

**PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

<Date>

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Operation Name	Nigeria Lagos Second State Development Policy Credit
Region	AFRICA
Country	Nigeria
Sector	Sub-national government administration (70%);General industry and trade sector (30%)
Operation ID	P123352
Lending Instrument	Development Policy Lending
Borrower(s)	FEDERAL MINISTRY OF FINANCE
Implementing Agency	
Date PID Prepared	January 9, 2014
Estimated Date of Appraisal	January 31, 2014
Estimated Date of Board Approval	March 19, 2014
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.
Other Decision	

I. Country and Sector Background

Lagos is a mega-city of an estimated 16-21 million inhabitants that has suffered for decades from large-scale poverty, rampant crime, environmental degradation, and insufficient public services. Over the last decade, however, Lagos State has achieved what many would not have believed possible, sustaining rapid growth, improving infrastructure and services, reducing crime significantly, and bringing millions out of poverty. The World Bank has supported Lagos State with a number of different instruments during this time. Since 2010, this cooperation has deepened to include budget support in the form of a programmatic series of three development policy operations, each for the sum of US\$ 200 million. This second operation supports the Lagos State Government in its quest to further increase value for money in budgetary spending, improve the business climate, maintain fiscal sustainability, and properly monitor and manage financial risks. The continued success of Lagos State in these and other endeavors has first order significance for inclusive growth and economic development in Nigeria and all of West Africa.

While the record of poverty reduction in Nigeria as a whole has been disappointing during the last decade, Lagos State has achieved major results in generating inclusive growth. Despite strong national GDP growth, the official poverty headcount in Nigeria declined only marginally between 2004 and 2010 from 48% to 46%. In Lagos, by contrast, the poverty rate declined from 57% to 23% during this period. Reforms that brought visible improvements to public services in Lagos helped foster greater trust of Government, which in turn facilitated increases in internally generated tax revenues to meet the growing challenges of urbanization. Lagos State has been an inspiration for public sector reforms in another Nigerian States. Lagos is a major urban growth

agglomeration in Nigeria that can potentially spread to other parts of the country, thereby catalyzing a takeoff into inclusive growth and poverty reduction for the country as a whole.

The Lagos State Government recognizes that sustaining the strong momentum in growth and poverty reduction will not be easy. Rapid economic and population growth have made Lagos increasingly congested, which can be associated with soaring rental rates, traffic jams, and growing demand for public services that has put particularly strain on water and power. Increases in tax rates and tax collection have boosted internally generated revenue (IGR), but they have also increased costs to entrepreneurs that face a still very challenging overall environment for doing business. The sharp increases in IGR achieved during the last decade exploited some lower hanging fruit of larger and more visible taxpayers, and sustaining this pace of growth has proved to be a challenge. While Lagos State still has a manageable debt position, it has been borrowing significant amounts to finance its infrastructure projects, and the medium-longer term sustainability of its debt position depends on continuing to achieve rapid economic growth. This Development Policy Operation is designed to assist Lagos State in its quest to continue its recent success and in the face of these challenges. The Lagos State Government is well aware that sustaining the strong positive momentum will entail further improvements in the effectiveness of public expenditures, the tax system, and the business climate.

II. Operation Objectives

As part of a programmatic series of three development policy operations, this Second Lagos State DPO supports the Lagos State Government in its quest to sustain the achieved positive momentum in growth and poverty reduction, and to implement reforms aimed at further improving governance, getting greater value for money in public expenditures, and making the State more conducive to business and entrepreneurship.

The expected results of the operation are

- Improved prospects for fiscal sustainability through better monitoring of financial risks for Lagos State and access to IDA financial support at lower than commercial rates.
- Improved quality of expenditures as measured in indicators for health, education, and other areas.
- Improved institutions for procurement and audit that will allow Lagos State to achieve better value for money in public expenditures.
- Greater transparency in public policy through improved accounting standards, progress in e-government, and more timely and comprehensive disclosure of public finance information.
- Substantially reduced costs for land registration and more objective assessments of market value for taxes and fees,
- Simplification of procedures to obtain development permits and certificates of occupancy through the introduction of electronic systems.
- A demonstration effect to other Nigerian States that the World Bank is poised to offer strong support and endorsement to State Governments with the determination to move ahead, and who can demonstrate results on the ground.

The proposed Development Policy Operation is in harmony with Lagos State's development objectives. The newly adopted Lagos State Development Plan highlights improving governance (including e-government) as a key overarching development objective. In this context, Lagos State prioritizes the key reforms in budgetary planning and execution emphasized in the DPO program. The Lagos State Development Strategy also prioritizes the business climate to improve incentives and opportunities for the private sector, including the areas of land registration and development permits supported by the DPO.

The programmatic DPO has four pillars: (a) fiscal sustainability, (b) budgetary planning, (c) budgetary execution, and (d) investment climate. The prior actions for DPO-2 in this programmatic engagement are:

- **For fiscal sustainability**, (a) the 2014 budget is consistent with a Medium Term Fiscal Strategy and long-term debt sustainability, including an assessment of key contingent liabilities, and (b) the Government submits a new draft law to the State Assembly to improve the functioning of the Lagos State Internal Revenue Service.
- **For budgetary planning**, medium term sector strategies are prepared for 25 MDAs, and that budgetary ceilings are communicated to the MDAs in a timely manner (before end-July 2013) for the preparation of the 2014 State budget.
- **For budgetary execution**, the prior actions are:
 - **Procurement**: The implementation of the new Procurement Law, including (a) publication of all contracts whose value lies above a threshold, (b) the mandated use of standard bidding documents by eight key (pilot) MDAs, (c) the inauguration of the Procurement Agency Board
 - **Audit**: The implementation of the new Audit Law, including (a) appointment of members of the Audit Service Commission and (b) audited accounts submitted to the State Assembly within three months after receipt from the State Treasury
 - **Oracle rollout**: The implementation of the “procure to pay module” of Oracle financials in at least five of eight key MDAs
- **For the investment climate**, the prior actions are:
 - **GIS system**: The accessibility of the Lagos State GIS system on line, the GIS database fully accessible to key identified MDAs, and a new draft Lagos State Strategy on how to move ahead with the rollout of the GIS in a manner that can bring the State more benefits from the system than it is currently experiencing.
 - **Land registration**: Piloting the electronic certificate of occupancy system and preparing the new methodology for objective land value assessments to support the 2014 land reform, which will reduce registration fees by more than 50% (Lagos-3 trigger).
 - **Development permits**: Include in planned 2014 Lagos State budget an explicit program and line item for piloting the automated Development Permit Approval Process in at least one local district office during 2014.

III. Rationale for Bank Involvement

Lagos State has established a strong track record in reform, achieving results on the ground, and implementing the programmatic DPO engagement. The preparation of Lagos-2 experienced a two-year delay owing to differing opinions in the Federal Government about state-level DPOs in Nigeria. Nevertheless, Lagos State continued with the implementation of most of the program even in the absence of finance, fulfilling a good share of the anticipated triggers for the second operation. That programmatic engagement has thus been a successful one, and has been maintained continuously. There is therefore a strong rationale to continue it.

Support for Lagos State is also quite consistent with the new emphasis in World Bank strategy toward the eradication of extreme poverty and the promotion of more inclusive growth. As noted above, the experience of Lagos has been virtually unique in Nigeria in generating inclusive growth that has brought millions out of poverty, including many migrants from other parts of Nigeria and West Africa. Going forward, Nigeria as a whole faces an enormous challenge in providing opportunities and jobs for a population with a median age of 14 and rate of population growth close to 3%. Increasing frustrations among Nigerian youth have already fed into greater instability in some parts of the country. For Nigeria to meet this challenge of job creation and poverty reduction, it will need additional urban growth agglomeration other than Lagos. In this process, the continued success and expansion of Lagos State is critical, both as a positive example for other States of what can be achieved in Nigeria, and as a point from which business and investment can physically expand out of an increasingly congested Lagos into other parts of the country. Nigerian States control over 50% of budgetary resources in the country under conditions of considerable autonomy, and the future development of the country therefore depends critically on state-level initiatives. Lagos State serves as an important example of success, and the DPO is a model for how the World Bank can support State-led development initiatives in Nigeria in a comprehensive manner. The World Bank now has a similar programmatic DPO engagement in Edo State, and strong results in both Lagos and Edo can give momentum for the expansion of the state-level DPO instrument elsewhere in Nigeria, including an envisioned multi-state DPO.

Given the current challenges facing Lagos State, including those on the revenue side, further reforms to get better value for money in public expenditures and induce higher private sector investment will be critical to sustaining the recent achievements in growth and poverty reduction. These are areas emphasized in the DPO program.

IV. Tentative financing

Source:	(\$m.)
BORROWER/RECIPIENT	0
International Development Association (IDA)	200
Borrower/Recipient	
IBRD	
Others (specify)	
	Total

V. Tranches

Single Tranche US\$ 200,000,000

VI. Institutional and Implementation Arrangements

The proposed Credit would be made to the Federal Republic of Nigeria, represented by the Federal Ministry of Finance. The credit proceeds would be transferred by the Federal Government to the Government of Lagos State under the same terms and conditions used for IDA investment loans on-lent by the Federal Government to a state government. The establishment of such an on-lending agreement shall constitute a condition of Credit effectiveness. A program agreement between IDA and the Government of Lagos State, outlining the commitments and obligations of the Government of Lagos State under the program, shall be negotiated and signed at the same time that the Financing Agreement for the Credit is negotiated and signed between IDA and the Federal Republic of Nigeria.

Progress according to the programmatic DPO will continue to be monitored closely according to results indicators specified in the Prior Action and Results Matrix in the Program Document. A careful assessment of the implementation of the DPO program will also be a central part of the preparation of Lagos DPO-3.

Lagos State already has a more advanced M&E system than do most States in Nigeria, which includes surveys of the population on the delivery of services and budgetary priorities. World Bank and DFID SPARC have been providing support for specific results indicators in health and education, some of which are being used for this operation.

VII. Risks and Risk Mitigation

There are four main risks potentially associated with the program as follows: (i) macroeconomic; ii) state risk; iii) country risk; and (iv) governance risk. Although mitigation measures are being undertaken for each area, not all risks can be fully addressed. The design of the operation as a single tranche operation embedded in a planned set of three operations will allow assessing the riskiness of the envisaged operations and the adequacy of the planned measures to address these risks.

- **Macroeconomic Risk:** Risks to the program could arise from a sharp fall in world oil prices or the inability of authorities to reverse the current decline in oil output. The Excess Crude Account (ECA) is currently covering the oil revenue shortfalls in the country. The balance of this fiscal reserve has fallen rapidly, however. There is a chance that it could become exhausted by the end of 2013. In case of zero balance in the ECA, Nigerian States would

begin to get lower transfers from the Federation Account, thereby tightening the revenue position. This could compel Lagos State to compress expenditures and reallocate efforts with an uncertain effect on the program. To mitigate this risk, the framework underlying the operation makes conservative assumptions on oil prices, non-oil growth and increases in non-oil revenue that are below the historical record. It is also the case that a tighter fiscal situation in Lagos would make many of the PFM reforms in the DPO program even more essential to maximize the impact of limited resources. The concessional finance provided by the DPO would become even more essential in this event.

- **State Risk:** The leadership of Governor Fashola since 2007 has been instrumental in fast-tracking Lagos' reform process. It is believed likely that the achievements of Lagos State in improving the quality of leadership and service delivery have become institutionalized to the degree that the post-Fashola Government that comes to power in 2015 will continue the positive momentum. There is nevertheless a risk that future leadership may slow this momentum. The presence of a programmatic DPO may help to keep new leaders focused on key reforms in such a case. There are negative scenarios for Lagos State in which the financial burden of sustaining the current levels of infrastructure and social spending could become unbearable. The concessional finance offered by this operation helps to mitigate that risk.
- **Country risk:** Lagos' reforms could also be affected by the instability that has emerged in Northern Nigeria or a general slowdown in reform or reversal at the level of the federal government. Factors that may mitigate this risk include the growing importance of an emerging middle class that has benefited from economic growth resulting from reforms; and the relatively good relationship and close policy dialogue established with the Bank.
- **Governance Risk:** Although significant improvements have been made in the public financial management system in Lagos, there are shortcomings affecting the transparency and accountability of resources. The state has demonstrated strong reform commitment through implementation of PFM reforms such as the operationalization of several components of the IFMIS. The DPO Program in the area of budget execution (procurement, audit, IFMIS) is directly concerned with further increasing the transparency and quality of governance in Lagos State. Capacity building is an integral part of the DPO Program, and extensive training has been carried out in the areas of procurement, audit, and the Oracle system. Much of this has been financed and managed by Lagos State itself, while DFID SPARC has also provided important support.

VIII. Poverty and Social Impacts and Environment Aspects

The proposed operation is not likely to have any significant direct impact on poor or vulnerable people in Lagos State, but is expected to have a strong positive indirect impact by improving state services, landholding rights, and contributing to the sustainability of growth in Lagos State, which has been strongly pro-poor. Lagos State has a solid track record in improving welfare through budgetary programs, and getting better value for money through budgetary reforms supported in the operation will further enhance this potential. Small entrepreneurs also stand to profit from the land reform, which should increase transparency and reduce land fees, as well as

the rollout of electronic systems of CofOs and development permit approvals, which will allow businesses to decrease the necessity of personal contacts with State officials.

While Lagos State reduced its poverty headcount to 23% by 2010, the lowest of any Nigerian State, this still implies that some 5 million Lagosians live below the poverty line. Thus, the numbers of the poor in Lagos State are still high, and new poor migrants continue to pour into the city. The recent success in achieving high growth, substantial job creation, and marked improvements in public services has brought millions out of poverty. The continuation of these trends will thus likely do the same. This DPO program directly concerns putting measures in place to sustain the “Lagos miracle” and deepen the success through PFM measures to ensure even greater value for money and improve conditions for entrepreneurs.

The widening of the tax net may impact some poorer Lagosians. The Lagos State Government has prioritized the development of a culture of tax compliance that includes bringing smaller tax payers into the tax net. While this policy represents a continuation of Lagos State’s program to solidify a culture of tax compliance on its territory, which has generally brought positive dividends to poorer Lagosians, there is a possibility of a one-off negative impact on some smaller tax payers who currently work entirely in the informal sector. Some of the activities under the World Bank and DFID project, Growth and Employment in States (GEMS), in Lagos have concentrated on strengthening entrepreneurs in light of the formalization of their activities.

The broader poverty impact of the proposed program will be assessed through future household Surveys. The next comprehensive household survey will be conducted in 2014-2015. Smaller surveys are now being conducted annually. This will allow the monitoring of specific changes in poverty and other welfare measures in Lagos State during the period of the DPO program.

The prior actions of this operation would not appear to have any environmental implications. The policies and measures supported by the budget support provided by the proposed operation could, however, potentially be associated with positive environmental effects. Environment and waste management are areas of high priority in the Lagos State Development Plan, and spending in these areas will likely receive augmentation from the DPO funding. Budgetary reforms supported by the DPO will also increase value for money in this spending. The government is planning to strengthen the enforcement of existing regulations over time in the context of ongoing capacity-building in the Ministry of Environment.

IX. Contact point

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