Journal of Economics, Finance and Management Studies

ISSN (print): 2644-0490, ISSN (online): 2644-0504

Volume 4 Issue 08 August 2021

Article DOI: 10.47191/jefms/v4-i8-08, Impact Factor: 6.228

Page No. 1307-1319

Assessment of the Legal and Institutional Framework for the Management of Fiscal Liabilities Arising from Public-Private Partnerships (PPPs) in Nigeria

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ABSTRACT: The procurement of infrastructure projects through the use of PPPs has a number of advantages including the potential of reducing life cycle costs, better project risks management and improved service delivery to mention a few. However, PPPs inevitably give rise to liabilities whether explicit or contingent. These liabilities where not properly managed may have adverse economic consequences for countries. This paper finds that whilst Nigeria has appropriate legal and institutional structures for managing fiscal liabilities generally, such structures are not designed or appropriate to deal with fiscal liabilities arising from PPPs. The paper makes suggestions on how this shortcoming may be addressed.

KEYWORDS: Fiscal Liabilities; Public-Private Partnerships; Nigeria; Risk Management; Infrastructure

1. INTRODUCTION

PPP may be defined as a long term relationship between public sector agencies and private sector entities under which the responsibility for any or all of the combination of designing, financing, construction, management and operation of public infrastructure and utilities that were traditionally undertaken by the public sector are contractually shared and jointly undertaken by both the public and private sector, usually in proportion to the kind of risks each party can best carry.[1]PPP projects differ from traditional or publicly financed infrastructure projects in the sense that under PPPs the different activities required for the delivery of infrastructure are bundled together and managed by a single private sector entity.[2]

These responsibilities assumed by the private sector investor under PPPs come with a lot of risks, which the private sector shares with the government.[3] This is why it is said that one of the most critical success factors for PPPs is the sharing of risks between the public and private sector parties.[4] Theoretically, the allocation of risk is done by the parties assigning values to each risk category. The price of each risk is derived from what the party shouldering the particular risk assumes it will cost it to manage the risk.[5]This practice is intuitive since the eventuation of an allocated risk has financial consequences for the party that assumed the risk.

By definition, risk is the exposure or chance of occurrence of events adversely or favorably affecting project objectives as a consequence of uncertainty.[6]The management of risk therefore involves a projection into an uncertain future, quantified in

[1]Nwangwu George 'The Legal Framework for Public-Private Partnerships (PPPs) In Nigeria: Untangling the Complex Web', *European Procurement and Public Private Partnership Law Review,* Volume 7 (2012), Issue 4, Pg. 268-277.

[2] Note that in most cases the private sector entity is made up of a combination of firms with different expertise coming together as a consortium.

[3] Risk is shared in the between the parties by taking into consideration the party that is best able to manage a particular risk.

[4] Grimsey D. and Lewis K. (2004) '*Public Private Partnerships: The Worldwide Revolution in infrastructure Provision and Project Finance*, (Cheltenham UK: Edward Elgar Publishing), 136.

[5] It follows therefore that the cheaper the mitigation measure, the less amount a party is willing to charge for assuming the risk.

[6] Risk is not always negative. From a project management point of view, risk also reflects the underlying uncertainty of developing and operating projects. It is when risk is viewed as an uncertain event, that it reflects the possibility of both threats and

monetary terms. Both parties try to forecast their possible liabilities and provide for them. This paper is focused on how the public sector assesses and manages the fiscal consequences of those portion of risks which it assumes under PPPs.

The use of PPP mechanisms to finance infrastructure projects has continued to grow in Nigeria.[7] The primary motivation for this trend appears to be insufficient government funds to improve the country's derelict infrastructure.[8] Therefore, the Nigerian government views PPPs as an alternative financing mechanism to augment its scarce resources.[9] The other reason is the obvious institutional inefficiencies of public authorities in providing public services and maintaining infrastructure.[10]It is hoped that the private sector would be more efficient in providing these services and ensuring the better maintenance of the infrastructure. Whether the underlining assumptions on which these policy objectives are predicated upon are accurate is subject to debate.[11]However, what is obvious is that these objectives are responsible for shaping the way the government sells PPPs to its citizens and also how it perceives and manages its fiscal risks and commitments.

PPP transactions are not exactly new in Nigeria as the country went through a privatization programme that also involved the concession of a number of brownfield infrastructure.[12] In recent times however, the number of projects that have been procured through PPPs have increased. Majority of the large transactions have been in the transport sector including a new airport terminal in Lagos and a toll road in the Lekki area of Lagos. There are a number of other projects currently in the pipeline like the light rail project for the Federal Capital Territory and Lagos and the concession of major road networks around the country.[13] In the agriculture sector, a number of grain silos were concessioned to private sector investors. While a number of transactions have also happened in the electric power sector.[14]Build Operate Transfer (BOT) arrangements appear to be the most common PPP delivery mechanism used in infrastructure projects in Nigeria.[15] However, there have also been a number of brownfield concessions to private sector investors.[16]

One of the major problems with the Nigerian PPP programme is the general assumption by a large section of policymakers that PPPs are risk free. This is evident from their policy statements as well as general conduct.[17]Policy makers act in a manner that suggests that PPPs merely involve the transfer of project risks to private sector parties who are then expected to offer risk free services to the user public.[18] This is manifested for instance in the indiscriminate issuance of sovereign guarantees to private sector investors in place of proper risk management.[19]However, PPPs are not free. They at best merely defer government fiscal

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opportunities. See Al-Bahar J.F. (1989) 'Risk Management in Construction Projects: A Systemic Analytical Approach for Contractors'. *PhD. Thesis* University of California Berkeley, 1989;

[7] This is evident at both the federal and state levels. Just like at the federal level, a number of states within the federation have set up structures for the delivery of PPP projects.

[8] This fact can be gleaned from the different government policy statements and policy documents. For instance, see: National Planning Commission, 'National Integrated Infrastructure Master Plan' The Presidency, Federal Republic of Nigeria, Abuja. Pg. 9

[9] See ibid.; See also: The Infrastructure Concession Regulatory Commission (ICRC) 'National Policy on Public Private Partnership (PPP), The Presidency Abuja. Pg.1

[10] Ibid.

[11] There are arguments to the contrary. See for instance Hall, D. (2008) *Public-Private Partner ships (PPPs) Summary Paper*, A Report Commissioned by the European Federation of Public Service Unions (EPSU). Pg 6.

[12] 26 ports terminals were concessioned across the country using the landlord-tenant model. In 2013, 3 hydro power plants, Kainji, Jebba and Shiroro were also concessioned.

[13] These projects are in various degrees of development.

[14] Most of the hitherto Government owned power assets are being completely divested through privatization. The only assets to be concessioned are the hydro power plants.

[15] Ibrahim A.D, *etal*'The analysis and allocation of risks in public private partnerships in infrastructure projects in Nigeria', (2006) Vol. 11 Iss: 3 Journal *of Financial Management of Property and Construction*, pp.149 – 164..

[16]The 26 Ports in the country were concessioned through the use of the "landlord tenant" model. Also three major hydropower plants (Shriroro, Kainji and Jebba) were all concessioned under a Repair, operate and transfer basis.

[17]A preliminary profiling of the large PPP projects so far concluded in Nigeria such as the concession of the country's 26 port terminals, the MMA 2 Local airport terminal and the Lekki toll road in Lagos show that project risks have not always been properly managed. See Nwangwu G. 'A Risk Based Approach to Enhancing PPPs in Nigeria' PhD Thesis (University of Hull:United Kingdom, 2013).

[18] n.15 above.

[19] This is most evident in the recent financing of rail projects where contractors (mostly Chinese) have borrowed heavily on behalf of the government on the basis of sovereign guarantees. Also, Nigeria currently does not have any detailed policy on the issuance of sovereign guarantee apart from the provision in S.3 of the Infrastructure Concession Regulatory Commission (ICRC) Establishment Act, 2005.

obligations. Therefore, whilst PPPs offer benefits if properly procured, they come with fiscal obligations for government. For instance, where PPP contracts are based on availability payment model, they merely allow the government to substitute the huge upfront capital expense for a series of future periodic payments.[20] Where the payment mechanism in the PPP contract is a user fee payment model, the government is merely delegating its power to collect tax to the PPP concessionaire, who collects user tolls from the citizens in return for the use of the infrastructure asset.[21]

Under a PPP procurement model, government always bears some liability. These liabilities may arise as a result of taking up some explicit contractual obligations under the PPP contract, like the obligation to provide land which will typically come with a concomitant obligation to pay compensation to the owners of the land. Furthermore, certain risks are typically transferred to the government which would include political risk, exchange rate risk and change in law risk. The government would usually also bear the contingent fiscal liabilities that arise from assuming these risks. There are also cases where the government provides undertakings to third parties or to a private sector investor itself to guarantee revenues or other obligations. These types of undertakings or guarantees also give rise to contingent liabilities as the government might be liable where the guaranteed obligation arises. Finally, there is an implied obligation in PPP projects that the government is the public service provider of last resort. It therefore has an obligation to step in and take over the provision of services from the private sector where the private sector is unable to continue to provide the contracted services. This implied obligation creates further contingent liabilities for government.

2. NATURE OF FISCAL LIABILITIES

Fiscal liabilities to government arise from projects, however procured. Under traditional procurement these liabilities are usually obvious and certain. However, due to the fact that PPPs are usually erroneously perceived as "free", casual observers of the PPP process do not typically avert their minds to the fiscal liabilities that come with it. Fiscal liabilities arise in PPP projects in different ways depending on how they are procured. Where PPPs are delivered as availability contracts, these liabilities are certain in terms of when they arise and the amount payable. Where the project is delivered using the user pay model, the government may be required to support the project through minimum revenue guarantees or other forms of support. In this case, there is no certainty in terms of the timing and amount of the support from government to the private sector investor. Again, regardless of whether projects are delivered using the availability or user fee payment models, there are still cases where the government supports projects through capital payments or subsidies.[22] These types of supports also create fiscal liabilities.[23]

In essence, fiscal liabilities arise for government throughout the PPP project lifecycle. At the project conceptualisation or the project preparatory stage, the public sector often needs to fund the project development studies. In the case of Nigeria, this will be the Outline Business Case (OBC) and the Full Business Case (FBC).[24] The public sector would usually also have to hire and remunerate the transaction advisors and other consultants that are required to develop the project. Part of these payments are contingent in nature and dependent on the success of the project. At the development stage, government may also have upfront obligations to contribute land or other resources to the project. In some cases, the support may be in the form of tax or custom duties waivers. This support may also extend to offering grants or other subsidies to make the project viable. In some cases, the public sector party may also be obliged to contribute either debt or equity to the project. This is usually the case where there is need to supplement available private capital. At the operational stage, the project may also require contingent support to help manage identified project risks. For example, there are instances where the government provides revenue guarantees to help manage demand risk or where the government undertakes to assume the consequences of fluctuation in the movement of currency.[25]As mentioned above, there are also cases where the government issues sovereign guarantees to cover payment risks or even loans that are granted to the private sector investor.

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[20] The availability payment model is common under the United Kingdom's PFI scheme.

[21] Two good examples of the User Pay scheme are the Lekki toll road and MMA 2 PPP concessions.

[22]These subsidies may take the form of capital expenditure contributions (capex), which can either be in the form of loans or equity as capital grants to the private sector.

[23]Iossa, E. *et al (*2007) 'Best Practices on Contract Design in Public-Private Partnerships', at http://www.gianca.org/papersHomepage/Best%20Practices%20on%20Contract%20Design.pff (last accessed on November 19, 2020)

[24] This would be the equivalent of prefeasibility studies and feasibility studies stages respectively. See the National Policy on Public Private Partnerships (PPP) Pg.72

[25] This is where the government assumes the currency risk.

Fiscal liabilities can also arise in projects either explicitly or implicitly. Explicit liabilities are known upfront by the government, even though government might not be aware of the exact size of this liability. They are typically created by contract or by law. A good example is an off-take obligation arising out of a power purchase agreement between the government and a private sector investor.[26] Implicit liabilities on the other hand do not emanate from any explicit obligation but arise as a result of the innate obligations of government. A good example is the so-called step-in rights of the government to prevent collapse of public services where the private sector concessionaire runs into difficulties.

Another form of classification of fiscal liabilities that is common is the distinction between direct and contingent liabilities. Direct liabilities are definitive in terms of time of occurrence even though the extent of the liability might not be certain. In the case of contingent liabilities, the obligation of government is triggered on the occurrence of certain events or circumstances. Typically, the crystallization of a contingent liability is dependent on an unpredictable future event, not wholly controlled by the government. This uncertain nature of contingent liabilities creates real issues for governments as they usually do not have the fiscal ability and flexibility to meet payments of contingent liabilities when they crystallize. In other words, since the obligation to make payment for contingent liabilities may arise unexpectedly, government might not have budgeted resources to make those payments. A good example of a contingent liability that arises from PPPs are termination payments.[27]

3. WHY DOES NIGERIA NEED A FISCAL POLICY FOR PPPs?

In the absence of a formal and rigorous management process, it is likely that fiscal liabilities arising from PPPs may become significant enough to adversely affect the country's economic health. The management of fiscal risks ensures that fiscal liabilities in PPPs are identified from the beginning, properly allocated and effectively mitigated throughout the project lifecycle. The problem faced when dealing with PPPs is that they may initially appear to be cheaper than traditionally procured infrastructure projects, however they may turn out to be more expensive over time. This is the reason why a formal value for money (VFM) assessment is recommended at the onset of project development.[28]The proper identification of fiscal risks at the project inception stage ensures that government only accepts liabilities that provide VFM throughout the project lifecycle.

Another important reason for the management of fiscal liabilities is that contingent liabilities arising from PPPs are capable of increasing the government's budgetary risk. The uncertainty surrounding contingent liability means that government might be unable to predict its expenditure in any given year. This is made worse because PPPs are exposed to the vagaries of economic factors. Where for instance, there is an economic downturn, like a recession, the likelihood of government's guarantees being triggered increases. This is because the underlying assumptions upon which the revenues of the PPP projects are predicated upon is negatively affected leading to revenue shortfalls. Where such projects enjoy minimum revenue guarantees, the likelihood that the government may be called upon to meet the obligation is increased.

The firm contractual nature of PPPs can be both a blessing and curse at the same time. The certainty of PPP contracts ensures the elimination of time and cost overrun risks to the public sector thereby ensuring that the economic benefits arising from infrastructure projects are available to citizens much earlier than they would have been under traditional procurement.[29] However, this also takes away the flexibility available to government to absorb fiscal shocks. For instance, where the government runs out of funds under traditional procurement, it has the option of scaling back or postponing the project to another fiscal year. This policy lever is not available under PPPs. Once the government has committed to a PPP, it is contractually bound throughout the project lifecycle and must fund its commitments when due.

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[26] Power purchase agreements usually contain "take or pay" clauses mandating the off taker (usually government) to pay for the power once generated by the private sector investor.

[27]Termination payments are made to the private sector investor regardless of whether it is at fault or whether the termination was triggered by the occurrence of a force majeure event. The reason for this is that long term infrastructure contracts, like PPP contracts, usually involve the construction of large infrastructure assets, which are typically sunk costs for the private sector party. These assets cannot, like in other conventional services contracts, be uprooted and taken away by the private sector party in the event of termination.

[28] This is usually done using the Public Sector Comparator (PSC) Model. The PSC basically compares the financial differences between two procurement options (traditional procurement and PPP) for the same project. This is done by preparing a hypothetical set of costs for the public procurement of the project delivering the same output, including an evaluation of the project risk borne by the private sector

[29] Time and cost overruns contribute a significant portion of project costs under traditional procurement. This erodes VFM in these projects

Where a government has a fiscal risk management policy, it goes a long way in signalling to investors and other stakeholders that the country is serious about PPPs and conscious of the fiscal consequences arising from it. It also decreases the likelihood that the country's risk exposure is overestimated, thereby leading to the of charging inordinate risk premiums by lenders. Generally, a fiscal risk management policy will help increase confidence in Nigeria's PPP process thereby helping attract more investment and lowering the cost of borrowing.

4. THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR THE MANAGEMENT OF PPP FISCAL LIABILITIES IN NIGERIA

The legal framework for the management of fiscal liabilities in Nigeria is provided for in various legislations and the responsibility for facilitating the management process lies in several institutions created under these legislations. Below is a discussion of some of these legislations and institutions:

4.1. The Debt Management Office Act 2003

The primary agency for the management of government's fiscal liabilities in Nigeria is the Debt Management Office (DMO). The DMO was established by the Debt Management Office Act.[30] The main duties of the DMO is to prepare and implement a plan for the efficient management of Nigeria's external and domestic debt obligations at sustainable levels compatible with the desired economic activities for growth and development; and participate in negotiations aimed at realising those objectives.[31]As a corollary to this, the DMO is also charged with the responsibility of verifying and servicing external debts guaranteed or directly taken by the Federal Government and to set guidelines for managing the country's risk and currency exposure with respect to all loans.[32]

Even though the Act does not expressly mention PPP transactions, it is clear that it is applicable to PPPs, since PPPs will obviously require the Government of Nigeria to borrow both externally and internally as well as issue guarantees. For this reason, the DMO is therefore the principal agency in charge of the management of fiscal liabilities arising from PPPs. This position is echoed by the PPP policy, which requires that DMO should be consulted in advance by MDA project teams where there is likely to be fiscal liabilities arising from PPPs. According to the National Policy on PPPs:

> "DMO will need to be satisfied that any contingent liabilities are manageable within the Government's economic and fiscal forecasts. The DMO will advise the Federal Executive Council as part of the approval process for individual projects. The DMO will also need to be consulted in advance of requesting approvals by project teams who are considering the involvement of multilateral agencies such as IFC, MIGA or IDA in providing guarantees or other financial instruments"[33]

In practice however, the DMO is hardly ever involved in the PPP vetting process in Nigeria. PPP projects would simply pass through the ICRC approval processes and once the ICRC is satisfied with the project, a "no objection" is given to the project to proceed without further consultations with the DMO. It must be noted however that since the establishment of the PPP Unit of the Federal Ministry of Finance, there has been a lot more coordination and attempts to involve the DMO in the approval process for PPPs. However, it is not certain that the DMO keeps a record of the fiscal liabilities emanating from PPPs for proper management.

4.2. The Infrastructure Concession Regulatory Commission Act (the ICRC Act, 2005

The ICRC Act, which was enacted into law in 2005, provides the primary legal framework for Private Sector Participation in Infrastructure Development in Nigeria and is the principal legislation for PPP in Nigeria. The main function of the Commission is to take custody of every concession agreement or contract entered into by the government ministry or agency and monitor compliance with the ICRC Act and the efficient execution of any such Concession Agreements[34].

The ICRC Act does not expressly provide for the management of fiscal liabilities arising from PPPs but grants the ICRC powers to vet projects for viability. It is only projects that have been given the all clear by ICRC that may proceed for procurement and finally contract award.[35] In furtherance of this gate keeping function, the ICRC has implied powers to refuse to grant a "no objection" to a project where it creates significant fiscal liabilities for the public sector. In practice however, ICRC does not have

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[30] Debt Management Office (Establishment)Act No. 18 of 2003 Cap D12, LFN 2004.
[31] S.6 (1) (c) of DMO Act
[32] S. 6 (1) (f) of DMO Act.
[33]The Presidency, 'National Policy on Public-Private Partnership (PPP)' A document of the Infrastructure Concession Regulatory Commission Abuja, p. 70.
[34] SS. 14, 15, 16 and 17 of the ICRC Act.
[35] n.33 above, p.66.

the capacity to do this effectively. The agency does not have powers to approve the budgets of MDAs and therefore has no say on whether such MDAs should assume fiscal liabilities or otherwise. Such powers lie with the Ministers or other heads of the affected agencies. The ICRC does not also have capacity to effectively track and monitor fiscal liabilities arising from PPPs. It neither has a view of all of the liabilities nor is it in a position to determine whether liabilities arising from a project are affordable.

4.3. Ministries, Departments and Agencies of Government

The ICRC Act vests government ministries, departments and other agencies (MDAs) with power to enter into contract with, or grant concessions, to the private sector for the financing, construction, operation and maintenance of any viable infrastructure.[36] The MDAs are therefore responsible for originating and developing PPP transactions and therefore play an important role in the management of fiscal risks in PPP projects.

During the Project preparation stage, the MDAs are responsible for the preparation of the feasibility studies. They are responsible for making sure that the PPP project is affordable and generates Value for Money (VFM) for the government. These processes are the first line of defence for the management of fiscal liabilities. Where projects are not commercially viable as a PPP, the MDAs are advised not to proceed any further with its development. It is important to note that fiscal and commercial viability are two different things. A project may be commercially unviable but made viable through governments fiscal support. In which case it is said to be commercially unviable but fiscally viable. However, where government cannot afford such fiscal support, then such project also becomes fiscally unviable and MDAs are advised not to proceed with such a project. In furtherance of their mandate to approve projects that are fiscally viable, MDAs determine through the feasibility studies whether the project is socially desirable and economically viable to enjoy government grants, subsidies or guarantees. The justification for this should be clearly stated in the OBC or the FBC.

4.4. Federal Ministry of Finance

The Federal Ministry of Finance is the key government Ministry that is responsible for the development of the country's fiscal policy and by extension the management of the fiscal risks arising from PPPs. In other to carry out this function effectively, the Federal Ministry of Finance recently set up a PPP Division that is housed in the Technical Services Department of the Ministry. The PPP Division of the Federal Ministry of Finance is currently responsible for assessing the financial viability of PPP projects within the country. The core function of the PPP Division is to manage government's contingent liabilities in PPP projects by identifying, tracking, mitigating and monitoring the liabilities. In addition, to evaluate projects for viability gap funding and support other MDAs by providing advice on the financial aspects of PPP contracts.

The PPP Division of the Federal Ministry of Finance is a welcome addition to the country's fiscal liability management process. This is because of the influence wielded by the Minister of Finance in the country's fiscal space. The DMO also reports to the Ministry of Finance and so there is the likelihood for better cooperation and coordination in the management of the country's PPP liabilities. It is hoped that with the creation of the PPP Division with the Ministry of Finance that it would help increase the quality of projects delivered through PPPs. It also helps augment whatever capacity gap exists within MDAs by providing technical support to the different MDAs involved in PPPs at the federal level.

For the PPP Division to properly carry out its mandate, it must have qualified staff that are both committed and dedicated to executing their respective regulatory and technical roles. The job of the PPP division is usually at the pre-feasibility studies and feasibility studies stages where it may approve or disapprove transactions after thorough review of risk mitigation measures, affordability and value for money assessments. Requests for approval to the PPP division must be supported by documents to prove the legal, technical, environmental viability and more importantly, financial implications of the project to the government's budget. The deliberations and the conclusions reached by the division must demonstrate that the project in its overall sense provides value for money as intended.

4.5. *The Federal Executive Council*

The Federal Executive Council (FEC) is the Cabinet of Nigeria and therefore highest executive decision-making arm of government. The members are appointed by the president and oversee the ministries and major parastatals of government. The ICRC Act specifically provides that the FEC must grant approval before PPP contracts may be entered into. [37] The ICRC Act also provides that no guarantees or similar undertakings may be given by any government agency to an investor without the approval of FEC.

[36] S.1 of the ICRC Act.

[37] S.2 (2) of the ICRC Act.

[38] ICRC has interpreted the provision dealing with approvals before the entering into of contracts to mean that approvals must be obtained from FEC before undertaking nearly all steps of the PPP process. This very wide interpretation of the role of the FEC in the PPP project development process has unduly elongated the timelines for completing projects.

Due to the fact that the FEC has significant powers to approve the delivery of PPP projects in Nigeria, the institution is therefore a very important part of the fiscal liabilities management process in Nigeria. It is the case that FEC may ask for the project delivery process be varied, suspended or out rightly discontinued due to the fiscal constraints the project might place on the country.

4.6. The Fiscal Responsibility Commission

The Fiscal Responsibility Act established the Fiscal Responsibility Commission (FRC). The Fiscal Responsibility Act[39] itself covers matters relating to public financial management, specifically relating to the total allowable debt by government, authorisation for borrowing by all tiers of government and the use of borrowed funds amongst others.[40]The function of the FRC that relates to PPPs is the promotion of the prudent management of the country's financial resources. This is done through the monitoring and enforcement of provisions of the Act that results in the greater efficiency in the allocation and management of public expenditure, revenue collection, debt control and transparency in fiscal operations. The Commission is also responsible for imposing limits on the country's spending and borrowing and thus invariably affects the nature and quantum of the fiscal support the public sector may offer to PPP project.

The Fiscal Responsibility Act provides a comprehensive framework for public debt management. For instance, the Act provides that government shall only borrow for capital expenditure and human resource development, provided that such borrowing shall be on concessional terms with low interest rate and with a reasonable long amortization period subject with the approval of the appropriate legislative body where necessary.[41]The Act also urges the government to ensure that the level of public debt as proportion of National income is held at a sustainable level[42] The Act mandates that any MDA that is desirous of borrowing shall specify the purpose for which the borrowing is intended and present a cost benefit analysis, detailing the economic and social benefits of the purpose for which the intended borrowing is to be applied.[43] Note the proceeds of the borrowing should be applied solely towards long term capital expenditures.[44]

The Act permits the Minister of Finance to issue guarantees on behalf of the Federal Government of Nigeria with the approval of the Federal Executive Council.[45] However, any guarantee granted by the Minister of Finance should be conditional upon the provision of a counter guarantee in an amount equal to or higher than the guarantee obligation. [46]It provides that guarantee provided in excess of debt limits set in accordance with the Fiscal Responsibility Act shall be an offence.[47] These provisions of the Act are very essential to the delivery of PPP projects.

The summary of these provisions is to the effect that if there is any kind of government borrowing, spending or provision of guarantees in respect of PPP transactions, it must be in compliance with the Fiscal Responsibilities Act. It is not certain whether the PPP projects that have been executed so far are in compliance with the provisions of the Act. For instance, it is not certain whether there are counter guarantees issued in respect of guarantees or whether contingent liabilities are taken into consideration when assessing the quantum of debt when seeking compliance with the provisions of the Fiscal Responsibility Commission Act.

4.7. The National Assembly

By virtue of the Constitution of the Federal Republic of Nigeria, the National Assembly has exclusive powers not only to make laws to regulate domestic and external borrowing of the country but is also granted power to approve through appropriation all

[38] S.3 of the ICRC Act.
[39] The Fiscal Responsibility Act, No. 31, 2007.
[40] S. 3 of the Fiscal Responsibility Act deals with the functions of the Fiscal Responsibility Commission.
[41] S.41 (1) (a) of the Fiscal Responsibility Act.
[42] S.41 (1) (c) of the Fiscal Responsibility Act.
[43] S. 44(1) of the Fiscal Responsibility Act.
[44] S.44 (2) (b) of the Fiscal Responsibility Act.
[45]S.47 of of the Fiscal Responsibility Act.
[46] S.47 (2) of the Fiscal Responsibility Act.
[47] S.47 (4) of the Fiscal Responsibility Act.

domestic and external borrowing of the country.[48] Therefore it follows that the Federal government cannot accrue any debt through PPPs without the prior approval of the National Assembly.[49]

From the foregoing, it is apparent that there ought to be coordination between the MDAs, ICRC, DMO and the Ministry of Finance with the Fiscal Responsibility Commission in the management of fiscal liabilities arising from PPPs. In practice, this coordination does not exist and what happens is that the different agencies work in silos and oftentimes at cross purposes with one another. The overview of the Legal and Institutional framework for the management of fiscal liabilities relating to PPPs in Nigeria show that there are serious gaps in the laws and that the legal framework that is available is not even being complied with. There is also manifest lack of coordination amongst institutions involved in PPP projects in the management of fiscal liabilities. In another sense this is another type of risk that is assumed by parties involved in PPP projects as some of the transactions conducted to date might even be illegal considering that thy have not been in compliance with the Fiscal Responsibility Act. The proper thing to do is probably to make regulations under the ICRC Act to ensure better integration of the roles of the different institutions involved in PPP fiscal liability management.

5.0. RECOMMENDATIONS FOR MANAGING FISCAL LIABILITIES

After assessing the legal and institutional framework for the management of fiscal liabilities in the previous section of this paper, this section recommends some of the best practices for the management of fiscal liabilities.

5.1. Carrying Out Affordability Assessments:

In making the decision on whether or not to deliver an infrastructure project as a PPP, the public sector must always consider whether the project is affordable.[50] In other words, whether the government possesses sufficient funds to make the periodic repayments required to meets its obligations when they become due.[51]There are of course projects where the social and economic benefits exceed their commercial costs, and these types of projects are to be considered regardless.[52]

Most countries pay lip service to the concept of affordability for various reasons. The first is the fact that PPPs allow governments an escape route from legally imposed fiscal restrictions, whether relating to its capacity to spend or borrow. Through the use of private sector investments as PPPs, governments are able to breach whatever fiscal ceilings that are imposed by law.

Secondly, the concept of representative democracy that is practiced by most countries usually imposes term limits on governments. This means that political parties campaign for re-election every 4 or 5 years. There is a tendency to seek to deliver infrastructure projects within those term limits at whatever fiscal costs. Governments therefore tend to overspend today and worry about the consequences later or pass those consequences over to incoming administrations. Another reason for the lack of proper affordability assessment prior to choosing to deliver a project as a PPP is the lack of capacity. A number of countries lack the capacity to structure PPP transactions properly and so end up with poorly conceived projects that the country cannot afford.

There is a tendency to ignore the fact that government liabilities, whether direct or contingent, extend over the lifetime of the project and affordability assessments in Nigeria, do not usually take this into consideration. There is also the need to include the value of contingent liabilities when costing projects at inception. This fact is nearly always lost on project development teams in Nigeria, as there is usually no certainty regarding whether or when contingent liabilities would arise. However, it is always advisable that where there is the possibility that a project would generate future contingent liabilities, then such liabilities ought to be taken into account in costing the project. Where future liabilities are properly assessed then it becomes clearer whether a project is capable of generating value for money or otherwise as a PPP. There are currently no provisions in any of the legal and institutional frameworks that have been analysed above that take this fact into consideration.

In carrying out affordability assessments, the proper analysis of credit risk likely to derive from explicit contingent liabilities is critical for the management of contingent liabilities. If conducted appropriately, such analysis ensures that the government's risk exposure is manageable and sustainable. Credit risk analysis not only provides the government with an understanding of the

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[48] See ss. 80, 81,82, 83 and 84 of the Constitution of the Federal Republic of Nigeria, 1999

[49] It is not clear whether the National Assembly's authority extends to granting approval for the assumption of contingent liabilities.

[50] See the Nigerian PPP Policy, n.33 above, which deals extensively with affordability.

[51] In actual terms, government merely defers its financial obligations under PPPs

[52] These projects are typically made viable through the use of viability gap funding. The National PPP policy rightly recommends that even in these situations there needs to be some rationing and prioritization of the projects in order to achieve a balance between competing calls on public resources. See pg. 35 of the PPP policy

risk exposure arising from guarantees and other similar instruments, but also guides them in deciding whether one form of fiscal support is preferable to others. For a country like Nigeria, the biggest advantage of having formal procedures in place for credit risk assessments is that it ensures that contingent risks are only assumed by government where sufficient justification is provided.

5.2. Better Accounting Treatment of Liabilities:

Another reason for the lack of proper management of fiscal liabilities in Nigeria is the improper accounting treatment of PPP liabilities. Presently, there are no official records of PPP fiscal liabilities either within the Debt Management Office or the Ministry of Finance in Nigeria. It is recommended that government should keep a centralized register of both direct and contingent financial commitments arising from PPP contracts. When the reporting of these liabilities or fiscal commitments is properly done, it helps keep government focused and accountable. The government is therefore able to examine whether it can assume additional liabilities when new projects come up for consideration. The enabling legal frameworks should therefore be amended to direct that the government should make financial reports of projects publicly available as this will lead to increased transparency. This will also enable different stakeholders, whether financiers, rating agencies, or the general public to make informed decisions regarding a project.

The proper accounting treatment of PPP transactions will also help facilitate the conduct of performance and VFM. This is essential because it not only enables the public sector gauge the success or otherwise of the project but also lessons learned can be used in better designing future projects. In practice in Nigeria however, once a project is successfully delivered, there are no effective post-delivery VFM assessments. Currently. the ICRC and the MDAs are jointly mandated to carry our monitoring and evaluation, but these monitoring exercises do not extend to VFM audits.

It is also suggested that in accounting for PPP fiscal liabilities the government should adopt an accrual basis of accounting instead of cash basis of accounting as this is more likely to reveal any hidden liabilities. As a basic rule, IAS 37 provides that PPP assets are classified in the private party's balance sheet and not on the government's balance sheet. For this to occur however, the following conditions ought to be met:

(i) the private party bears the construction risks covering events like late delivery, respect of specifications and additional costs;

(ii) the private party bears at least one of either operating risk or demand risk. Operating risk covers the volume and quality of output (performance of the private party), while demand risk covers the variability of demand—that is effective use by end-users and revenue or payments that vary with demand. In some cases, demand risk may be shared between the government and private party; and

(iii) that the risks taken on by the private party are significant and material.

From the forgoing, it is clear that as a basic rule, contingent liabilities would appear on the balance sheet of the party that bears the most risks in a PPP project. Nevertheless, it is good practice to ensure that even where the liabilities are not recognised on government's balance sheet that they are still required to be disclosed on the notes to the accounts.

It is not clear whether the Nigerian government recognises contingent liabilities arising out of PPPs on its balance sheet since there are no clear policy statements to that effect. Nevertheless, it is suggested that it is good practice to do so.

5.3. Enthroning a Strong regulatory framework for managing contingent liabilities

Risk mitigation instruments and other similar interventions are no comprehensive panacea for dealing with fiscal liabilities. At best they help bridge the gap whilst a country establishes a sound legal, regulatory and policy framework that will reduce the risk and support the efficient sharing of fiscal risks. It is therefore obvious that the long term and most effective instrument for managing fiscal risk is the enactment of a sound regulatory framework. Where this exists, it limits political influence on how projects are executed and fosters consistency in policymaking thereby reducing the cost of guaranteed debt.

From the analysis of the legal and institutional framework carried out in the previous sections of this paper, it is obvious that there ought to be a significant realignment of existing legal framework to ensure that it meets the requirements for managing government's fiscal liabilities. For example, the regulatory framework should ensure that guarantees are issued cautiously and that the best possible terms are negotiated with beneficiaries to mitigate the risk of default. Presently, the law confers too much discretionary powers on the Minister of Finance when it comes to issuing guarantees. It is recommended that enabling laws should go further in stipulating the procedures and conditions that ought to be met for the issuance of guarantees. Also, the provision of the Fiscal Responsibility Act that requires that guarantees should be issued only for capital projects should be strictly enforced and monitored.

The DMO typically has oversight of the government's financial position and is consequently well placed to assess the costs and risks of projects and guarantees. Lessons from studies show that in many African and OECD countries DMOs are involved in managing contingent liabilities arising from guarantees to state institutions, but not those arising from guarantees to PPP projects.[53] There is a need for this anomaly to be rectified in Nigeria to ensure that the DMO is always involved in the analysis of contingent liabilities arising out of PPPs and the reporting thereon. This lacune may be filled through the amendment of some of the extant laws

5.4. Strengthening the capacity to manage projects and to negotiate contracts:

There is the need to strengthen government's bargaining power so that it is able to engage the private sector from a position of strength when negotiating PPP agreements. It is a fact that there is very limited capacity within MDAs to deliver PPP projects. This problem is not however peculiar to Nigeria. For instance, in a survey carried out by the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), it was identified that limited knowledge and capacity related to PPPs was a major obstacle to PPP development.[54] Also it is in recognition of the correlation between capacity building and the advancement of PPPs that the Addis Ababa Action Agenda on the Financing for Development put capacity building for PPPs at the core of its agenda.[55]

At the minimum, MDAs should have in-house staff with requisite skills in financial, legal, technical, procurement and project management areas. Where necessary, the capacity should be complemented with external consultants to fill gaps. This is because one of the leading causes for improper management of fiscal liabilities is the lack of capacity. Specifically, financial and legal advisors must understand the financial instruments being proposed and issued and also the risks that are likely to originate from them. It is only where these risks are properly identified that proper mitigation strategies are put in place to help manage them.

It is on record that the most effective method of knowledge transfer is through on-job learning. One of the core responsibilities of ICRC is "providing advisory services, technical assistance, training and capacity development to MDAs in PPP project preparation and development".[56] However, the agency has only been able to carry out very minimal number of trainings so far and the gap still exists. Another factor responsible for the capacity gap constraints is the itinerant nature of civil servants in Nigeria. Civil servants keep getting transferred between Ministries and even between departments within ministries. Therefore, staff that are trained in PPPs more often than not leave the PPP units within the Ministries to other assignments. This leads to a severe loss of capacity within the PPP units in different PPP active MDAs.

5.5. Judicious use of Guarantee Instruments:

In deserving cases, the government can provide loan guarantees (partial or full) for a project to help reduce its risk level and thereby minimize financing costs. This is also helpful to make the project commercially viable. If such a guarantee is available, investment risks by the private partner can be assessed at the zero or no risk level.[57]However, as pointed out above, such guarantees expose the government to potential liabilities in the event of a loan default. In addition, providing guarantee to the project reduces the incentives for the private operator to manage the project risks since financing risk is assumed by government. In view of this, the government must be extremely circumspect in making available guarantees to projects. The Nigerian government has recognised the dangers that come with the indiscriminate use of guarantees and the rules stipulate that MDAs must seek FEC approval before issuing guarantees.[58]

Apart from sovereign guarantees that are provided directly by the government, guarantees are also available from other bilateral and multilateral agencies. Two of the most popular of these instruments are the political risk insurance and the political risk guarantees (PRG).[59] These instruments typically cover losses arising from the breach of host government's contractual obligations to private sector investors. In summary, they cover risks such as expropriation, breach of contracts, sovereign debt default and currency transfer or controvertibly risk. Some of the providers are Government export credit agencies (e.g EDC, OPIC), the World Bank (MIGA) and private insurers (Zurich, AIG etc). When multilateral institutions offer these instruments, they are

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[53]Nwangwu George 'Managing Contingent Liabilities Arising from Public-Private Partnerships' (2018) 9 *Afe Babalola University Journal of Sustainable Development Law and Policy, p. 67-83*

[54]Verougstraete Mathieu, 'Building Capacity for Public-Private Partnerships' World Bank Blogs. Found Online at: https://blogs.worldbank.org/ppps/building-capacity-public-private-partnerships (Last accessed June 3, 2020).

[55] United Nations Department of Economic Affairs 'Addis Ababa Action Agenda of the Third International Conference on Financing for Development, United Nations 2015.

[56] n.35 above, p.8.

[57] This may diminish the incentive of the private sector party to operate the project in an optimal manner.

[58] See S.3 of the ICRC Act. It is also not clear whether the approval of the National Assembly is also required.

[59] PRG is also used as an abbreviation for a similar instrument called partial risk guarantees

usually complementary to the credits offered to the host countries by these agencies. They have the advantage upgrading the host government's credit rating and lowering financing costs of the project because the premium placed on the insured or guaranteed risk by the private sector when pricing the risk is considerably lower.

Some countries have developed autochthonous mechanisms for providing loan guarantees. For example, the Philippines created a national agency that provides loan guarantee for projects undertaken by Local Governments.[60] The Nigerian government through the Ministry of Finance may consider establishing similar structures to facilitate project development.

5.6. Budgeting and Paying for PPP Liabilities

The government should implement a systematic process to budget and pay for liabilities arising from PPP transactions. Such a process will strengthen incentives within government and reassure the private sector investor that the government will meet its obligations when they become due. In Nigeria, Federal budgets are done over a three-year cycle under the Medium Term Expenditure Framework.[61] The budgeting and planning for infrastructure in Nigeria should ordinarily be synchronised with the National Integrated Infrastructure Master Plan (NIIMP). However, this is hardly the case as budgeting and planning for PPPs are still done in a haphazard manner.[62]

The crystallization of a contingent liability is an unpredictable event. This is because by definition, a contingent liability only occurs if a future event not wholly controlled by the MDA occurs. This uncertainty creates the need for governments to have the fiscal ability and flexibility to meet payments of contingent liabilities when they crystallize. This uncertainty also means that because contingent liabilities payment may arise unexpectedly during a fiscal year and thus are unlikely able to be reflected in the annual budget, as for other types of government expenditures. For this reason, the resources to make payment may not be immediately available.

5.7. Establishing Contingency Reserve Fund

A Contingency Reserve Fund (CRF) or Contingent Liability Fund (CLF) provides a mechanism to improve the credibility of the country's PPP program by providing a source of funds for contingent liability payments and also through disclosure of the likely magnitude of contingent liabilities. Depending on the option chosen for a CLF, it can also provide an important monitoring and management mechanism. CRFs act as fiscal buffers and limit direct pressure on the budget. They may also make the cost of contingent liabilities more transparent, thereby establishing links between contingent liabilities and the budget. In practice, political support for these sorts of funds has been limited. Government officials are usually reluctant to support the setting up of contingency reserve funds where fiscal deficits and budgetary pressures are high and therefore there exists other competing uses for funds.

The National PPP Policy states that the government is considering the creation of Guarantee Fund but this has not materialized to date.[63] This is not surprising since the establishment of a CRF may require the passage of an Act of parliament or at a minimum cooperation from other tiers of government.[64]One way for going around the legal impediments to setting up such a fund is to encourage MDAs to set aside funds through the annual budget process instead, after securing the necessary approvals. There is also concern that reserve funds increase the likelihood of moral hazard. In other words that if MDAs are aware of the existence of a CRF, funds may not be utilised judiciously.

5.8. Engaging external audit and disclosing fiscal liabilities

The audit and disclosure of fiscal liabilities, whether express or contingent, by government improves the credibility of the PPP programme. Disclosure is done in financial statements and budget documents. Amongst the items disclosed are the volume, likelihood of materialization of the liability and its impact on the budget. It is also valuable to publish information on the

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[60]The Philippine Guarantee Corporation (PHILGUARANTEE) is a government-owned and controlled corporation attached to the Department of Finance. It is the principal agency for State Guarantee Finance of the Philippines. See website at https://philguarantee.gov.ph/

[61]The Medium- Term Expenditure Framework (MTEF) is an annual, rolling three year expenditure planning. It sets out the medium term expenditure priorities and hard budget constraints against which sector plans can be developed and refined. It also contains outcome criteria for the purposes of performance monitoring.

[62] The Executive arm of government prepares budgets from year to year which are approved by the National Assembly. MDAs are not permitted to enter into contractual arrangements including PPPs unless there is an appropriation within the budget for such contracts.

[63] National PPP Policy, pg.58.

[64] It would certainly require the National Assembly to make necessary appropriations to facilitate it.

beneficiaries of any guarantees and the government's justification for providing this form of support. This improved disclosure of fiscal liabilities facilitates informed policymaking and may limit growth in contingent debt. Consistent dissemination of comprehensive information to stakeholders, including the National Assembly increases accountability, predictability and fiscal credibility, allowing for reduced borrowing costs. Ideally, the DMO through the Ministry of Finance should require mandatory disclosure by MDAs of all fiscal liabilities and, analysis of the risks associated with them. This should also be reported to the National Assembly alongside the annual budget.

Another medium through which liabilities are disclosed is in the MDA accounts and annual returns. It is worth noting that accounting standards require guarantees to be reported as liabilities on the balance sheet only if there is greater potential of materialization than not, and if the debt owed is measurable.[65] On the other hand, Statistical standards acknowledge contingent liabilities only if they materialize and when payment is due.[66] Auditors play an important role in reviewing and evaluating the quality of information disclosed according to these two standards. Where auditing processes are effective, they improve disclosure and therefore the management of contingent liabilities by ensuring that responsible stakeholders within and outside the government are aware liabilities arising from PPPs.

6.0. CONCLUSION

This paper assessed the legal and institutional framework for the management of fiscal liabilities arising from PPPs in Nigeria. It concludes that even though there are existing legal frameworks and structures for the management of fiscal liabilities generally, they are ill suited for managing liabilities arising from PPPs. In practice, there is no coordination amongst the different agencies and what happens is that the different agencies work in silos and oftentimes at cross purposes with one another. There is therefore a need to quickly develop a more integrated legal and institutional framework since PPPs are likely to generate liabilities and the lack of a management framework could have serious implications for the economic health of the country.

There are a number of steps that can be taken to achieve a better fiscal liability management regime for the country. This paper recommends:

i) Carrying out affordability assessments;
ii) Better accounting treatment of liabilities;
iii) Enthroning a strong regulatory framework for managing contingent liabilities;
iv)Establish dedicated PPP units and strong PPP Technical Committee at national level;
v) Strengthening the capacity to manage projects and to negotiate contracts;
vi)Judicious use of guarantee instruments;
vii) Establishing a contingency reserve fund:
viii) Budgeting and paying for PPP liabilitie**s;**
ix) Engaging external audit and disclosing fiscal liabilities.

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[65] This is dealt with by IPSAS-32. In summary, availability payment PPPs should be reflected on government's balance sheet while the decision on whether to reflect user pay PPPs in government balance sheet would depend on the nature of the underlying contract. See also IPSAS 19 for treatment of contingent liabilities.

[66] See for instance IMF's Government Finance Statistics Manual available at https://www.imf.org/external/Pubs/FT/GFS/Manual/2014/gfsfinal.pdf

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