Chapter 10

Public–Sector Project Abandonment Decision: A Test of the Ricardian Equivalence Theory on the Failed Lagos Metroline in Nigeria

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ABSTRACT

This chapter examines the implications of projects abandonment with test of the Ricardian Equivalence on the failed Lagos metro line project in Nigeria as case study. The main variables used are Rail and Pipeline Output, Budget Deficit, Interest Rate, Corruption Index, Savings and some others. The study results on the Ricardian Equivalence hypothesis on deficit financing of projects using Vector auto-regression model from 1980-2012 indicate that no causal influence holds in Nigeria. Results show that poor planning, corruption, political factors, poor support infrastructures, poor quality of local resources, etc. were attributable. The results of the Impulse Response tests reveal that Rail and Pipeline output and a few others responded positively to shocks in the short run (years 1-2), and negatively to others. The result affirms that Government should privatize the railway system, legislate against project abandonment and ensure that projects are adequately planned, funded, insured and insulated against corruption.

INTRODUCTION

One of the fundamental challenges facing developing economies globally is the need to fill huge infrastructural gaps limiting the transformation of their economies and ensure sustainable development. Lofty social and economic policies and planned goals to improve living standards are handicapped due to lack of disciplined use of development capital. Public capital investment remains strategic policy deci-
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sion that falls within the purview or domain of the highest government authority. Hall and Jones (1997) argue that differences in economic successes across countries are attributed to institutions, government policies and infrastructure that shape the economic environment in which people produce and transact. A government that engages in fund raising from investors for the purpose of capital investment decision must ensure that optimal social returns are obtained on the funds. Dwivedi (2008) regards investment as committing money, time and labour to create assets that can generate income for the long-term or which enhance returns on the existing asset. When technical, financial and political feasibilities are shoddy, project failure or abandonment becomes inevitable. Dean (1951) suggested that capital project should be examined in terms of economic behaviour rather than in terms of “accounting convention”. Public projects are usually of social dimension for development and improvement in the living standard of the people.

Capital project decisions are normally irreversible, with expectation of immense future benefits over a reasonable long period in the future; otherwise it could result in time, capital and social welfare loss. Projects benefits may be pecuniary, non-monetary or partially monetary. Olowe (2011) identified the following as critical to a successful capital investment decision process: identifying possible investment project; identifying possible alternatives to the projects being evaluated; acquiring relevant data to the project under consideration; evaluating the project from the date assembled; project selection; project execution; and project monitoring and control. Before implementing these criteria, it is assumed that probable funding obstacles and other reasons that could result in abandonment would have been taken care of ex ante. Yescombe (2014) defines project abandonment as when the sponsor fails to continue construction or project operations; arguing that project abandonment clearly exposes the lender and the investors to much higher risk, such that there may not be real market upon a sale decision. Meir and Sepe (1989) argued the valuation effects of abandonment on the entity: that abandonment can be by termination or by sell-off. In a sell-off, the project assets are sold to outsiders, while in a termination assets remain with the firm. However, this chapter sees it as discontinuance of project with direct loss of capital, non-optimization of economic resources, and with indirect negative implications on outputs, employment, tax, and human welfare, etc. Thus the chapter examines the implications of public-sector project abandonment.

Lagos and the Metro-Line Project of 1981: The Case Study

Lagos state is the smallest state in the Nigerian federation and yet the most populous, being a coastal city. The current estimated population figure is put at 18 million and increasing at 3.2% per annum (BusinessDayOnline, 2014). Lagos’s share of Nigeria’s urban population is also a hefty 27.4%. As a result of overpopulation, the city is however severely challenged with poor infrastructure, particularly in the area of public transport. As at 2010, the size of the Lagos economy was estimated at ₦12.091 trillion ($80.61 billion), accounting for 35% of Nigeria’s GDP (Lagos State GDP Report, 2010). Lagos had been the political and commercial capital of Nigeria since the colonial years up to 1990 when the administrative capital moved to Abuja. The city is characterized by perennial transportation problem, dominated by inefficient land transit resources. On the average the city daily witnesses broken down trucks, a major means of movement of goods and people. Though an oil producing economy, over 80% of refined petroleum are imported through its two main seaports and hauled by road through the city to other parts of the country. According to the project publication on the ill-fated transport system, the Lagos State Ministry of Public Transportation (LSMPT) Final Report (1981) Phase 1 on the failed Lagos Metroline project, the rapid growth in population of Lagos metropolitan area, then estimated at