infrastructure. Although some form of charges to users usually generates the private sector's

profits, the private sectors can also be attracted by shadow tolls. Where shadow tolls are used, users do not pay directly; rather the government pays the private sector a sum per road user or availability payments conditional on the road's meeting performance specification. This methodology can be used to push construction- and market-risk onto the private sector; but it loses the advantage of user payments as a means of rationing use of the road to those who value it most, and it requires a secure source of funds for the shadow tolls.

### **COMMON CHALLENGES IN INFRASTRUCTURE**

Building and maintaining roads, ports, electricity grids, and telecommunications networks is expensive, so it is no surprise that poor countries in Africa, South Asia, and elsewhere have worse infrastructure than rich countries. But the challenge of improving infrastructure is not just one of finding more money. According to Warlters et al (2005), the problem of infrastructure provision has its roots in the potential for market power that results from economies of scale. It rarely makes sense to have two competing roads between two points—or competing electricity grids. Indeed, all infrastructure activities were once thought to be “natural” monopolies, so that a particular market could be served at least cost by a single supplier.

However, the potential abuse of market power in services that affect many consumers creates pressure for governments to intervene, either through intensive regulation of private suppliers or through provision by the public sector. Whether provision is public or private, governments tend to tightly control the prices that infrastructure providers charge and are often reluctant to allow prices to rise even when costs have. This reluctance can create problems because of another feature of many infrastructure services—long-lived, immobile investments. Once built, a road or hydroelectric dam cannot sensibly be dismantled and moved elsewhere.

Investors in infrastructure are often vulnerable, therefore, to changes in government regulations, including those limiting prices. Before they invest, the government may promise them prices high enough to cover the costs of investment, but afterward the government will be tempted to please customers and voters by keeping prices low. So long as prices cover operating costs, the investors cannot credibly threaten to withdraw their services. The underlying problem in the provision of much infrastructure is thus the combination of two reasonable concerns: customers fear that firms will use their market power to overcharge, and firms fear that governments will use their regulatory power to prevent them from covering their costs.

Private firms originally created much of the world's infrastructure, but the playing out of these fears, combined with a prevailing skepticism about markets and private ownership, led to widespread nationalization of infrastructure after World War II. Under public provision, however, the problems reemerged in different guises and were joined by others. Infrastructure services remained highly politicized, and governments frequently kept prices below costs. The low prices were sometimes presented as necessary to help the poor, but the beneficiaries tended to be those who had access to services, so the poorest members of the community usually missed out. To take just one example, a study of the incidence of "lifeline" electricity tariffs in Honduras, under which the government subsidized the first block of household electricity consumption, found that about 80 percent of the subsidies went to households that were not poor. (World Bank, 2002).

Governments also used their infrastructure agencies to channel assistance to particular regions and give jobs to favored groups, increasing the agencies' costs and frustrating attempts to hold them accountable for the efficient delivery of services. With high costs and low prices, the agencies were unable to finance investment from their own cash flows or borrow on their own

credit. As long as governments heavily subsidized public infrastructure agencies, the agencies could still operate and expand. Fiscal pressures and mounting dissatisfaction with public services, however, made governments reluctant to go on providing large subsidies. That combined with a change in the prevailing views about markets and private ownership led many governments to turn again to the private sector for at least some infrastructure services. While public provision remains important, private participation has now spread throughout much of the developing world.

Although private provision has often lowered costs and improved services, the problems of political economy remain. Many customers have opposed privatization, believing it will do more to enrich big business and its political allies than improve public services. At the same time, many infrastructure investors have been disappointed by their returns in developing countries, often believing that governments have broken their promises on regulation for fear of losing votes. Partly because of these problems, the amount of investment in private infrastructure projects in developing countries has declined in the last few years.

### **Improving Infrastructure By Improving The Climate For Investment In Infrastructure.**

Addressing these problems requires recognition that the performance of infrastructure providers is shaped by their investment climate: a good investment climate helps improve infrastructure. In some respects, the concerns of infrastructure firms— whether private or publicly owned but commercially run are no different from those of other firms. All firms worry about the security of their property rights and the burdens imposed by regulation, taxation, and corruption. They want to be able to hire good workers without having to keep them if business turns down. And they want access to financing. (Easterly et al, 2003).

The problems arising specifically from market power and immobile investments in infrastructure highlight the central role of secure property rights. Infrastructure firms are concerned not only about outright expropriation, but also about whether governments will progressively undermine their profitability by imposing ever more severe regulation. The problems affect small providers as well as multinationals. Governments must therefore take care to craft rules and institutions that constrain market power without unduly weakening property rights. With this aim, governments often set out regulations and infrastructure investors' rights in contracts that cannot be changed unilaterally and allow disputes to be settled by domestic or international arbitration when investors do not trust the independence or reliability of local courts.

Decision-making about the implementation of rules is often delegated to independent regulatory agencies more insulated than politicians from day-to-day political pressures. To work well, however, the government's approach must not only secure investors' property rights on paper. To be credible to firms, the arrangement must be sustainable, which means it must be perceived as reasonably fair and legitimate by consumers. Arrangements widely perceived as legitimate and fair thus reduce risks faced by providers, lower the returns that commercial investors must be promised, and so lower the prices that customers must pay, for any given degree of legal protection.

One cause of popular resistance to private participation in infrastructure in the 1990s was the opacity of some procedures used to privatize infrastructure businesses and adjust the tariffs the privatized business could charge. In the absence of transparency, suspicions were reasonably raised about whether bribes or the public interest had motivated policy. Responding to these concerns, most countries have turned to transparent competitive bidding to award contracts. Such

countries as Brazil, Panama, and Peru now publish many infrastructure concession contracts on the Internet. In 2002 Mexico passed a freedom-of-information law that will require information about such contracts to be made public.

The creation of independent regulatory agencies can be viewed as an attempt to reconcile the partly competing demands for investor protection and public legitimacy. If legitimacy could be ignored, investors' property rights would be most secure if contractual tariff adjustment rules were interpreted by independent international experts and serious disputes resolved by international arbitration. Using national regulatory agencies, courts, or arbitration increases one type of risk for investors, because the national institutions are more susceptible to political pressures to keep prices below costs—but decisions made by national institutions may be viewed as more legitimate, enhancing the sustainability of the arrangements.

Competition has the power to transform infrastructure industries by increasing legitimacy and strengthening investors' property rights. It pushes firms to become more efficient and cut prices. As a result, it helps assure customers that they are getting a reasonable deal. This in turn reduces pressure on governments to regulate in ways that weaken investors' property rights. Where competition works, it can thus help infrastructure provision escape the problems that have traditionally afflicted it under both public and private provision. Private participation is often advocated because it provides an alternative source of financing to governments that have limited resources. Such reasoning is flawed—and can encourage privatization with few real benefits. The big problem is paying for services, not financing them, and though private investors may finance services, they don't pay for them. The real advantage of well-designed private participation is different and deeper: it lies in changing the political economy of infrastructure provision.



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First, when the government is no longer a provider of services, it can more easily allow genuine competition. So private participation can be part of a strategy to help garner the benefits of competition—reducing costs and the property-rights problems of intensive regulation. Second, to attract private investment, a government needs to make a credible commitment to allow prices to cover costs and not interfere in commercial operations—a commitment it cannot make under public provision, because it can renege on commitments to public agencies with impunity. (World Bank, 2002)

If a government can credibly make this commitment to investors by using the policies described above—and simultaneously persuade customers that their interests are being protected—it will have gone much of the way toward creating a good investment climate for infrastructure providers, thereby doing much to provide good infrastructure services to all and to their broader societies.

#### **Improving public management.**

Although private participation plays a powerful role, governments remain major financiers and providers of much infrastructure, especially roads. Even in sectors where a good deal of investment is private, complementary public investment in the parts of the sector owned by the government can be important. When governments do not provide or finance infrastructure, they often subsidize it—sometimes directly, sometimes indirectly through guarantees and other instruments. Because government budgets are always more limited than the plans of project proponents, governments need ways of deciding how much to spend on infrastructure, how to allocate that spending, and how to administer it.

The questions are both technically difficult and politically charged. For example, if the government can afford to construct and maintain just one more road in the next year, should it

connect a poor rural area to the capital, or should it strengthen the network around a congested and more prosperous commercial center? Answering requires technical capability to undertake cost-benefit analyses, financial reporting that reasonably reflects the true costs of different policies and decision making processes that give weight to the results of those analyses while allowing a socially acceptable balancing of competing interests. (Irwin, 2004).

When governments provide infrastructure, they need to think about the best way to organize themselves to do it. Traditionally, governments provided services through ministries, but a desire to free service providers from some of the constraints of bureaucratic procedures, give them some managerial independence from ministers, and increase their accountability for results led many governments to establish legally independent, though still wholly government-owned, infrastructure agencies.

Some governments have taken extra steps, such as making the state-owned agency subject to company law, appointing as directors people outside the government with commercial experience, and requiring the agency to prepare audited financial reports according to high-quality accounting standards. In South Africa, for example, the state-owned electricity agency, Eskom, is now a company with mainly outside directors with business experience, which reports according to international accounting standards. Even when all these steps are taken, however, it can be difficult for governments to resist political pressures to interfere in business decisions and keep prices below costs. This is part of the reason why many governments undertaking these reforms have eventually turned to private participation. The challenges of improving infrastructure are similar in all sectors, but there are enough differences between sectors, especially in the opportunities for competition, to make it easier to discuss them one at a time.

#### **Factors Influencing the Public/Private Choice**

### **Competition vs. Monopoly**

In competitive markets private firms are likely to demonstrate performance superior to public firms. In non-competitive markets, the overall effectiveness of private firms is dependent on the effectiveness of regulation. In this context, market definition is important. Market structure reform entails the separation of competitive sub-sectors from remaining natural monopoly sub-sectors. Competition is the strongest force for ongoing improvement in business performance. In some infrastructure areas such as telecommunications or electricity generation, competition may occur "within the market;" i.e., where there are multiple firms that compete with each other to gain market share. Competition within the market provides firms with incentives to lower their prices improve service quality and expand their client base. One conclusion that may be drawn from this discussion is that "competition in the market" is less likely in small isolated markets.

Alternatively, competition "for the market" can be used where multiple firms are not feasible; i.e., where the sub-sector is a natural monopoly. Examples include distribution networks in water, gas or electricity. In these areas, governments may auction the right to serve the market. When the auction is carefully designed and executed, the winning firm should be the most efficient bidder. A problem with competition for the market is that the pressure it applies is not constant. It is in force at the time of the auction, but as the competitive moment recedes into the past the benefits of the initial contest decrease. At the end of a 30-year concession period, there is no guarantee that the incumbent is still the most efficient firm in the industry.

Competition requires the possibility that firms can fail and disappear; this is more easily tolerated in markets where there are multiple private providers of the good or service. In sub-sectors where competition is possible, it should be introduced and protected, and preference

given to the private sector. This is now generally the case in telecommunications, where technological advances have made almost all parts of the sector subject to competitive forces.

## **SUMMARY AND CONCLUSION**

Given the limited public financing resources available and foreign exchange risks associated with typical donor support, there is growing recognition that mobilizing capital from local financial markets to tap domestic saving is essential in developing sustainable infrastructure financing at this level. Governments and citizens alike are concerned with satisfying the developing world's enormous unmet need for infrastructure.

Over the last 40 years, recognizing that grant and subsidy funding is not sufficient, international financial institutions (IFIs) have lent large sums of money to meet local government needs in the developing world. This support recognizes the important role decentralized sub-sovereign governments can play in providing urban and local infrastructure services, and acknowledges that such projects can be self-financing.

There is also a growing recognition that mobilizing capital from private domestic sources is essential to develop sustainable infrastructure finance at the sub-sovereign level. All nations share the problem of developing and maintaining an effective infrastructure service that is socially, economically and environmentally sustainable, and which ensures accessibility to as wide a proportion of the population as possible. Although private provision has often lowered costs and improved services, the problems of political economy remain.

Competition has the power to transform infrastructure industries by increasing legitimacy and strengthening investors' property rights. It pushes firms to become more efficient and cut prices. As a result, it helps assure customers that they are getting a reasonable deal. This in turn reduces

pressure on governments to regulate in ways that weaken investors' property rights. If the government is a long way from successfully attracting private participation, investment in a public project should be considered. At the same time, purely public project should aim at addressing the major constraints to private participation. In the long run, the aim should be to encourage the private sector to assume a greater proportion of total infrastructure investment.

Where many elements of a sound environment for private participation appear to be in place, but investors' concerns about risk hamper investments, management contracts with performance bonuses, or with an option to take an equity position at the end of the contract, should be employed. Where competitive *energy* markets can be established, they should be pursued as the ultimate reform goal.

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