Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 18-Apr-2018 | Report No: PIDC154311

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BASIC INFORMATION

A. Basic Program Data

Country India	Project ID P166923	Parent Project ID (if any)	Program Name Uttarakhand Public Financial Management Strengthening Program
Region SOUTH ASIA	Estimated Appraisal Date 03-Oct-2018	Estimated Board Date 27-Nov-2018	Does this operation have an IPF component? No
Financing Instrument Program-for-Results Financing	Borrower(s) Republic of India - Department of Economic Affairs	Implementing Agency Finance Department Government of Uttarakhand	Practice Area (Lead) Governance

Proposed Program Development Objective(s)

The Program Development Objective (PDO) is "contribute to improve efficiency and accountability in the management of public finances and enhance the effectiveness of revenue administration in Uttarakhand".

COST & FINANCING

SUMMARY (USD Millions)

Government program Cost	26.50
Total Operation Cost	26.50
Total Program Cost	26.50
Total Financing	26.50
Financing Gap	0.00

FINANCING (USD Millions)

Total World Bank Group Financing	21.20
World Bank Lending	21.20
Total Government Contribution	5.30

B. Introduction and Context

1. India is among the world's fastest growing economies and has made remarkable progress in poverty reduction and human development. India experienced rapid and unprecedented growth between 2004 and 2008 with GDP growing at 8.8 percent and averaged annual 7.3 percent growth during 2007-2015. Growth helped India exceed the first Millennium Development Goal to halve poverty and India now expects to eliminate extreme poverty by the end of the next decade. Over the past thirty years, per capita incomes quadrupled, poverty retreated, illiteracy rates dropped and health-related statistics improved. India's economic momentum temporarily slowed down with a decline of real GDP growth to 7.1 percent in 2016-17 and to 5.7 percent in the first quarter of 2017-18 due to twin policy events, demonetization and the uncertainty surrounding Goods and Services Tax (GST). However, economic activity has stabilized during the latter part of 2017-18 and growth is expected to resume gradual acceleration to a rate of 7 to 7.5 percent.

2. While growth in India has been impressive, it has been unequally shared. India's size and its immense diversity are its biggest challenges. India is simultaneously home to the third largest number of billionaires and the highest number of poor people in the world. Income gaps between Indian States have been widening. Poverty rates in India's poorest states are three to four times higher than the more advanced states.

3. Uttarakhand was constituted as the 27th State of India in November 2000 when it was carved out of northern Uttar Pradesh. It is a relatively small state with a population of 10 million at the 2011 census, ranking 20th of 29 States. Uttarakhand has a hilly terrain, a supply of perennial rivers, and significant forest cover. 10 of the State's 13 districts are in the hilly regions. Uttarakhand faces specific development challenges arising from its high elevation, topography, resource dependence, and ecological vulnerability, as well as from a changing and more competitive external fiscal environment. Its proximity to international borders as well as the presence of geographically inaccessible terrains and sparse population in some areas, make development and service delivery to the last mile a challenge for the State government.

4. While Uttarakhand is one of India's fastest growing states and has seen rapid poverty reduction since 2005, inequality is increasing and the State performs poorly on employment creation and some key social indicators. Uttarakhand annual SGDP growth rate averaged nearly 12 percent from 2005 to 2012, the highest growth rate among Indian States. Growth has subsequently slowed to 6.8 percent in 2017. Per capita income is Rs. 1,77,356, nearly 40 percent higher than the national average. 11 percent of the population lived below the poverty line in 2012. Poverty rate declined from 33 percent in 2005 to 11 percent in 2012, again the strongest performance amongst Indian States. Poverty is concentrated in the central and southern districts and amongst Scheduled Castes, Scheduled Tribes and Other Backward Castes that constitute 41 percent of the population and have poverty rates around 40 percent. Growth and poverty reduction have been accompanied by a shift in employment away from farm to non-farm employment, with farm employment dropping from 75 percent of total employment in 1994 to 49 percent in 2012. However, the overall job growth in the state has been negative since 2005. Just 18 percent of workers are in salaried employment and women's participation in the labor has declined since 1994. Literacy rates are relatively low at 79 percent, 70 percent among women and there is a marked gender imbalance at birth (963/1000).

Sectoral (or multi-sectoral) and Institutional Context of the Program

5. **The PFM framework at Union and State emanates from the Indian Constitution and is guided by Central policies and processes**. India has a federal, three-tier structure of Government comprising: the Union level; State

level; and Local bodies. While State Governments have their own Finance Acts that regulate PFM practices, some areas of PFM at the state level are necessarily guided by initiatives taken at the Union level, notably with regard to the chart of accounts, which follows a uniform classification system across the Union and States, and accounting and financial reporting, since responsibility at the state level is vested in the Accountant General and the basis of accounting and financial reporting is guided by the Constitution and Comptroller and Auditor General and the Controller General of Accounts. The Fiscal Responsibility and Budget Management Acts (FRBM) at Union and State level provide a rules-based framework for fiscal consolidation and management. The objective of the FRBM is to ensure a sustainable fiscal policy, prudent debt management through limits on the Government borrowing, limits on debt and deficits, greater transparency in fiscal operation, and conduct fiscal policy in a medium-term framework. The General Financial Rules (GFR) guide the financial, internal control and procurement framework in GOI.

6. **Recent policy level changes at the Union level have significantly impacted Union-State fiscal relations and the PFM framework for the States**. The Planning Commission has been dismantled and its successor, the National Institution for Transforming India (NITI Aayog), has assumed the mantle of policy think tank and no longer plays a critical role in determination of plan size, its sectoral allocations and the appraisal of investment projects for both the Union and State Governments. The distinction between plan and non-plan expenditure, which added layers to planning and budgeting process, was scrapped in April 2014. Economic growth has swelled public budgets allowing more ambitious social and developmental programs. At the same time, spending responsibility has been devolved. The 14th Finance Commission met a long-standing demand of the States for greater devolution and greater flexibility in the use of funds. The States' share of the central divisible pool increased from 32 percent to 42 percent, leading to higher share of untied funds to the States. The Commission recommended a three-fold increase in the value grants to local bodies for improving basic services during the period 2015-20. The number of Centrally Sponsored Schemes (CSS) was reduced to 66 – with a further reduction in number to 20 proposed – and allocations to tied-grants cut. Since April 1, 2014 all funds for CSS are routed through the State treasuries instead of transferring the funds directly to the special purpose vehicles from the center. Today almost up to 80 percent of development spending at the union level is in the form of transfers to lower levels of government: most public spending in India occurs at sub-national levels. Introduction of the Goods and Services Tax in 2017 will result in further significant increases in the resources available to States for allocation to their development priorities. As a result of these reforms, States are both better resourced and empowered to allocate those resources in line with State priorities and local needs.

7. **Realizing the full potential of these reforms and achieving the states' own priorities will require competent and efficient PFM systems in the States, coupled with enhanced transparency and accountability**. Individual states will need to manage a complex set of three PFM objectives involving trade-off and sequencing. The first is to improve the quality and sustainability of fiscal deficits, contingent liabilities, and fiscal risks; the second is to increase public investment; and the third is to focus on the outcomes of government expenditure rather than on merely outlays. Consequently, these are expected to impose significant pressure on existing systems of planning, revenue administration, and management of expenditure and reporting on the use of public funds in the states.

8. **The Government of Uttarakhand (GOUK) faces fiscal challenges and has witnessed a substantial increase in expenditure and revenue deficits over the last few years**. GOUK managed to achieve targets set under its 2005 Uttarakhand Fiscal Responsibility and Budget Management Act (FRBM) through to FY2014, but the last three years – FY2015, FY2016, FY2017 – have seen revenue deficits and overall fiscal deficits in two of the last three years – FY2015 and FY2016. The deteriorating fiscal situation is largely due to stagnant non-tax revenues, increases in salary, pension, interest payments and – since FY2015 – increases in capital expenditure.

9. **GOUK has worked over the last decade to strengthen the PFM systems inherited from Uttar Pradesh.** The Uttarakhand Economic Assessment Report 2012 carried out by the GOUK in coordination with the Bank, outlines the PFM systems, key challenges and proposes the way forward for PFM reform. Some progress has been made in implementing reforms in Treasury computerization, payroll automation, e-procurement and procurement rules, integration with e-Kuber for electronic payments, revision of budget manual, strengthening internal/local fund audit and moving towards outcome budgeting. These State-level initiatives would benefit by anchoring them in a strategic PFM reform action plan.

10. **GOUK has embarked on further reforms to strengthen PFM with a focus on the development of a next generation Integrated Financial Management Information System (IFMIS**). The IFMIS will support a range of systems and process improvements that includes implementing human resource management system, enhancing bill processing through online approvals, discontinuing physical bill submission, transitioning works accounting to treasury mode, and full electronic submission of state accounts to the Accountant General. These reforms are expected to bring in efficiencies in public spending and improve the credibility and predictability in budget execution to overcome the presently low budget outturns.

11. **GOUK has identified a number of additional reform priorities.** These include: measures to enhance urban revenue generation and to improve PFM in urban and rural local bodies; improvements in planning and budgeting systems to support results oriented public resource allocation and moving towards a medium-term outlook; strengthening cash and debt management; modernizing the key PFM documents containing the rules and procedures of the PFM architecture in the state; strengthening efficiency in the revenue administration systems to enhance the state's own source revenue; improving non tax revenue through policy and implementation interventions; and better management of fiscal risks of parastatals.

12. **GOUK's request for World Bank support for its PFM reform agenda arises from its experience working on PFM issues across the Bank portfolio in Uttarakhand, its interest in accessing the Bank's experience on PFM issues across Indian States and its international experience, particularly in the management of complex information technology solutions**. GOUK acknowledges that it needs to adjust its on-going PFM efforts to accelerate reforms and focus more on core challenges for managing public resources. Both DEA and GOUK identify the Bank as the appropriate partner to help the State in this shift direction through rigorous program preparation, supervision and technical assistance. GOUK has indicated that the project may have a positive impact on the broader Bank engagement by building capacity to review and support all Externally Aided Projects and focus on the reduction of implementation bottlenecks in the PFM system.

Relationship to CPF

13. **The proposed operation is consistent with the World Bank's Performance and Learning Report (Report No. 99283-IN), discussed by the Executive Directors on October 20, 2015**. The operation is also aligned with findings of the Systematic Country Diagnostic (under preparation) regarding the importance of improvement in public sector effectiveness as one of the three biggest challenges the country faces to sustain its growth and join the ranks of the global middle class. The key elements identified in the SCD as vital for transforming the public sector include improving accountability, efficiency, and effectiveness to reduce waste and boost the returns on public spending by tightening the chain from inputs to outputs. Because most services are delivered by lower-tier governments, the compact between the layers of government will influence what services are delivered to citizens and how front-line service delivery agencies perform. The SCD recognizes that recent policy level changes at the Union level resulting in increase of untied transfers to States and increased devolution of funds to the local bodies, will need to be accompanied with strengthening of public financial management systems of the State and the lower tiers of the Government. This entails strengthening public financial management and public

procurement, upgrading of IT systems, greater transparency, and improvements in revenue administration and M&E functions. This PFM project is fully aligned with the SCD.

Rationale for Bank Engagement and Choice of Financing Instrument

14. **The Bank has a strong and ongoing PFM engagement with Union and State governments that has been nurtured over the last decade**. GGP's engagement with the Union and State Governments span reforms in various elements of PFM, such as budget, information systems, cash management, audit and financial reporting. This has been built on the foundation of: strong operational knowledge of PFM systems and their links to service delivery gained from experience in Bank-financed projects; diagnostics including PEFA assessments at the union level and states and State Financial Accountability Assessments; and studies of PFM in centrally sponsored schemes, power sector and local governments. Both Union and State Governments see the World Bank as a strategic partner supporting PFM reforms, contributing knowledge on globally-accepted good practices and experience in the implementation of complex institutional reforms. The Bank's has extensive experience in supporting implementation of public financial management and revenue administration reforms involving information technology. The Bank's support brings an independent perspective on project design and implementation and helps mitigate the risks of PFM reform.

15. **The proposed operation will be developed as a Program for Results.** This instrument would allow the Bank and client to design a comprehensive reform action plan which can serve as the basis for the Bank-financed program. The PforR offers a number of advantages: both the DEA and GOUK are interested in focusing on results; the use of country systems is consistent with the thematic focus on PFM reform and will ensure greater ownership and sustainability of the improvements to be made over the medium term; the P4R reduces transaction cost and administrative over-load for the client during preparation and implementation, allowing the authorities to focus on the reform agenda. Support for the implementation of reforms can be complemented by a technical assistance component to support capacity building and advisory services.

C. Program Development Objective(s) (PDO) and PDO Level Results Indicators

Program Development Objective(s)

16. **The Program Development Objective (PDO) is "contribute to improve efficiency and accountability in the management of public finances and enhance the effectiveness of revenue administration in Uttarakhand".**

PDO Level Results Indicators

17. **An indicative list of PDO results indicators is presented based on the GOUK program proposal.** Further work is needed to refine and streamline indicators.

- Improved budget credibility measured by reduced expenditure variance
- Improved transparency through enhanced public disclosure of key budget/fiscal information
- Enhanced accountability through improved audit effectiveness
- Improved effectiveness in performance of the tax administration system
- Improved PFM in urban local bodies through strengthened accounting and auditing systems, and enhancing public disclosure of fiscal information
- Increased alignment of annual budget with medium-term projections or policy priorities

D. Program Description

PforR Program Boundary

18. **The PforR will support the GOUK's program for strengthening PFM to enhance efficiency, effectiveness and accountability in public expenditure and enhance the effectiveness of revenue administration**. During preparation, the Government's ongoing reforms and future plans will be structured into a coherent PFM action plan which will be adopted by GOUK by issuance of a Government Order (GO). The reform strategy and operation will continue to support activities that have already been taken up by GOUK and address gaps and challenges in the systems and processes that are essential to further strengthen PFM in the state.

19. **The Bank proposes to define the Bank's Program of financial support under the PforR in line with the Government's PFM reform program encompassing operations of the Departments of Finance and Planning, Department of Revenue and Department of Urban**. A preliminary estimate of the Program is USD 26.5 million of which USD 21.2 million would be financed by the Bank. The overall impact of reforms is significantly broader: improvements in PFM systems will influence spending of the entire State budget, amounting to USD 6,900 million. The structure and scope of the program is still tentative based on the preliminary discussions with GOUK. The team is currently exploring the feasibility of extending the scope of the program by addressing PFM issues downstream closer to service delivery point working with social sectors. At the same time, the team will work with the GOUK to refine the scope of the PFM reform program to ensure that it is adequately sequenced and aligned with capacity to implement.

20. **The three-key results area envisaged under the program are outlined below**:

PDO: Contribute to improve efficiency and accountability in the management of public finances and enhance the effectiveness of revenue administration in Uttarakhand		
RESULTS AREA 1: STRENGTHENING THE PUBLIC FINANCE FUNCTION.	**RESULTS AREA 2: STRENGTHENING REVENUE MANAGEMENT.**	**RESULTS AREA 3: IMPROVING PFM IN PARASTATALS AND LOCAL GOVERNMENT.**
• Strengthening Financial Management Information Systems. • Improving Planning and Budgeting Process. • Strengthening Planning and Implementation of Capital Expenditure • Strengthening Cash and Debt Management Framework • Strengthening Finance Department, PFM training and Capacity Building • Strengthening Internal Audit • Strengthening Procurement Framework • Modernizing PFM Rules and Codes	• Strengthening efficiency in Commercial Tax Department • Strengthening Excise Department • Improving non-tax revenue	• Improving PFM in Urban Local Bodies. • Strengthening accounting and corporate governance framework in SOEs. • Strengthening accounting in Gram Panchayats.

21. **The PforR will be disbursed against five to six DLIs aligned with the three results areas.** DLIs will include process, output, and outcome indicators that reflect different phases of Program implementation enabling a smooth profile of disbursements throughout the life of the PforR. The DLIs will be developed and refined during pre-

appraisal based subsequent discussions with the GOUK and ongoing assessments and verification protocol will be developed.

E. Initial Environmental and Social Screening

22. **The draft result areas are all overall beneficial and have no negative environmental externalities.** With respect to program expenditures: (a) related to IT equipment will necessitate preparation of a plan to manage and finally dispose the electronic wastes as per the national regulation on electronic wastes; such a plan will be prepared as part of the project, even if the hardware and other IT equipment experience obsolescence after the project duration; (b) civil works for the buildings, located in an urban area, and where the proposed plot is surrounded by other buildings will not have any noticeable environmental impact, provided that the civil works is designed and implemented as per the national building code as has been proposed. Overall, the environmental risk is, therefore, low.

23. **The primary focus of the proposed PFM reform program will be to support GOUK public financial management and revenue management systems and practices and no adverse social impacts are anticipated.** Within this ambit of proposed activities, efforts shall be made to ensure that project interventions do result in sustainable social benefits.

24. **State undertakes gender budgeting and has budgetary provisions for Minorities, Scheduled Tribes, Scheduled Castes and Women**. Hence, the proposed assessment will include assessment of relevant provisions and implementing departments to identify areas for enhancing the existing systems in respect of the processes of planning, budgeting, audit and capacity building, and focus on citizen engagement and transparency within these processes.

25. **There is a proposal to construct a new building for some of the key state level finance directorates on existing government land**. The site, measuring 2068 square meters in size is located inside State Infrastructure and Industrial Development Corporation of Uttarakhand Limited (SIDCUL) complex and is surrounded by other under construction buildings such as Shopping malls, HUDCO Bhawan, Luxury hotels. At present the site only has a few shrubs and no trees and is free from have any encroachment or squatters and hence is free from encumbrances.

26. **As a part of the preparation PforR lending instrument warrants a comprehensive assessment of environmental and social systems, to gauge the adequacy of environmental and social systems within the state at all levels**. ESSA will assess the extent to which the program systems promote environmental and social sustainability; manage land related issues; provisions related to indigenous peoples and vulnerable groups; and, avoid social conflict. The ESSA will identify required actions, if any to enhance program systems both to mitigate environmental and social risks as well to enhance social benefits. These identified actions along with ESSA will be discussed with the borrower, agreed upon and disclosed prior to appraisal.

CONTACT POINT

World Bank

Name :	Krishnamurthy Sankaranarayanan		
Designation :	Sr Financial Management Specialist	Role :	Team Leader(ADM Responsible)
Telephone No :	5785+79137	Email :	skrishnamurthy@worldbank.org

Name :	Puneet Kapoor		
Designation :	Sr Financial Management Specialist	Role :	Team Leader
Telephone No :	5785+79233	Email :	pkapoor@worldbank.org

Borrower/Client/Recipient

Borrower :	Republic of India - Department of Economic Affairs		
Contact :	Bandana Preyashi	Title :	Director MI
Telephone No :	1123092345	Email :	bandana.preyashi@gov.in

Implementing Agencies

Implementing Agency :	Finance Department Government of Uttarakhand		
Contact :	Amit Negi	Title :	Secretary Finance
Telephone No :	911352711439	Email :	amitnegi.gov@gmail.com

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects