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Report No: 34014-IN

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 82.2 MILLION
(US$120 MILLION EQUIVALENT)

TO THE

REPUBLIC OF INDIA

FOR THE

KARNATAKA PANCHAYATS STRENGTHENING PROJECT

May 30, 2006

Agriculture and Rural Development Sector Unit
South Asia Regional Office

CURRENCY EQUIVALENTS
(Exchange Rate Effective October 25, 2005)

Currency Unit = Indian Rupees
Rs. = US$0.022
US$ = SDR 0.69

FISCAL YEAR
April 1 – Mar ch31

ABBREVIATIONS AND ACRONYMS

AFS	Annual Financial Statement	M&E	Monitoring and evaluation
ANSSIRD	Abdul Nazir Sab State Institute of Rural Development	M&L	Monitoring and learning
		MDGs	Millennium Development Goals
ARCS	Audit Report Compliance System	MIS	Management information system
BG	Block Grant	MOU	Memorandum of Understanding
BPL	Below poverty line	MLA	Member of Legislative Assembly
CAS	Country Assistance Strategy	NCB	National Competitive Bidding
CBO	Community based organization	NGO	Non Governmental Organization
CC	Community Coordinator	O&M	Operation and maintenance
CEO	Chief Executive Officer	OP	Operational procedures
CIG	Common Interest Group	PFMS	Project financial management system
CM	Chief Minister	PFT	Project facilitation team
DA	Development Audit	PIA	Project implementation agency
DAC	Decentralization Analysis Cell	PMR	Project management report
DCBO	District Capacity Building Organization	PMU	Project Management Unit
DCC	District Community Coordinator	PRI	*Panchayat Raj* Institution
DPIP	District Poverty Initiatives project	RDPR	Rural Development and *Panchayat Raj*
DPU	District Project Unit	SA	Social assessment
DRDA	District Rural Development Agency	SC	Scheduled Castes
EAR	Environmental Assessment Report	SFC	State Finance Commissions
EMF	Environmental Management Framework	SGSY	*Swarnjayanti Gram Swarozgar Yojana*
FMS	Financial Management System	SHG	Self Help Group
GO	Government official	SP	Special Account
GOI	Government of India	SPU	State Project unit
GOK	Government of Karnataka	ST	Scheduled Tribes
GP	*Gram panchayat*	SSC	State Steering Committee
GS	*Gram sabha*	TDP	Tribal development plan
HRD	Human Resource Development	TOR	Terms of Reference
ICB	International Competitive Bidding	TP	*Taluka* Panchayats
IP	Indigenous People	TRC	*Taluka* Resource Center
JRY	*Jawahar Rozgar Yojana*	VDC	Village Development Committee
JGSY	*Jawahar Gram Samridhi lojana*	VTDA	Village Tribal Development Agency
KSAD	Karnataka State Audit Department	ZP	*Zilla Parishad*

Vice President:	Praful C. Patel
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SOUTH ASIA

AGRICULTURE AND RURAL DEVELOPMENT SECTOR UNIT

Date: May 30, 2006	Team Leader: Geeta Sethi
Country Director: Michael F. Carter	Sectors: Sub-national government administration (80%);Other social services (20%)
Sector Manager/Director: Constance A. Bernard	Themes: Rural policies and institutions (P);Rural services and infrastructure (P);Environmental policies and institutions (S)
Project ID: P078832	Environmental screening category: Partial Assessment
Lending Instrument: Specific Investment Loan	Safeguard screening category: Limited impact

Project Financing Data

[ ] Loan [X] Credit [ ] Grant [ ] Guarantee [ ] Other:

For Loans/Credits/Others:
Total Bank financing (US$m.): 120
Proposed terms: Standard IDA Terms

Financing Plan (US$m)

Source	Local	Foreign	Total
BORROWER/RECIPIENT	13.33	0.00	13.33
INTERNATIONAL DEVELOPMENT ASSOCIATION	119.97	0.03	120.00
LOCAL COMMUNITIES	0.00	0.00	0.00
Total:	133.30	0.03	133.33

Borrower:
Government of India
Responsible Agency:
State of Karnataka

Estimated disbursements (Bank FY/US$m)

FY	6	7	8	9	10
Annual	2.40	6.00	24.00	48.00	39.6.00
Cumulative	2.40	8..40	32.40	80.40	120.00

Does the project depart from the CAS in content or other significant respects? ***Ref. PAD A.3***	[ ]Yes [X] No
Does the project require any exceptions from Bank policies? ***Ref. PAD D.7*** Have these been approved by Bank management? Is approval for any policy exception sought from the Board?	 [ ]Yes [X] No [ ]Yes [ ] No [ ]Yes [X] No
Does the project include any critical risks rated "substantial" or "high"? ***Ref. PAD C.5***	[X]Yes [ ] No
Does the project meet the Regional criteria for readiness for implementation? ***Ref. PAD D.7***	[X]Yes [ ] No

Project development objective ***Ref. PAD B.2, Technical Annex 3***
The development objective of the project is to improve the effectiveness of service delivery by Karnataka *Gram panchayats* (village governments) particularly with respect to the management of public resources and the delivery of relevant services that the rural people prioritize.

Project description *[one-sentence summary of each component]* ***Ref. PAD B.3.a, Technical Annex 4***
Component A) Block grants to *Gram panchayats*. The project would finance block grants to *Gram panchayats*. The block grants would finance services listed in *Panchayat* participatory plans and budgets.
Component (B) Information Systems for Constituents. This component would increase the ability of rural people to voice their demands on local governments and elicit responses from them, in particular for the poorest and excluded people such as women, scheduled castes and scheduled tribes.
Component (C) Building the capacity of *Panchayats*. This component would increase the capacity of all three levels of *Panchayats* in managing resources, collecting revenues and delivering services.
Component (D) Building the capacity of the state. This activity would put in place systems at the state level to enable it to oversee, facilitate and manage the *Panchayat* system.

Which safeguard policies are triggered, if any? ***Ref. PAD D.6, Technical Annex 10***
Environmental Assessment, Indigenous Peoples

Significant, non-standard conditions, **if any**, for:

Board presentation: None

Loan/credit effectiveness: None

Covenants applicable to project implementation:
(i) Gram Panchayats (GPs) are following planning guidelines; (ii) GPs have put in place the new financial management framework; (iii) GPs hold periodic *Gram* and Ward *Sabhas* as per state stipulations; and (iv) GPs receive block grants in timely fashion as per state budgets.

A. STRATEGIC CONTEXT AND RATIONALE

1. Country and sector issues

Most of India's poor live in rural areas. Of India's 1.05 billion people, 756 million are rural and of these 30 percent are below the poverty line. Compared with other countries India spends a larger proportion of GDP on rural development, about US$7 billion by some accounts, but despite some progress, results are not commensurate with the magnitude of the expenditures. Rural areas continue to lag in poverty and social and economic indicators, and regional disparities are increasing both between and within states. Traditional delivery mechanisms (state line agencies) are unable to cope with the magnitude of the challenge of providing services to more than 700 million rural people often in locations of limited accessibility. Central and State funding is fragmented into a large number of schemes (budget items) with large administrative costs. Schemes are tied into administrative procedures and narrow objectives that are not adaptable to the diversity and heterogeneity of the Indian countryside. A large proportion of central funds remain undisbursed.

India opted for decentralization to increase the accountability of government, improve services and expenditures, and reach out to rural people. In 1993 a revision to the Constitution (73d and 74th Constitutional Amendments) created once and for all rural governments at the district, block and village levels[1] and urban governments at the city and township levels, mandated states to hold periodic elections for these bodies and devolve functions and funds to them. Decentralization to rural governments thus became a state subject. States proceeded at different speeds. Progress has not always been easy in part due to vested interests often opposing the process. The current administration at the Center sees rural governments as the key mechanism for delivering key services to rural people and one of its priorities is to make this approach work in some states to serve as an example and a model for the rest of the country.

Karnataka is often considered one of the fastest developing states in India. It is mostly known for its booming IT sector and ability to attract private investment. However this performance benefits primarily the urban sector and hides increasing disparities between urban and rural areas and between different regions of the state. With 53 million people Karnataka ranks seventh among 28 states in absolute number of poor people, and eighth in absolute number of rural poor, more than any other southern state. In terms of percentage of poor people Karnataka ranks seventh in India, close to Maharashtra, Uttar Pradesh and West Bengal. It ranks poorly also in children malnutrition and road access. A state High Powered Committee (2002) reviewed the status of regional disparities according to several indicators and identified 39 rural blocks concentrated primarily in Northern Karnataka as the most backward with another 75 considered to be lagging in development indicators (out of 176). These blocks also show the highest concentration of scheduled caste, *dalit,* and tribal people.

Karnataka is the ideal candidate for a model of decentralized service delivery to set an example for the rest of India. The poorest parts of Karnataka have many features typical of more northern states, with high incidence of poverty, difficult access and severe resource constraints. But Karnataka also has a long history of rural local governments, more than any other state in India. For many years it was a pioneer in sub-state devolution. Its 1983 reforms served as the basis for the Constitutional Amendments. It is now regaining leadership in this agenda through some bold steps.

[1] Rural local government in India is a three tiered—Zilla *Panchayat* at the district level (average population of two million), *Taluk panchayat* at the block level (average population of two hundred and fifty thousand), and Gram *Panchayat* at the village level (average population of 5000).

Karnataka's recent policy reforms on decentralization are path breaking in India. GoK recently completed a Report on Rural Decentralization that outlines the strategy to improve rural governance and empower local governments. As a result of this strategy the state undertook a series of policy initiatives towards devolution (see Box 1 in Annex 1). Key among these are the Amendments to the state *Panchayat* Act, devolution of 29 subjects and 28% of public expenditures to district, block and village governments, clearer expenditure assignments, block grants in the transfer system, improved financial management, improved planning guidelines. A Government Order dated October 16th, 2004 mandated line agencies to transfer to *Panchayats* activities that had been devolved to them and required international organizations, including the Bank, to implement its projects through the *Panchayat* system.

Notwithstanding these bold steps, the reform agenda is incomplete and service delivery at the village level is weak and ineffective. This results in high informal and formal transaction costs for local residents in need of alternative services. The majority of the rural poor can be targeted and reached only by the lowest level of village government, the *Gram panchayat*, and this level is also the one with the best information on local needs and demands. But the current system for resource transfers from central to state to local levels is ineffective and inefficient resulting in large disparities in service delivery, considerable delay and associated opportunity cost, and failure to take local preferences into account for service delivery options. **First,** and despite some consolidation, the transfer system is still mostly based on tied schemes that limit the ability of local governments to adjust resource allocation to local preferences. The block grants are small and unpredictable. Moreover these grants are the same for every *Gram panchayat* independent of population, poverty or need. The system needs to move to one that is equalizing, allows for autonomy, creates incentives for service delivery, and increases the funds available to the poorest *Panchayats* to enable them to catch up. **Second,** fiscal stress at the state level makes it difficult to finance the huge needs of rural governments, particularly in the most disadvantaged areas. Some estimates have estimated these needs to be over one billion US dollars. To finance this gap *Panchayats* must be called upon to contribute their own share through increased revenues. On capacity building alone the challenge is daunting, requiring a continuing process for over 5,000 local bodies and 100,000 local elected representatives and the ability at the state level to oversee and manage the process. **Finally,** devolution threatens the existing power structure and this could still reverse some of the reforms or slow down the process. State line agencies still need to undergo institutional reforms to bring them in line with the *Panchayat* system.

2. Rationale for Bank involvement

There are strong reasons for supporting the decentralization process in Karnataka. Firstly, the Bank is actively involved in Karnataka. Several of the sectoral projects (e.g. health, education, watersheds, tanks, rural water) need to rely on local bodies for implementation, but the *Panchayat* system is still weak and the policy framework is incomplete. Because the issues spread across sectors, this calls for a non-sectoral operation that strengthens the environment and creates the capacity of local bodies to deliver across a range of services. Without such an operation, the combination of state schemes and Bank supported sectoral projects would create the risk of *Panchayats* being transformed into service agents for higher levels government only, rather than into true local governments with autonomy and discretion as the Constitution of India and the State *Panchayat* Act demand. Secondly, rural local governments in Karnataka have been given responsibility over sectors directly related to the Millennium Development Goals (MDGs), such as some areas of primary health, primary education, drinking water and sanitation, and local economic development. Increasing their capacity to deliver will make it more likely that MDGs will be achieved. Thirdly, since 1999 the Bank has been involved in a dialogue with GoK on matters related to decentralization and has accumulated considerable experience and knowledge on the subject.

The proposed operation would help implement many of the recommendations emanating from Bank's ESW (Fiscal Decentralization to Rural Governments, 2003; Overview of Rural Decentralization in India, 2000, *Panchayats* and Resource Allocation in South India, 2004, and Local Organizations for Decentralized Development in India, 2004) as well as from several workshops on the subject. Fourthly, together with the economic restructuring program and a proposed urban development operation, the proposed operation would offer an opportunity to tackle systemic issues at both state, urban and rural governments, ensuring coordination and consistency across the various tiers. And finally support to rural decentralization is a key area in the current Country Assistance Strategy. Finally, The Country Assistance Strategy (CAS) highlights a specific need of improving government's effectiveness through decentralization and accelerating pro-poor rural development through more effective delivery mechanisms, and by strengthening the rural safety net and beneficiary participation. The proposed project would support these objectives.

3. Higher level objectives to which the project contributes

At the national level the project would have a demonstration effect. It would create a model of service delivery through rural governments in one state that could then be replicated across other states in India. At the state level the project would contribute to improve public services and investment under the responsibility of *Panchayats* in the poorest ones, contributing to improving the MDGs and fostering local economic growth in disadvantaged areas. It would also help sustain the decentralization reform process, by consolidating reforms already undertaken, leveraging further reforms through a demonstration effect, and financing some of the implementation costs of the reform during a period in which the state is fiscally stressed.

B. PROJECT DESCRIPTION

1. Lending instrument

The proposed instrument is a programmatic loan in the form of a Sector Investment Credit through which IDA would provide additional funds to the poorest *Gram panchayats*. IDA would rely on GoK's own rules and procedures to implement the program including for financial management, reporting and auditing. Special provisions on environmental safeguards would be introduced until an Environmental Framework for *Panchayats* is put in place as one of the outputs of the proposed operation.

2. Project development objective and key indicators

The development objective of the project is to improve the effectiveness of service delivery by Karnataka's *Gram panchayats* (village governments) particularly with respect to the management of public resources and the delivery of relevant services that the rural people prioritize.

The project would be considered satisfactory if the following outcomes are achieved:

- Rising number of Gram or Ward *Sabhas*[2] with high and representative participation and relevant participatory plans reflecting community preferences of local population;
- Rising satisfaction of village residents with service delivery by *Gram panchayats*;
- Gradual increase in own-source revenue and stronger financial health of GPs.

[2] Gram *Sabhas* and Ward *sabhas* is a village meeting of all voting adults in that particular village or wards. The *PanchayatsGram panchayats* are expected to implement the decisions of the Gram *Sabhas*.

3. Project components

The strategy to achieve this development objective is to improve and augment the flow of funds to *Gram panchayats*, develop the capacity of all three tiers of district, block and village *Panchayats*, as well as of some state agencies, and improve the information flow to enhance transparency and accountability of local governments to their constituents. Specifically it would support the following components and activities:

(a) **Block grants to *Gram panchayats***. The project would finance block grants to *Gram panchayats*. The block grants would finance services listed in *Panchayat* participatory plans and budgets. To be eligible for the grants, GPs would have to put in place the new Financial Management and Accounting System prepared by the state of GoK acceptable to IDA. In addition to the above, GPs that are eligible would also need to implement the new planning guidelines, and hold regular *Gram sabha* meetings with open participation and publicly display FM and procurement information. Block grants will be initiated in the 1,343 *Gram panchayats* in the poorest 39 *Taluks*. In the first year, the 1,343 GPs block grants would be transferred based on a formula that will give weight to poverty (population of schedule caste and tribe), area (a proxy for costs of service provision), and illiteracy (proxy for service deficit)[3]. From the second year onwards provided that the GPs remain eligible, money will be transferred based on revised formula which will also incorporate some performance indicators.

(b). **Information Systems for Constituents.** This component would increase the ability of rural people to voice their demands to local governments and elicit responses from them, in particular for the poorest and excluded people such as women, scheduled castes and scheduled tribes. Karnataka has a large number of community organizations such as women self help groups (SHGs), watershed associations, drinking water committees, and others. The component would build on this strength by providing further support to such groups or by assisting new groups to be formed. Specifically it would include:

- Information to constituents on roles and responsibilities of GPs and on service delivery performance at the village level; and
- Capacity building of organizations of the poor (SHGs, community based organizations [CBOs], non governmental organizations [NGOs]) to enable them to participate in the new *Panchayat* planning process, voice their demands from government, and access services and programs, including GoI anti-poverty programs.

(c) **Building the capacity of *Panchayats***. This component would increase the capacity of all three levels of *Panchayats* in managing resources, collecting revenues and delivering services. In total about 5,500 local governments and 100,000 elected representatives would benefit. Specifically it would include:

- *Creation of GP resource cells at the Taluk level.* The resource cells would be supported by experts in the following areas: financial management/accountant, social mobilization, and computers. Where not yet in place, these would be recruited from government or outsourced. Their role would be to assist GPs on participatory planning and budgeting as per new state guidelines, financial management, and providing technical oversight on infrastructure projects. These cells would also assist GPs in implementing GoI centrally sponsored anti-poverty schemes, state anti-poverty and vulnerable group schemes, and with the management

[3] More details are provided in the Operational Manual for this project.

of the environmental framework for GPs. These cells will also play an important monitoring function.

- *Service delivery monitoring system.* This activity would support the Planning Unit of District *Panchayats* in administering an annual survey of service delivery standards at the GP level. The survey would be done by the GP under guidance and supervision from the District and would monitor service delivery issues and outcomes including health profile of the population, HIV incidence, student and teacher attendance, drinking water and sanitation coverage, and others. This survey would also be the instrument to collect baseline data and information for the final impact evaluation. It would include questions intended to measure the level of satisfaction of rural constituents with service delivery by *Panchayats*.
- *Training programs for Panchayats through the State Institute of Rural Development.* These activities would consist of distance and face-to-face learning for *Panchayat* members and staff, and line agency functionaries at the *Panchayat* level. Topics to be covered would include duties and responsibilities of *Panchayats*, legal matters, financial management, planning, consultative decision-making, education, health, HIV, environment, watershed management, water and sanitation, and others.
- *Computerized financial management system for GPs.* These activities would help implement many of the recommendations of the State Public Financial Accountability Assessment (SFAA), namely by putting in place a new financial management system (accounting, reporting, auditing) for GPs; this would also include computerization of all GPs and development of relevant software, and IT training.
- *Environmental Guidelines for Panchayats.* This activity will consist of the design, implementation and operation of environmental guidelines that include a negative list, screening mechanism, assessment tools, monitoring & evaluation, training & capacity-building plans and selected analytical studies. In addition, this activity would consist of the design and implementation of an environmental framework for the three tiers of rural local governments, environmental audits, and district environment profiles to support district planning.

(d) **Building the capacity of the state.** This activity would put in place systems at the state level to enable it to oversee, facilitate and manage the *Panchayat* system in general and this project in particular. Specifically it would include:

- *Decentralization Analysis Cell (DAC).* A cell accountable to both the Finance Department and *Panchayat* Department. The cell will be responsible for analysis, evaluation, monitoring of fiscal flows to *panchayats*, own revenues and service delivery and provide inputs for the development of the intergovernmental fiscal system by carrying out policy analysis including design of formulas for transfers, advise the state on fiscal matters pertaining to *Panchayats* and support State Finance Commissions (SFC) when these are operating. The Cell director would be in charge of this cell.
- *Panchayat monitoring system at state level.* This activity would put in place a comprehensive system for collecting and compiling *Panchayat* fiscal and service delivery data.
- *Policy support.* This includes special studies and technical assistance on matters such as own revenues, expenditure assignments, service delivery, etc.
- *Strengthening of the State Institute for Rural Development.* This activity will finance equipment for the ANSSIRD campus in Mysore and the creation of ANSSIRD training centers at the *taluk* level equipped with audio-visuals;
- *Restructuring of line agencies.* This component will provide technical assistance to state line agencies for the design of their institutional restructuring towards new roles in a decentralized service delivery framework.

4. Lessons learned and reflected in the project design

The project builds on lessons from Bank supported ESW as well as a number of rural poverty and local governance projects. The Bank has conducted four studies on local governments in Karnataka and other Indian states: "Overview of Rural Decentralization in India", "Fiscal Decentralization to Rural Governments", "*Panchayats* and Resource Allocation in South India", and "Local Organizations for Decentralized Development in India". Some of the key conclusions of these studies were:

- *Panchayats* are unable to perform the functions assigned to them due to lagging fiscal and administrative decentralization. In Karnataka twenty-eight percent of state expenditures are channeled through *Panchayats*, but only 14% of these flow to the lowest level, the *Gram panchayats*, which have a very limited role. The state government has since increased funds to *Panchayats*.
- Unclear expenditure assignments between state government and *Panchayats* and between the three tiers of *Panchayats* create overlaps, confuse authority, and undermine accountability; the state government has since taken steps to address this problem.
- Limited expenditure discretion of local governments that limit their ability to meet local needs and preferences; the state government has since increased the proportion of block grants.
- Weak revenue effort and collection; the state government has since taken actions that doubled demand.
- Complicated, non-transparent and non-equalizing transfer system; for example *Panchayat* entitlements are about US$5,000 per *Panchayat* independent of need or fiscal capacity. The proposed project would contribute to addressing this issue.
- Unpredictable transfers that make it impossible for *Panchayats* to carry out meaningful planning. The proposed project would help address this issue.
- Widening horizontal disparities, with higher expenditure by more affluent *Gram panchayats*. The proposed project would help address this issue.
- Outdated local government accounting systems, with no linkages between planning, budgeting, spending and monitoring. A new system has been designed. The proposed project would assist with implementation.
- No adequate information on *Panchayat* finances which reduces accountability. The proposed project would address this issue.
- Reserved seats for women and scheduled castes and tribes improve resource allocation towards these groups. The proposed project would develop the capacity of these people.
- Experience is one of the main determinants of the quality of local governance. The proposed project would address this issue through training.
- *Gram sabhas* (village assemblies) improve resource allocation at the local level. The proposed project includes incentives for regular and high quality *Gram sabhas*.

There is also considerable experience with the community driven rural poverty projects. Some of the relevant lessons are:

- Presence of organized groups of poor people help to ensure transparency and accountability of local governments to them;
- *Panchayats* need to be involved in local infrastructure to ensure its sustainability;
- *Gram sabhas* (village assemblies) generally take place when they have relevant decisions to make.

- Where communities contribute towards local investments these are implemented at lower costs and are more likely to be sustained.

5. Alternatives considered and reasons for rejection

There were two main alternatives considered and rejected. The first alternative was a more traditional rural poverty project. In these projects funds are directly transferred from an autonomous state organization specially set up for the purpose to groups of poor people who organize themselves around a common activity. These community organizations receive funds in their bank accounts, save for their own contributions, and implement and operate the investment. There are few restrictions on what the funds can be spent on. This approach was rejected for several reasons. First, in India, given its size, Bank projects have little impact unless they can contribute to mainstream programs. Second, GoK has access to many state and central schemes that target vulnerable groups, such as women (one of which is financed by the Bank), scheduled tribes and castes, and there is already a large number of community organizations and self help groups operating in the state. Many of those schemes are financed as central grants and therefore the priority for the state is not to borrow to increase the total amount of targeted schemes and funds, but rather to improve implementation of the existing ones. And third, the weakest link for improving local governance is the local government side.

The second alternative was to finance infrastructure grants in the poorest *Panchayats* and capacity building across *Panchayats* without pooling funds with government and relying on project own rules and procedures and the establishment of a project unit. This approach was rejected because it would not directly support the government program but would create structures and procedures parallel to them increasing confusion in the system as well as administrative costs. The reformed financial management system prepared by the Government offers enough assurances for the Bank's fiduciary requirements.

C. IMPLEMENTATION

1. Institutional and implementation arrangements

The project will support GoK to strengthen its decentralized system of governance, improve efficiency in public expenditures and service delivery. In this project, the institutional and implementation arrangements are based on the reforms that GoK has been implementing in this area over the past four year. The analytical underpinning for these reforms are based on two studies—Fiscal Decentralization to Rural Governments and the State Financial Accountability Study—conducted by the Bank in collaboration with GoK. These reforms are designed to rationalize resource allocation to *Gram panchayats* and ensure the appropriate and efficient use of these resources at that level. In parallel, as a part of the implementation design, mechanisms have been established to track and confirm that the use of these resources are consistent with the purposes for which they are intended, remedies have been defined and processes elaborated to recover misused resources and/or penalize these misuses. The details of these arrangements are discussed in relevant sections of the PAD. The institutional aspects are elaborated in Annex 6: Implementation Arrangements.

The primary agencies responsible for overall implementation of the program are the GoK Department of Finance and the Department of Rural Development and *Panchayat Raj* (RDPR). They would work in conjunction with other State bodies including the State Institute of Rural Development, the Energy Department and the Environment Department as appropriate. The investment program implementation responsibilities in the field are at the *Panchayat* levels, and in particular, with the *Gram panchayats*. The two lead State-Government Level Departments will institute structured consultation and coordination arrangements between relevant agencies for the various aspects of the program. The arrangements as well as operating policies and procedures for the program are documented in an Operational Manual.

The Department of Finance

Critical aspects of these arrangements include the establishment of the Decentralization Analysis Cell (DAC) which will be located in the Department of Finance, but will be overseen jointly by the Department of Finance and RDPR. The DAC will be responsible for analysis, evaluation and monitoring of *panchayat* fiscal and service delivery performance. This Cell therefore has an important role in the oversight of the program's implementation. In addition, the DAC may provide technical and data support to State Finance Commissions Secretariats when these are established. The DAC also will provide information to the Department of Finance and RDPR with regard to the quality of service and expenditure performance as a part of the fiduciary review that RDPR needs to carry out to assess the effectiveness of this program.

The Department of Rural Development and *Panchayat Raj* (RDPR)

A project Facilitation Cell (FC) has been established in RDPR. The FC will oversee day-to-day project management and the overall project implementation. It will also ensure that the overall project management, inter-department coordination, financial management, implementation of environmental guidelines and procurement proceeds as planned.

FC will recommend transfer of Block Grants (BG) funds to GPs, record these in the Annual Financial Statements (AFS) of the project and monitor corresponding GoK transfers. This component will be governed by a fiduciary framework comprising: (i) Directive from RDPR to GPs saying the BG funds may only be spent on eligible activities[4] which will be detailed in the OM. (ii) Approval procedures ensuring that the proposed uses of BGs are approved by the *Gram sabha*. RDPR will confirm that proposed uses were properly approved by the *Gram sabha* before release of BG funds. (iii) Directives from RDPR ensuring roll out of the FM reform which will in turn ensure the appropriate accounting of BG funds in the books of the GP and (iv) Assurance on end use of BG funds through audit and social accountability mechanisms. All the requirements on the fiduciary framework will be monitored by the FC at RDPR which will have overall oversight responsibility for this component (refer to Annex 7 under Implementation Arrangements).

In addition, the FC will be responsible for the implementation of Components B, C and D of the project through the Project Implementing Agencies (PIAs) which will be *Taluka Panchayats* (TP).

Technical support to *Gram panchayats* will be provided by RDPR by creating resource centers at the block level specifically created for this purpose. These resource centers will also help strengthening the capacity of districts to monitor service delivery at the *Gram panchayat* level. In addition, these centers will conduct or contract out the following critical activities:

- information campaigns for constituents.
- technical assistance to assist poor people's organizations
- implementation of the financial management framework and computerization of *Panchayats*

[4] Eligible activities will be improvement and expansion of services as defined by the 29 activities that are devolved by GOK

- monitoring the quality of *Gram sabhas* and Ward *Sabhas*.

The State Institute for Rural Development will have primary responsibility for carrying out the capacity building activities at the *Panchayat* level, including installing and operating training centers at the block level.

The Energy Department will work with RDPR to ensure that the agreed program for ensuring that the problems of electricity billing and payment are satisfactorily resolved, while the Environment Department will contribute to the work of the FC on the implementation of environmental guidelines.

In addition, RDPR would also manage the technical assistance funds to assist the reform of line agencies.

Panchayats

At the *Panchayat* level all tiers would benefit from the capacity building programs. District *Panchayats* would assume a special role in monitoring service delivery standards and performance at the GP level. Block level *Panchayats* would assist *Gram panchayats* in the areas of accounting, social mobilization, and engineering services. *Gram panchayats* would develop participatory village service delivery plans based on guidelines (included in Operations Manual) recently issued by the State. These plans would be based on consultations within Gram or Ward *Sabhas* and approved by the *Sabhas*. The quality of *Gram sabhas* would be closely monitored by an independent agency which will contracted by RDPR. The development plans approved at the *Gram sabha* would be financed through block grants or existing schemes where available (e. g. Rural Water Supply) and the quality of their implementation would be closely monitored by the block level resource centers and by the independent agency.

2. Monitoring and evaluation of outcomes/results

District *Panchayats* would monitor service delivery at the *Gram panchayat* level. The Decentralization Cell will monitor fiscal flows, own revenues and service delivery aggregating data collected at lower levels. Proposed key output indicators are in Box 1.

Overall project evaluation would be outsourced to an independent agency. A recently completed Rural Census will provide the preliminary information for the baseline. If additional data are required, additional questionnaires will be prepared and the data will be collected to complement the rural census. At least two more of these censuses will be done during the duration of the project to provide the information to carry out the evaluation. In addition the independent evaluators would sample the quality of the surveys on service delivery.

Box 1. Output and Impact Indicators

Output Indicators

- Increase in discretionary funds at disposal of poorest *PanchayatsGram panchayats* disbursed according to formula;
- 90% of GPs implementing planning guidelines;
- Computerized financial management system in place in at least 5,000 GPs.
- Annual "State of *Gram Panchayat* Fiscal,and Service Delivery Reports" published starting in 2007.
- *Taluk* training and resource centers operational in at least 50 *taluks* including the 39 poorest *taluks*.
- Fiscal cell in the Finance Department created and fully staffed including at least one representatives from Department of *Panchayats*.
- *Gram Panchayat* revenues, expenditures, and procurement decisions, publicly disclosed in 90% of GPs.
- *Panchayat* budgets executed according to plans and procedures.
- Timely transfers to GPs equal to entitlements and budgets;

Impact Indicators

- Formula based, equalizing, transfer system adopted by the state and legal instrument issued;
- Increased own revenue effort (200%) and potential (100%), compared to 2005;
- Regular Gram *Sabhas* meeting participation and inclusion parameters in 90% of GPs;
- Number of state schemes channeled through *Panchayats* reduced to less than 200.
- Capital investment of 20% poorer *Panchayats* increases by 500% compared to 2005.
- Improved services delivered by GPs based on household and community surveys

Proposed key impact indicators are in Box 1. Impact indicators will be matched to the decisions taken by the GP since impacts need to be conditional on specific activities chosen. Examples would include:

- Household perceptions of the quality of public services
- Number of children in schools (public and private)
- Number of people ill in past month, proportion using health services (public and private)
- Cost of infrastructure built by GP versus line agencies

A key goal of the evaluation is to be able to match GP decisions via the monitoring system and output indicators with the ultimate impacts to determine causal links between inputs to outcomes. Most emphasis will have to be put on the perceptions of households on services that the GP has direct control over as the amounts of money in the block grant are very small relative to the costs of services provided by agencies of the state government. The results of the evaluation will be made public as per the requirement of the Right to Information Act of GoK. This will benefit citizens as well as the GP's themselves as lessons on policy outcomes emerge.

2. Sustainability

There are three main aspects of sustainability. The first is the sustainability of the devolution process. In a democracy as large as India it takes time to debate and build consensus before an implementation plan can emerge. However there is strong evidence of a national consensus on the need for decentralization. The 73d and 74th Amendments to the Constitution issued in 1992 enshrined devolution in the Constitution of India and mandated states to hold regular elections and transfer funds and functions to local bodies. The devolution process has continued steadily but slowly since 1992. With the Constitutional Amendments decentralization to rural and urban bodies became a state subject. All states have had elections for local bodies now, some for the third time, although some had to be brought to the High Courts through litigation to get the process started. All states have enacted state Acts regulating the decentralization process. All have set up SFC as per the Constitutional Amendment to propose the share of state revenues to be transferred to local bodies. Because of the slowness of some states in devolving resources the 11th and 12th Central Finance Commissions (that oversee Central/State fiscal relations) intervened and made ad-hoc allocations to rural and urban bodies. The Central Government rechannelled several Centrally Sponsored Schemes (Central government budget items) to local governments. The new national government that came into power in May 2004 has been particularly vocal about the need for decentralization. It created a new Ministry of *Panchayats* to raise the profile of the process and the new Ministry has started a process of national debate towards a clearer devolution of activities to local bodies, avoiding concurrency and giving them a more important role in development. Among states, Karnataka is a pioneer in devolution and as discussed above it has been taking important reforms to deepen the devolution process. On the other hand there are vested interests that could slow down or try to reverse the process. Central or state politicians may fear losing credibility if faced with competition from local politicians. State or district officials on the other hand may resist the loss of powers. Therefore one of the objectives of the project is to create an environment of fiscal stability for GPs over a period of time to give them space to establish and strengthen themselves reducing the risks of policy reversals.

The second aspect of sustainability relates to the fiscal situation of the state and its ability to absorb a larger *Panchayat* bill at the end of the project. At 0.08% of government expenditures the *Gram panchayat* bill is miniscule, even by developing country standards, so even the doubling of this share would be relatively easy to absorb. In any case all the indications are that the state would increase the share of *Panchayats* in the budget even without the project. Determining the share of *Panchayats* is a responsibility of the SFC. Both SFC and Central Finance Commission have been increasing funds allocated to *Panchayats* at about 10 to 20% a year, which would more than cover the implicit liability arising from the project.

The third aspect of sustainability applies to service provision. Here the project is expected to have a positive impact in making those services more sustainable. As a result of the project, own revenues would increase improving the financial situation of GPs, thus enabling them to sustain higher levels of services to rural people. Because the project would also increase accountability to rural people and therefore lead to expenditures that are more consistent with local preferences there would be strong incentives for *Gram panchayats* to maintain and operate the assets created. Studies carried out by the Bank for Karnataka have shown that higher revenue collection and service provision are highly correlated.

3. Critical risks and possible controversial aspects

Risks	Risk Mitigation Measures	Risks After Mitigation
the context of fiscal stress and vested interests • Commitment weakens due to changes in political and administrative leadership; • Real value of block grants may decline • Releases less than entitlements and erratic transfers • Revamped formula based transfer system not formalized	The risk of weakening commitment cannot be mitigated; Raising awareness of elected representatives through training and some covenants in legal agreement; Disbursement arrangements create incentives for state to sustain current level of transfers; the project will model a formula based transfer system; flow of funds through commercial bank accounts will reduce impact of Ways and Means measures; state level expenditure management is improving in part due to the Economic Restructuring Loans.	S
Shifting relative resources to most needy and poorest jurisdictions.	Financing of poorer *Panchayats* is a legal covenant; Equalizing formula will be designed ensuring there are no losers.	M
Improve incentives for the delivery of priority services through greater accountability to rural people • GPs may avoid *Gram sabhas*; • Low own revenue effort; • Bias towards infrastructure in service provision when not a priority	Information campaigns in project design; Quality *Gram sabhas* are necessary for block grants; Incentives in formula for own revenue generation; Planning guidelines to cover wide range of services; Monitoring of service delivery included in the proposed project	M
Expanding the *Panchayat* and State capacity to implement and manage the process • Systems not put in place timely • Lack of coordination between Finance, Rural, Urban and line agencies	Detailed capacity building action plan and covenant regarding financial management; Staffing of Decentralization cell to eventually represent the three Departments; technical assistance for the restructuring of line agencies.	M
To component results		
Block Grants to *Gram panchayats*	Given the weak the fiduciary environment and capacity at the GP level, there is a risk that the usage, accounting and assurance of the BGs funds will not be satisfactory. To mitigate this risk, a fiduciary framework governing Block Grant approval, usage, accounting and assurance is set out in the PAD and captured in the legal covenants. This is in addition to a detailed FM capacity building plan for GPs that has been embarked on by GoK and will be monitored by the Bank. So, even while fiduciary risk is rated 'High', adequate mitigating measures have been taken to address these and the financial management framework for the project supports the overall development objectives of the project.	H
Information System for Constituents	Process already under way; captured in legal agreements	M
Building the capacity of *Panchayats*	Adoption and training started before appraisal; staff (mostly	S

• Slowness in financial management system • Block resource centers slow in staffing and possibility of outsourcing included	engineers) already in place in many blocks;	
Building the capacity of the state • Finance gives low priority to Decentralization Cell	Possibility of outsourcing included; upfront agreement with Finance on role and staffing of Cell as condition of negotiations	S
Overall Risk Rating		S

H: High; S: Substantial; M: Moderate

4. Loan/credit conditions and covenants

Credit covenants are:

(i) State government will maintain financial commitment to *Gram panchayats* as per formula agreed with IDA and will release funds periodically and in a timely and predictable way in accordance with this commitment. State government will ensure that its own State Finance Commission (SFC) releases to the GPs are transferred each quarter as appropriate.

(ii) State Government will monitor *Gram sabhas* and will only release additional amounts to be financed by IDA to those *Panchayats* holding quality *Gram sabhas*.

(iii) Department of Finance will create, staff and operate a Decentralization Analysis Cell.

(iv) RDPR and the Decentralization cell will set-up a Monitoring System including for monitoring the inclusion of tribal population

(v) Financial Management Guidelines acceptable to IDA will be followed. The Facilitation Cell will be staffed with a Financial Management Specialist with qualifications acceptable to IDA. This position will be in place throughout the duration of the project.

(vi) Planning Guidelines for *Panchayats* acceptable to IDA will be followed.

(vii) State government will set out the framework for the approval, usage, accounting, public disclosure and assurance of Block Grants which will be detailed in the Operations Manual.

(viii) The transitional environment framework will be approved and the permanent one designed and approved and both would need to be acceptable to IDA.

(ix) GoK will provide evidence of progress on agreed indicators and undertake evaluation studies agreed during the Review Missions.

(x) GoI will ensure no involuntary resettlement.

(xi) State government will ensure that (a) project annual financial statements are regularly maintained and are based on accounts maintained by project implementing agencies; (b) semi-annual financial management reports (FMRs) are delivered within 45 days of close of the half year, (c) audit reports are delivered within six months after the end of the GoK fiscal year. The State government shall also ensure that the consolidated audit report of the

GPs and the special audit report are received by IDA annually within six months of the close of the financial year.

D. APPRAISAL SUMMARY

1. Economic and financial analyses

Cost Benefit Analysis. The project would finance block grants to *Gram panchayats* and capacity building activities. Because the expenditures of *Gram panchayats* would be defined during the project life and as part of a participatory planning process that reflects villager's priorities it is not possible to carry an ex-ante cost-benefit analysis. Following past patterns, most likely *Panchayats* will spend on the provision of basic services at the village level, including for drinking water, sanitation, water reservoirs for domestic animals and micro-irrigation, upgrading schools and health clinics, street lighting, local libraries, scholarships for the disadvantaged, common land management, and others. There is some indirect evidence that *Panchayat* expenditure will be more efficient than state and central government expenditure. Firstly, a recent study comparing the effects of decentralization across several Southern Indian states has shown that Karnataka performs better than others in rural service delivery, precisely because of its longer history of devolution and its accumulated experience. Secondly, experience with the implementation of rural poverty projects across India, which include village level infrastructure, has shown that locally financed infrastructure costs much less than infrastructure financed through line agencies, but is of the same quality. Thirdly, the project would increase resources for the poorest and neediest jurisdictions where the cost effectiveness and/or returns to the marginal investment are likely to be higher. And finally, there is wide evidence of the poor expenditure management for rural development by the center and states, where only a small proportion of the budgeted amounts trickle down to actual investments on the ground and often for activities that do not reflect the needs of local people. By shifting resources towards a level of government that is closer to the people, the proposed project would improve the quality of expenditures. The recent Bank study on "Fiscal Decentralization to Rural Governments" identified the following deficiencies in *Panchayat* financing, which the proposed project would address:

- Expenditure needs are not recognized by the lump sum allocation ($10,000 to each *Gram panchayat*). *Panchayats* receive the same allocation even though the sizes of their populations may be different. They may also have vastly different land areas which also affects expenditure needs.
- The lump sum formula does not recognize different levels of poverty, or even fiscal capacity differences, and therefore it is not equalizing.
- There is no incentive built in to the formula for increased revenue mobilization by local governments.

The project will support the efforts of the GOK to move to a formula that remedies some of these defects. The goal is to distribute the funds among local governments so that some of the above goals might be better served.

Financial Sustainability Analysis. By the end of the proposed five and a half year period GoK would ensure financial sustainability of the GPs by continuing to disburse untied funds to them according to a formula recommended by SFC and accepted by the government. This formula would also need to be recommended by the 3rd State Finance Commission due in about 3 years and the experience from the project will provide lessons to the State Commission on how the system could work best. State flows to *panchayats* would increase three fold[5], from about US$32 million per year (86 cents per capita) to about US$84 (nominal) million per year (2 dollars per capita) after 5 years (about 1.18% of projected government revenues). This increase would be financed from three different sources. **Firstly,** government revenues are expected to increase by about 40% in nominal terms according to revenue projections. Assuming that the vertical share of GPs would increase at the same rate as the vertical urban share the block grant transfers for GPs would amount to about US$60 million per year after 5 years. **Secondly,** the allocations to the less poor *Panchayats* would remain constant in nominal terms (500,000 rupees per year) and would thus decline in real terms. **Thirdly**, funds would be made available through transfer and consolidation of schemes into the transfer system.

2. Technical

The project includes three activities that would ensure an adequate technical outcome from investments. **Firstly,** the Capacity Building program for *Panchayats* includes several modules on technical issues, including preventive health, HIV, environment management, gender issues, tribal issues, government schemes, planning, and others. **Secondly,** the project would finance the creation of resource centers at the block level to be staffed adequately to provide support and facilitation services to *Gram panchayats*. Following government procedures all infrastructure investments greater than 10,000 rupees would have to be cleared by a certified engineer. **Thirdly,** recent policy reforms at the state level allow *Gram panchayats* to outsource services from the private and NGO sectors. **Fourthly,** there is ample evidence that when investments are chosen through a participatory process with the involvement of communities there are strong incentives for operation and maintenance.

3. Fiduciary

Financial Management: The financial management arrangements for the project meet the Bank's fiduciary requirements of OP/BP 10.02. The overall responsibility for financial management will vest with the FC in the RDPR. The FC will be staffed with a Financial Management Specialist (FMS) with qualifications acceptable to the Bank who will be in place throughout the life of the project. The FMS will be responsible for ensuring that financial management arrangements including accounting, financial reporting, internal control, oversight and submission of accounts to audit are satisfactory, in accordance with relevant state government requirements and project Legal agreements. The FMS will compile Annual Financial Statements (AFS) based on accounts maintained by various project implementing agencies. All implementing agencies will maintain accounts using mainstream government accounting systems and report expenditures monthly to provide a basis for compilation of the AFS. (The AFS of the project produced on a quarterly basis will serve as Financial Monitoring Reports-FMRs.)

The majority of project expenditures will be made by GPs under project component A: Block Grants components (approximately 85%). These BGs will be accounted for in the books of GPs on accrual basis in accordance with the new guidelines for accounting issued by GoK and which are acceptable to IDA. The AFS will report the total amount of BGs quarterly/annually and these will be tallied with the BG transfers reported as a single line item in GoK accounts annually. The remaining 15% expenditures will be made by the other implementing agencies: DAC, the Abdul Nazir State Institute for Rural Development (ANSSIRD), and *Taluka Panchayats* and will be accounted for in their accounts.

The main challenge to satisfactory financial management is the poor quality of accounting and financial reporting at the GP level. However, this weaknesses will be overcome by instituting a fiduciary

[5] State flows to *Panchayats*, presently are about 0.8% of government revenues, which is negligible even by developing country standards

framework for the BG component comprising (i) Directives from RDPR that BG funds be used only on eligible activities[6], (ii) Approval procedures ensuring that the proposed uses of BGs are approved by the *Gram sabha* and RDPR will confirm that proposed uses were properly approved by the *Gram sabha* before release of BG funds; (iii) Directives from RDPR ensuring roll out of the FM reform which will in turn ensure the appropriate accounting of BG funds in the books of the GP and (iii) Assurance on end use of BG funds through audit and social accountability mechanisms.

Disbursements: Project disbursements will be based on six monthly FMRs. The FMRs will be subject to confirmation/certification by the annual audit reports. Any discrepancies between expenditures reported in the FMRs and those certified by audit will lead to adjustments of subsequent disbursements, to be recovered or reimbursed to GoK, through the next disbursement. An indicative disbursement schedule is provided in Annex 7.

Audit: For fiduciary purposes the following report will be received by the Bank and monitored in ARCS:

- Audit of AFS/ FMRs (on all components). These will be audited by a firm of private Chartered Accountants.

Internal Controls: For the purposes of monitoring, capacity building and assurance on end use of BG funds, the RDPR will monitor the following:

- Consolidated audit report of GPs receiving Block Grants audited by Karnataka State Audit Department (KSAD).

- Additional fiduciary reviews of a sample of GPs receiving Block Grants will be undertaken by a firm of private accountants periodically during the implementation phase. The purpose of these reviews will be to provide additional assurance of the controls at the GP level and recommend strengthening actions if required. RDPR will create a panel of CA firms in consultation with KSAD from which the reviewers will be selected. This panel may be either at the district level or at a regional level[7] to conduct these special reviews in which both financial management and procurement will be covered at the GP level.

Procurement. The procurement procedures of the Government/ *Panchayat* will be followed for most of the project expenditures which are likely to be individually small and geographically spread out. The Bank's assessment has confirmed that the procurement procedures being followed by the Government of Karnataka are acceptable to the Bank. For international competitive bidding(ICB) and International Consultancies, Bank's procurement procedures would be followed. However no ICB is expected under the project. The assessment of the procurement procedures of Government of Karnataka indicated the following:

The Government of Karnataka has embarked on a program of reforms in public procurement. The Karnataka Transparency in Public Procurement Act in 1999 has been enacted. Karnataka Transparency in Public Procurement Rules 2000 was issued in October 2000. These are available on the website of the Finance Department, Government of Karnataka. The only deviations in the procedures from the

[6] Eligible activities will be improvement and expansion of services as defined by the 29 activities that are devolved by GOK

[7] GoK will develop criteria for selection of the audit firms and TORs describing the scope of the audit to be conducted.

Procurement Guidelines of the Bank relate to negotiations and a two-cover system. However, these will not affect procurement under the proposed project.

In order to ensure transparency in Public Procurement and bringing in uniformity across all the procurement entities of the state, the Government has proposed to mandate the use of standard tender documents for procurement of Goods, Works and Consultancies. The draft procurement rules have been posted on the website of the Finance Department, Government of Karnataka to elicit response from the stakeholders. The documents will be finalized after the comments are received and changes if any, in the document are made.

Procurement under the proposed project will largely comprise procurement by the *Gram panchayats*. The draft rules for the procurement under *Panchayat* are described in the Karnataka *Panchayat Raj* (*Gram panchayats* Accounts and Budget) Rules 2003 (Draft). These rules have been scrutinized by the Bank and are acceptable.

4. Social

The Karnataka *Panchayat* system includes several aspects that are positive to marginalized groups such as women, scheduled tribes and scheduled castes. **First** and most important are the reserved seats in GPs. Recent ESW by the Bank (*Panchayats* and Resource Allocation in South India) has shown that reserved seats result in higher benefits for marginalized groups and that women representatives are not tokens (dominated by men or elite). **Second** the Planning Guidelines for *Panchayats* recently adopted by the state bring excluded groups (women, dalits, tribal people) to the center stage of the planning process manadating GPs to ensure their inclusion and the targeting of expenditures to them. **Third** state expenditure guidelines for *Panchayats* require that 18% of the expenditures be used for the benefit of scheduled castes and tribes. **Fourth** the 39 target *taluk*s in the project have the higher concentration of dalits and tribal people. **Fifth** the proposed formula for transfers would assign higher transfers to *Panchayats* with a higher percentage of vulnerable groups. This indicator would in fact be the proxy for poverty. And **finally** the program envisions information for vulnerable groups and increasing the capacity of their organizations. What is missing is a mechanism to monitor, and the project would put such mechanisms in place through the monitoring of participation of excluded groups in *Gram sabhas*, implementation of the new planning guidelines which have many inclusive features (a condition for the financing of block grants for GPs), and of benefits accruing to tribal people (to be included in service delivery *Panchayat* monitoring system

5. Environment

The project aims to provide support for local rural development by giving additional funds to the *gram panchayats*. Whereas the additional development activities to be supported by this project may not create large, irreversible impacts by themselves, GPs often operate in a constrained resource environment, and their actions, albeit small, could have local negative impacts. Issues could include: (i) drinking water availability, (ii) exploitation of groundwater, (iii) excessive use of fertilizers and banned pesticides, (iv) improper & unstructured quarrying / mining activities, (v) improper sanitation and sewage system, (vi) improper solid waste management, and (vii) lack of environmental awareness and knowledge on good practices.

The project proposes to address environmental issues in two phases. The first phase would put in place, by project start-up, a simple set of Environmental Guidelines that would ensure that activities under IDA financed block grants would conform with OP 4.01. These guidelines would consist of simple rules for the screening of *Gram panchayat* instruments for potential negative impacts and procedures to ensure that adequate mitigation is put in place. The *Panchayat* system needs a more comprehensive framework, though, one that would extend to all three levels of *Panchayats* and that would guide their decisions other than for investments, for example in the awarding of building or quarrying licenses. This comprehensive environment framework would be developed and put in place during project implementation and would therefore be an output of the project.

To develop the Guidelines, an environmental study was undertaken by independent environmental consultants. This included (i) reviewing *gram panchayat*'s activities from an environmental perspective by analyzing secondary information as well as undertaking field visits to and stakeholder consultations in selected villages; (ii) carrying out a training needs assessment to form the basis for developing a training plan; (iii) analyzing the current legal framework to understand the context and to identify gaps that require to be addressed, and (iv) developing a monitoring & evaluation framework to ensure environmental safeguards are adhered. As an output of the environmental study, a document titled Environmental Guidelines was prepared. This includes information on the applicable government policies, a summary of the environmental analysis & issues, a framework comprising screening of activities and mitigation measures for specific type of activities, training & capacity plans, monitoring & evaluation arrangements, and analytical studies that need to be done during implementation. To ensure effective implementation of the Environmental Guidelines, the project will have a full-time, state-level environmental officer.

The GoK will disclose the Environmental Guidelines in the Ministry of Rural Development & *Panchayati* Raj in Bangalore and in the Districts where the backward *Taluka*s are located. The executive summary will be translated in the local language - Kannada - and this will also be disclosed along with the other documents. These reports will also be disclosed at the Bank's Info Shop in New Delhi and Washington D.C.

6. Safeguard policies

Environmental Assessment. See section D5 above.

OP 4.20. Indigenous Peoples. The project will be active in areas that contain tribal groups and hence this policy is triggered. Both the Karnataka *Panchayat* system and the project include various pro-tribal measures, therefore a separate Tribal Development Plan would not be developed. The main objectives and the principles of OD 4.20[8] would be achieved in 7 important ways, 6 of which have been built into the design of the project (i to vii):

(i) The building of capacity is across the entire State and will cover all *Panchayats*, including those with groups who qualify as indigenous peoples (IPs). This will enable IPs (either as local government representatives or as constituents) to benefit from the capacity building programs.

(ii) *Panchayats* with the highest proportions of IPs will be eligible for larger grants, ensuring that those with the greatest need receive greater resources.

(iii) Through the monitoring system to be created at the state inclusion and participation of IPs would be monitored as well as service delivery for IPs.

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[8] The objectives of OD4.20 are to:

- Ensure that indigenous peoples affected have a voice in project design and implementation.
- Ensure that adverse impacts on indigenous peoples are avoided, minimized or mitigated.
- Ensure that benefits intended for indigenous peoples are culturally appropriate.

(iv) The main tenets of participatory planning and monitoring have been included in the State Planning Guidelines for *Panchayats* and would be disseminated as part of the capacity building/ training of rural government staff.

(v) Mobile communications units will train and disseminate information to constituents including IPs on their roles and responsibilities and citizen score cards will increase awareness of rights to services.

(vi) *Panchayat* development planning guidelines include requirements for ward and *gram sabhas*, as well as *Panchayat* Development Seminars with key stakeholders to review the draft plan. The guide requires documentation of vulnerable group attendance and participation at both stages, which can be monitored to assess improved participation and voice.

(vii) The Government of Karnataka's commitment to improving the STs of the State by the passing the *Panchayat* Act in the Legislative Assembly and by implementing special programs targeted at the SCs and STs (the Department of Social Welfare) will help further the objectives of the Bank's OD 4.20.

OP 4.12. Involuntary Resettlement. There would be no involuntary resettlement. Many villages may not have sufficient *Panchayat*-owned lands to carry out sub-projects. Small plots of private land may be required for certain small infrastructure sub-projects such as check dams, culverts, bore wells, pump houses and drains. These lands will be acquired through voluntary donations or purchase, provided they are legally available, litigation free and under the legal guidelines of the State of Karnataka. Similar approaches are already in place for the State's rural water and sanitation services project and these would be adopted for the proposed project. All voluntary land transactions will meet the following criteria: (i) the land in question will be free of squatters, encroachers or other claims of encumbrances; (ii) lands will be chosen (by the community) after ensuring site suitability; (iii) verification of the voluntary nature of land donations in each case; (iii) land transfers will be completed -land title will be vested in the GP through registered sale deed or MOU. The format for the MOU will be agreed with IDA; and (iv) provision will be made for redressal of grievances. Further, lands will not be accepted from such land owners whose holding will be less than the minimum economical viable stipulated size (2.5 acres). Any land with disputed title and/or legal or illegal settlements will be excluded from the project.

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment (OP/BP/GP 4.01)	[X]	[ ]
Natural Habitats (OP/BP 4.04)	[ ]	[X]
Pest Management (OP 4.09)	[ ]	[X]
Cultural Property (OPN 11.03, being revised as OP 4.11)	[ ]	[X]
Involuntary Resettlement (OP/BP 4.12)	[ ]	[X]
Indigenous Peoples (OD 4.20, being revised as OP 4.10)	[X]	[ ]
Forests (OP/BP 4.36)	[ ]	[X]
Safety of Dams (OP/BP 4.37)	[ ]	[X]
Projects in Disputed Areas (OP/BP/GP 7.60)*	[ ]	[X]
Projects on International Waterways (OP/BP/GP 7.50)	[ ]	[X]

7. Readiness

GoK is already implementing many of the activities of the program. IDA support will scale-up some of the activities, such as flow of funds to *Panchayats* and capacity building, but it will rely on systems that are already in place and have been experimented with. The only two new areas are the introduction of

* *By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas*

financial management and planning guidelines. Here however the state has initiated special training programs to make *Panchayats* ready for implementation. BG will be transferred to GPs through a formula that will give weight to poverty (population of schedule caste and tribe), area (a proxy for costs of service provision), and illiteracy (proxy for service deficit)[9]. In addition, these GPs need to have the following conditions met:

- Are following planning guidelines;
- Have put in place the new financial management framework;
- Hold periodic Gram and Ward *Sabhas* as per state stipulations; and
- Receive block grants in timely fashion and as per state budgets.

[9] More details are provided in the Operational Manual for this project.

Annex 1: Country and Sector or Program Background

Background

The proposed project is seen as support for a larger and longer-term program of the state government to establish an effective *Panchayat* system able to deliver key services to rural people. The project would strengthen the Government's ongoing decentralization program by financing additional resources to the poorest *panchayats*. This component will be initiated in the 39 *taluks* identified as the poorest by the Nanjundappa Committee. It will also scale up the capacity building program for all the State and the *panchayats* and in doing so help sustain the reforms already achieved and increase allocations to the poorest *Panchayats* in the context of the fiscal difficulties of the state.

The Bank has been working closely with the Government of Karnataka through ESW to assist with the decentralization process. An internal Bank document, "Overview of Rural Decentralization in India" (2000) included Karnataka as a case study and was discussed with GoK through a workshop in 2001 contributing to initiating the current process of reforms. This was followed by a study on "Fiscal Decentralization to Rural Governments in India" (2004) with Karnataka again as a case study. Around the same time the Bank completed a "State Financial Management and Accountability Study" that looked at the *Panchayat* financial management system. More recently a study was completed on "Local Organizations for Decentralized Development in India" (2004) covering drinking water, watershed management and women's empowerment. A study on "*Panchayats* and Resource Allocation in Southern India", was also completed in 2004. These studies have provided a wealth of insights both to GoK and the Bank on the situations of *Panchayats* in the states and obstacles in making them effective units of local governments, including limitations in the policy framework.

India has opted for decentralization as a means to increase the voice of the rural poor and improve public expenditures and service delivery and strongly enshrined this approach through an Amendment to the Constitution of India in 1992. However, because of the vitality and complexity of India's democracy, progress has not been even and is often reversed, due to opposing vested interests and the turnaround of political leadership. Nevertheless important reform outcomes were achieved. All states have now held elections for local bodies, some more than three times, State *Panchayat* Acts were issued or amended, SFC have issued their reports (some for the third time), states have notionally devolved functions and responsibilities to lower tiers of government, several states have devolved increased financial resources to lower bodies, and the Center has complemented this through allocations through its own 11^{th} and 12^{th} Finance Commissions and the channeling of some of the development schemes through the *Panchayat* system. Several states have upgraded their Institutes of Rural Development towards capacity building for local bodies. The recently completed Bank study on "*Panchayats* and Resource Allocation in Southern States" looked at the behavior of local bodies and concluded that it is a mature system exhibiting all the behavior of an established democratic model.

But the devolution process is largely incomplete. States have moved at different speeds and while some such as Kerala, West Bengal and Karnataka have put *Panchayats* at the center of rural development, others such as AP and Bihar are lagging further behind and only moved when subject to public litigation. In most states the state administration did not reform itself in line with the new institutional reality and there is widespread overlapping of roles that undermine accountability. Most staff supposedly working at the *Panchayat* level remain in state agency payrolls with limited accountability to local bodies. Financial resources flowing to *Panchayats* are either negligible or tied into strict administrative procedures and expenditure categories that do not give discretion to local governments to make their own decisions. As a result the local role of *Panchayats* remains very limited in practice and constituents themselves seem to invest little effort in influencing local decisions since these have limited relevance to their lives. Hence the low attendance in *Gram sabhas*.

Karnataka is one of the leaders on decentralization. In 1987 it put in place a decentralized framework that inspired India's Constitutional Amendments. In 2001 it developed a Decentralization Strategy and since then it amended its *Panchayat* Act, redesigned the financial management framework for *Panchayats*, allocated 20% of government budgets to the *Panchayat* system, assigned a block grant of US$10,000 to

Box A-1. Rural Decentralization Policy Initiatives of GoK

- The *Panchayat* Act has been amended to: (i) create ward *sabhas* (neighborhood assemblies) as the lowest unit of constituent representation and participation to enhance accountability downwards; (ii) allow associations of *PanchayatsGram panchayats* to explore economies of scale in service delivery; (iii) allow outsourcing to technical staff for the delivery of *Panchayat* services;
- Draft guidelines have been prepared to keep reserved seats constant for up to 15 years to allow local representatives to run for reelection (policy clearance awaited).
- Activity mapping to clarify expenditure assignments (i.e. responsibilities of *Panchayats* in service delivery) has been carried out.
- A proposal for consolidation of schemes (budget line items) consistent with the activity mapping has been presented to Cabinet (passed).
- A new accounting and reporting framework for *Panchayats* has been designed and is pending approval by the Law Department.
- New procurement guidelines for *Panchayats* have been issued (Transparency Act).
- Government Order issued to enhance transparency of *Panchayat* expenditure; details of expenditure-incurred need to be displayed on the same day failing which action could be initiated against the secretary and Adhyaksha.
- *Panchayats* no longer need approval of *Taluk Panchayat* for making payments.
- Government Order has been issued mandating that transfers to GPs be made through commercial bank accounts rather than through treasury accounts (operational).
- State block grants to GPs (entitlements) have been increasing during the past 5 years standing today at 500,000 rupees (about US$11,000) per *Gram Panchayat.*
- Electricity bills for 100% of the GPs have been reconciled.
- Draft planning guidelines for GPs have been issued and discussed at workshop and will be tested in May, 2004.
- A capacity building program on *Panchayat* duties and responsibilities, service delivery aspects, and own revenue collection is being carried out by the Mysore training institute through traditional courses and distance (satellite) learning.
- Fiscal data on *Panchayats* has been collected for the years from 1999 to 2003 and the information collection system is being institutionalized (completed).
- 123 *taluk*s out of 176 have completed enlisting of all the taxable entities for property taxes; the demand has been enhanced from Rs.57 crores (US$13 million) to Rs. 159 crores (US$37 million).

each *Gram panchayat*, developed clear expenditure assignments, consolidated many of the state tied schemes (initially over 600) into a smaller number of budget lines, and recently issued a Government Order dated October 16th, 2004 transferring most of these schemes to the *Panchayat* system.

Karnataka is often considered one of the fastest developing states in India. But the state's overall performance obfuscates the large regional disparities. Some blocks of the state are more similar to lagging blocks in eastern and western states than to urban centers or areas of commercial agriculture in Karnataka. With 53 million people Karnataka ranks seven among 28 states in absolute number of poor people, and eight in absolute number of rural poor, more than any other southern state. In terms of percentage of poor people Karnataka ranks seventh in India, close to Maharashtra, Uttar Pradesh and West Bengal. It ranks poorly also in children malnutrition and road access. A state High Powered Committee (2002) reviewed the status of regional disparities according to several indicators and identified 39 blocks concentrated primarily in Northern Karnataka as the most backward with another 75 considered to be lagging in development indicators (out of 175).

Karnataka sees decentralization as one instrument to address regional disparities if it can be pursued in an equalizing fashion by divesting more resources to the poorest blocks and villages and capacity can be developed at the local level. But even Karnataka, despite its impressive record, has yet a way to go before local bodies can rise to their potential. Existing programs, in part because of the fiscal stress that the state currently faces, are not adequately supporting this challenge even though in the last two years, full entitlements to GPs has been passed down, their fiscal role remains negligible despite the many advances in the policy environment. Moreover some funds (block grants) are supposedly transferred equally to each village independent of population, but once aggregated transfers to the village governments are not equalizing; richer villages get more transfers per capita than poor ones. The recently completed study on "Fiscal Decentralization to Rural Governments" identified some of the key impediments to making *Panchayats* more effective in delivering services, particularly in poorer regions. Issues in the *Panchayat* system include:

- Unclear expenditure assignments between state government and *Panchayats* and between the three tiers of *Panchayats* that create overlaps, confuse authority, and undermine accountability;
- Limited expenditure discretion of local governments that limit their ability to meet local needs and preferences;
- Twenty eight percent of state expenditures channeled through *Panchayats* but limited fiscal role of *Gram panchayats;*
- Weak revenue effort and collection;
- Complicated, non-transparent and non-equalizing transfer system; for example *Panchayat* entitlements are about US$5,000 per *Panchayat* independently of need or fiscal capacity;
- Unpredictable transfers that make it impossible for *Panchayats* to carry out meaningful planning; for example during the past few years the state government has not disbursed half the *Gram panchayat* entitlement of $5,000, and most in the last quarter
- Widening horizontal disparities, with higher expenditure by more affluent *Gram panchayats*;
- Outdated local government accounting systems, with no linkages between planning, budgeting, spending and monitoring;
- No adequate information on *Panchayat* finances which reduces accountability.

The **first** challenge for deepening and improving decentralization is to improve the transfer system. Karnataka needs to Increase the fiscal role and autonomy of *Gram panchayats*, the most likely level of representative local government, to enable them to better meet local needs, use the transfer system to increase funds available to the poorest *Panchayats* in the poorest blocks to address regional disparities, and create incentives for improved revenue collection. Only in this way can it improve delivery of basic services such as rural water, sanitation, street lighting, connectivity, village infrastructure and anti-poverty programs.

The transfer system needs to be modified from one which is based on tied schemes and small and fixed but unpredictable grants per *Panchayat* (Figure 1 in Annex 9) to one that is equalizing, allows for autonomy, creates incentives for service delivery and increases the funds available to the poorest *Panchayats* to enable them to catch-up (Figure 2 in Annex 9).

The **second** challenge for making the *Panchayat* system more effective is to build their capacity and improve their systems. This is no small task given that there are close to 6,000 local governments and more than 100,000 locally elected representatives. Fortunately Karnataka has recently developed the state's capacity to deliver training to *Panchayats* through a model training program.

The Abdul Nazir Sab State Institute of Rural Development (ANSSIRD) has been designing and conducting training programs, that provide an environment for participants to reflect, share experiences, discuss, debate and analyze situations with a view to creating an openness for change. The ANSSIRD satellite centre comprises a studio and earth station. The SATCOM system, developed with technical support from the Department of Space and ISRO is a 'one-way-video, two-way-audio' system. From the studio anchor- persons and panelists facilitate training through live or pre-recorded presentations, discussions, demonstrations and talkback sessions. These presentations and discussions are transmitted to the satellite through an earth station, which is linked to the studio. The satellite relays the signals for reception directly by small satellite terminals and relay them through TV monitors located at the training centre in different districts and *taluk*s of the state. Participants at the training centers can seek clarification or raise doubts to the resource persons present at the studio on an audio channel/fax through telecommunication lines located at the training centers. At the studio the questions received from a training centre are looped back on the audio channel of the TV signal emanating from the studio so that the questions can be heard at all the training centers in the different districts and *taluk*s. The response to the question goes on the TV signal and is received by all the training centers.

In 2002-03, ANSSIRD conducted training and communication programs for *Gram panchayats* using a unique mix of modern satellite technology coupled with participatory training techniques, which covered 18,207 *Gram panchayat* members in 1,310 *Gram panchayats* of 44 *taluk*s. A large number of departments are beginning to understand the immense potential of their satellite centre. The satellite facility was utilized by the Departments of Education, Health, Agriculture, Youth Services, Watershed, and Rural Development. In addition, KRSAC and Open University also utilized the facility. ANSSIRD also provides face to face training as well as video-conferencing facility. In fact, due to demand, the satellite facilities are over-stretched today.

The **third** challenge facing the state is to induce some key line agencies to reform themselves towards a role of facilitators and regulators of the *Panchayat* system. Most agencies continue business as usual, with their own staff implementing activities that have been devolved to *Panchayats*. This applies to sectors as varied as primary education, primary health, veterinary, agriculture, watershed management, and many others. Each agency needs to develop a plan of actions it will undertake in the future towards a role that focus more on monitoring, oversight, standards, and managing incentives for local bodies than direct implementation.

Finally the **fourth** challenge facing the state is to monitor what is happening at the *Panchayat* level to guide its policy decisions and the decisions of local constituents. There is a need to monitor both the fiscal performance of *Panchayats* but also their performance in delivering services to rural people.

Annex 2: Major Related Projects Financed by the Bank and/or other Agencies

Sector Issue	Project	Latest Supervision Ratings	
		Implementation Progress	Development Objective
Watershed	Karnataka Watershed Project	S	S
Rural water supply and sanitation	Karnataka Rural Water Supply and Sanitation II	S	S
	Karnataka Community-Based Tank Management Project	S	S
Health	Karnataka Health System Development and Reform Project	under preparation	
Urban	Karnataka Municipal Reform Project*	NA	NA

* Project was just approved on March 14, 2006.

Annex 3: Results Framework and Monitoring

Results Framework

PDO	Outcome Indicators	Use of Outcome Information
Improve the effectiveness of service delivery by Karnataka's *Gram panchayats* (village governments) particularly with respect to the management of public resources and the delivery of relevant services that the rural people decide and prioritize.	Rising number of Gram or Ward *Sabhas* with high and representative participation and relevant agendas Rising satisfaction of village residents with service delivery by *Gram panchayats* Gradual increase in own-source revenue and stronger financial health of village governments	Independent monitoring Annual service delivery surveys *Panchayat* accounting system
Intermediate Results One per Component	**Results Indicators for Each Component**	**Use of Results Monitoring**
Component One: Block grants for *Gram panchayats*	**Component One:** Increased block grants to poor *Panchayats* equal to IDA disbursements based on formula *Panchayat* budgets executed according to plans and procedures Timely releases equal to budgets and entitlements	**Component One:** *Panchayat* accounting system and government budget Independent monitoring *Panchayat* accounting system and government budgets
Component Two: Building the capacity of constituents	**Component Two :** GP revenues, expenditures, and procurement decisions publicly disclosed in 90% of GPs	**Component Two:** Independent monitoring
Component Three: Building the capacity of *Panchayats* and state	**Component Three:** Number of trained members and periodicity *Taluk* training centers Fully staffed decentralization cell Improved financial management system available in at least 5,000 GPs	**Component Three:** Project monitoring system

Arrangements for results monitoring

		Target Values					Data Collection and Reporting		
Outcome Indicators	**Baseline**	**YR1**	**YR2**	**YR3**	**YR4**	**YR5**	**Frequency and Reports**	**Data Collection Instruments**	**Responsibility for Data Collection**
Rising number of Gram or Ward *Sabhas* with high and representative participation and relevant agendas	NA	20%	40%	60%	60%	60%	Annual	Independent monitoring	Department *Panchayats*
Rising satisfaction of village residents with service delivery by GPs	NA	20%	40%	60%	60%	60%	Annual	Service delivery surveys	Zilla *Panchayat*
Gradual increase in own-source revenue and stronger financial health of village governments	US$6 million	US$8 million	US$10	US$12	US$14	US$16	Annual	Accounting system	*Panchayats* and decentralization cell
Results Indicators for Each Component									
Component One :									
Increased grants to poorer *Panchayats* equal to IDA disbursements based on formula	0%	100%	100%	100%	100%	100%	Annual	Accounting system and state budget	Decentralization Cell
Panchayat budgets executed according to plans and procedures	0%	50%	70%	90%	90%	90%	Annual	Accounting system and independent monitoring	Decentralization Cell
Timely releases equal to budgets and entitlements	50%	70%	100%	100%	100%	100%	Annual	Accounting system and state budget	Decentralization Cell
Component Two : GP revenues, expenditures and procurement decisions publicly disclosed	NA	30	60	70	80	90	Annual	Monitoring system	RDPR

Annex 4: Detailed Project Description

1. Project Description

The Bank project would support some of the building blocks of the state program. The amount of the IDA credit would be US$120 million over a 5.5 year period. The IDA credit would help finance part of the transition costs of GoK's *Panchayat* program, contributing to sustaining it over a change of administration and of *Panchayat* representatives. Hence the duration of the project would be to ensure that it crosses two administrations and two batches of elected local politicians in the state. New *Panchayat* elections were held in January 2005 and the project should become effective in time to contribute to the 2005 budget year. Most IDA resources (about US$110 million) would go towards co-financing block grants for *Gram panchayats*.

2. The key **outputs** of the State program would be:

- Formula based transparent transfers;
- Consolidation of state schemes;
- Revamped financial management and procurement system for GPs;
- All GPs computerized;
- Higher transfers to poorer *Panchayats* and blocks;
- Monitoring of service delivery performance at the GP level (e.g. rural drinking water, education, participatory planning, financial management, capacity building);
- Improved framework for own revenue collection;
- Environmental framework for GPs;
- Expanded capacity building programs;
- Improved planning guidelines with provisions for enhanced participation;
- Monitoring system on fiscal and service delivery aspects of *Panchayats*;
- Information on *Panchayat* performance available to constituents;
- A decentralization cell at state level (possibly Finance) to monitor and manage the process.

3. The **key outcomes** from the program would be:

- Predictable state disbursements (transfers) and as per commitments;
- Higher investments by GPs in poorer jurisdictions;
- Greater local revenue mobilization;
- Improved monitoring and delivery of key services to rural populations;
- More informed and higher expectations of rural households on rights and *Panchayat* performance;
- Improved participation of households including the poorest in local planning and improved targeting of poorer households;

(A) Block grants to *Gram panchayats*

In the first year, the 1,343 GPs block grants would be transferred based on a formula that will give weight to poverty (population of schedule caste and tribe), area (a proxy for costs of service provision), and illiteracy (proxy for service deficit)[10]. There are two main problems with the current fiscal flows to *Gram panchayats*. First, due to fiscal stress, the state has only been able to meet about half (US$32 million) of *Panchayat* annual entitlements (currently around US$62 million). Second, entitlements are a lump-sum equal for every *Gram panchayat* (500,000 rupees or US$10,000) independently of population, poverty or fiscal capacity. [11]The IDA credit would assist the state in meeting its commitments and in increasing allocations to the poorest *Panchayats* through a formula based system that benefits them. The IDA credit would also co-finance state expenditures in capacity building activities for the state and *Panchayats*.

The credit would be additional funds. The program will be initiated in only 39 poorest *taluk*s. Over the second year onwards, the funds will flow to the GPs on a formula basis in order to equalize over fiscal disparities and needs. GoK would commit to meeting the 500,000 rupees (nominal) entitlements of GPs, as prescribed in the law, and increase allocations to the poorest *Panchayats* though an equalizing formula.

(B) Information Systems for Constituents

This component would increase the capacity of rural people, in particular the poor, to voice their demands on local bodies and put pressure on them to perform. This would be achieved through three distinct activities. **First** special mobile communication units would be created by outsourcing this service to NGOs, government organizations or private sector, to carry out information campaigns at the village level on the responsibilities of *Panchayats* and resources put at their disposal by the state. These mobile communication units would make use of Gram or Ward Sabha meetings to the extent possible to disseminate this information. **Second** the Planning Unit of the District Government would make information on service delivery at the village level regularly available at the village level, by relying on radio, TV, press, notices in public places and information at meetings. **Third** technical assistance would be provided to organized groups of poor people, such as self help groups, watershed associations, etc., in their areas of intervention on how to access and make use of available government services and programs.

(C) Building the Capacity of *Panchayats*.

This component would create capacity at the District, Block and Village level to function effectively as a local level of government. Because *Gram panchayats* are the weakest link, most capacity building efforts would be targeted at this level.

Resource Cells at the *Taluk* Level. Because village *panchayats* are small (average about 5,000 people) there are diseconomies of scale in developing expertise capacity at that level. Hence expert services would be concentrated at the *taluk* level and would cover about 60 village governments. Expertise is mostly needed in three areas: (i) in accounting and financial management, in particular given the new framework that needs to be put in place; (ii) in technical specifications, design and oversight of investments in small infrastructure; and (iii) in mobilizing the most vulnerable groups, assist *Panchayats* in targeting services to them, and in promoting participation and facilitating decision-making at village meetings. To provide these services a cell would be created at each *taluk* staffed with an accountant, and engineer and a social worker.

[10] More details are provided in the Operational Manual for this project.

[11] The recently completed State Finance Commission Report recommends an annual increase of 50,000 rupees (US$1,100) for the block grant for each *Panchayat*, which would lead to an entitlement per *Panchayat* of about 750,000 rupees per year in 5 years time. This would correspond to about US$95 million for all *PanchayatsGram panchayats*.

Most *taluks* already have an engineer in place. The services of an accountant or social worker could be outsourced or staff already in place could receive special training related to their new roles. The services of these experts would be provided on demand and the project would facilitate their travel so that they could show regular presence at villages.

Service Delivery Monitoring System. The objective of this activity would be to regularly monitor the service delivery needs and the quality of service delivery at the *Panchayat* level. The state of Karnataka has put in place an annual survey in pictorial form to assess levels of poverty as an input in the identification of BPL households. While this follows GoI guidelines, the state government has expanded the survey to capture various human development indicators such as literacy, health, and others. This survey instrument would be further developed to collect information on a wide range of indicators covering health, education, housing, access to water, sanitation, HIV incidence, conflict, and others. Responsibility over the administration of this survey would fall with the Planning Unit of the District Government, although the GP itself would be expected to provide the information. But because there is an inherent conflict of interest in the GP since lower indicators might increase the amount of central and state resources made available, the district would closely monitor the administration of the survey. The results of the survey would be made widely available to rural people to allow them to make decisions regarding the performance of their local representatives (see B).

Training program for *Panchayats*. The training programs described below would be targeted at elected representatives and staff of *Panchayats*. Feedback and issues raised by participants in face-to-face training mode and through satellite will flow back to the Rural Development and *Panchayat Raj* Secretariat so that it becomes part of a process of change and improvement in the *panchayat* system with the active participation of all the stakeholders involved.

Table 2. Summary of Training Program for *Panchayats*

	Target Group	Content of Training	Mode
A	*GP elected representatives* (New elections will be held in 5,639 GPs across the state in 2005-06).	To understand history of *Panchayat* Raj, salient features of the 73rd constitutional amendment and the Karnataka *Panchayat Raj* Act, principles of reservation, rotation and roster, no confidence motions, Gram/Ward *Sabhas*, *Gram panchayat* meetings, budget, accounts and resource mobilization, Right to Information. It will also include sectoral issues of education, health, HIV, child care, nutrition, drinking water, sanitation and watershed development.	Satellite (10 days)
B	*GP re-elected representatives* (will also be available for new members upon completing the first training)	To understand issues in decentralization and development, as well as the status of human development in Karnataka.	Satellite (2 days)
C	Joint training of *GP Chairpersons/ Vice chairpersons and Secretaries* (Accounts)	To understand mutual responsibilities, problems and the need for conducive environment to discuss and sort out differences. Conducted in cascade mode by using available infrastructure facilities in the district and *taluk* levels and developing a cadre of district/ *taluk* Resource Persons.	Cascade (5 days)

D	*ZP/TP members* – 10 one-day modules	Modules will include: Decentralization and Development, *Panchayat* Planning & Budget, *Panchayat Raj* and Poverty Alleviation, *Panchayat Raj* and Water/ Sanitation, *Panchayat Raj* and Watershed Development, *Panchayat Raj* and Education, Child Labor, *Panchayat Raj* and Health, *Panchayat Raj* and Agriculture and allied subjects, *Panchayat Raj* and Social Justice, and *Panchayat Raj* and Information Technology	Satellite (one day a month)
E	*GP Secretaries*	focus on the importance of respecting the will, experience, wisdom and native knowledge of the people in designing and implementing development programs as opposed to the scheme based top-down approach currently followed. This training will also focus on the importance of transparency in government transactions and peoples' right to information about the variety of development programs initiated by different agencies in their areas. The overall objective of this training will be to enable the *Gram panchayat* Secretary to grow into a 'facilitator' for the *Gram panchayat.*	Satellite (2 days)
F	*Panchayat Engineering staff*	To understand and analyze the differences in implementation of development programs before and after the PRI system. It will also enable participants to analyze the social, economic and human effects of 'projects', the work that engineers do and the reasons why people approach engineers with a view to enabling engineers to be more people centric in the execution of development works. A separate 2 day training program in face to face mode for the engineering staff on *gram panchayat* budget and accounts. It will focus on the importance of elected members of *gram panchayats* being involved in actual measurement of work and its certification before the measurement is processed for payment in the form of bills. The training will familiarize participants with the salient features of the Karnataka Financial Code, the Manual of Contingent Expenditure, Karnataka	Satellite/ cascade (4 days)
G	*Collection staff* (*Gram panchayats* appoint Collection Staff, like Bill Collectors, Tax Inspectors, Office Assistants for collection of revenues).	To understand the sources of each revenue, the provision of rules and the procedure of levy and collection. It will familiarize them with the records/ registers that require to be maintained – for example, receipt books, day books, demand, collection and balance registers, remittance registers, assessment registers, mutation registers, etc. It will also provide opportunity for them to discuss the problems involved in maintenance of records and register.	Cascade (3 days)
H	*Watermen / Borewell*	One-day orientation which will cover (i) specification-	Cascade

	mechanics	wise maintenance of stock inventory with details of receipts and issues and closing balance of stock, (ii) importance of issuing or receiving stock only on approved indents.	(1 day)
I	*Audit staff*	To provide a understanding of the Karnataka Financial Code (Receipt Management, Expenditure Management, Budget Provision, Sanctions) and the Manual of Contingent Expenditure. It will cover the Karnataka Public Works Account and Departmental Code to explain rules relating to custody, maintenance and use o measurement books, nominal muster roles, work bills, work registers, contractors ledgers, use of machines – hire charges, etc. In addition it will cover the Karnataka Transparency in Public Procurement Act and the Karnataka Local Fund Authorities Fiscal Responsibility Act, Karnataka Right to Information Act.	Cascade (6 days)

In addition, there will also be training programs that will enable GP members to better understand poverty issues as well as having better access to centrally sponsored government schemes like SGSY. The details are summarized below:

	Poverty Alleviation and Rural Credit		
		Content of Training	**Mode**
A	Poverty alleviation – *GP members*	To enable participants to identify the interlinkages between poverty, nutrition, income, wages, control over resources and health. It will provide opportunity for participants to analyze existing government programs for poverty alleviation – programs that are employment related, housing related, nutrition related, water related and make an analysis of the strengths and weaknesses of existing programs.	Satellite (2 days)
B	Poverty alleviation – *SHG and CBO members*	To analyze the causes of poverty and examine inequities in access to resources, as also discrimination with reference to education, health, social practices, economic conditions and political participation. It will provide them opportunity to understand the processes of group/ collective formation through interaction with representatives of, for example, Mahila Samakhya. This training will also enable participants to understand the credit needs of the poor and the formal and informal banking systems in rural areas.	Satellite (2 days)
C	Management of SGSY / *SHG members*	To enable government functionaries understand issues involved in the management of self help groups – including inter alia the need to look at	Face to Face (5 days)

		rural prosperity as more than eradication of income poverty, encompassing gender and caste equality in education, health, nutrition, drinking water and food security. As in the case of the training program for self help groups, this training will also enable functionaries to understand the processes of collective action for social and economic change.	

Training of the magnitude envisaged will require the development of a variety of material on all aspects of development, be it agriculture and irrigation, animal husbandry and fisheries, watershed, industry, energy, housing, transport, education, health, drinking water and sanitation, etc. Gender and caste equity will be a cross cutting theme across all the material developed. A variety of material has already been developed as part of the literacy and continuing education program by a number of agencies, including among others, the State Resource Centre for Adult Education, Bharat Gyan Vigyan Samiti, Mahila Samakhya and other NGOs.

ANSSIRD will set up a Committee of Experts for identification of material to be prepared. The Committee will comprise writers, *panchayat* and NGO representatives, artists and designers. ANSSIRD will aim at providing a set of 50 titles to all *gram panchayat* in its effort towards promoting adult education and continuing education. ANSSIRD will also bring out a variety of charts, wall newspapers and posters in various aspects of poverty alleviation and development for dissemination to all *gram panchayats* In addition, to the existing film material, a series of films will be created inter alia on the following issues:

- *Panchayat* raj, poverty alleviation & food security – interlinkages between income, work, food, nutrition, health, HIV.
- Feminization of poverty – caste, gender and bonded labor
- Vulnerable groups in agriculture
- Poverty alleviation, credit and access to resources

The new film material will be developed through workshops. They will be derived from the experience of elected *gram panchayat* members, discussing and thinking about what they bring out, and considering lessons for one's own *gram panchayats*. The film will not be pre-scripted. There will be no expert lectures. The films will reflect the *lived* experience of elected *gram panchayat* members. Gender and caste equality will be a cross cutting theme. The format will include workshop discussions, individual interviews and dramatized plays. Wherever possible, NGOs will be involved in developing the film material.

To develop case study material for the training programs, ANSSIRD will take up an action research program. The case studies will develop best practices and guidelines for various aspects of *Panchayat* decision-making including:

- *Panchayat* functioning in all aspects;
- Effective community participation with reference to *Gram sabha*, Ward Sabha, functioning of committees
- Partnering amongst functionaries, *Gram panchayats* and people
- Planning and implementation
- Acts, policies, circulars, etc which are in existence but either not put into practice or not practiced effectively

- Constraints faced in effective decentralization – due to non-existent or conflicting Acts, policies, circulars, etc
- Attitudes, insecurities and related parameters in dual reporting by functionaries – to the elected bodies and to the parent departments.
- Attitudes, practices, beliefs w.r.t. existing provisions of reservation, gender equity, community participation w.r.t. *Gram sabha* / Ward Sabha, the politics / class / caste aspects involved at various stages
- Attitudes, practices, beliefs in partnering efforts between elected representatives, functionaries, community based organizations, NGOs and people – the essential requirement in decentralization
- Constraints faced due to lack of clarity / interventions by multiple tiers of the legislature and the executive viz. at the *Taluk Panchayat*, Zilla *Panchayat* and state level.
- Assessing the needs w.r.t. capacity building of all stakeholders mentioned above
- Innovative approaches in sectoral functions
- Formation of committees at *taluk* / District / state level to address the various issues arising during the project period and to take effective measures to translate the findings for the benefit of the whole state
- *Gram panchayat* functioning on various aspects viz. funds (block grants and tied) and management, community participation (*Gram sabha* / Ward Sabha), committees, reservation, tax collection, etc
- Development indicators in health, education, child care, primary sector, social justice, etc and their relation to the functioning of the respective sectors (including partnering with the *Gram panchayat* and the community)

Computerized Financial Management. This activity would help implement the new accounting and financial management system for *Panchayats*. It would finance computers so that all GPs would be computerized and would also assist with development of appropriate software. The roll over of cash to accrual accounting as envisioned by the State in the new Accounting Guidelines proposed for the GPs would be supported under this activity.
Environmental Guidelines. GoK has recently developed a strategy for addressing environmental issues at the state level (Karnataka State of the Environment). However, this strategy focuses on the industrial and urban sector and does not cover the rural sector substantively. Under this activity, an environmental framework for *gram panchayats* – referred as Environmental Guidelines – was developed. These Guidelines consist of a screening framework, an environmental assessment tool (OK cards), mitigation measures, applicable legal information and responsibilities at various levels. Adequate training / capacity-building for the implementation of the Guidelines has also been included.

(D) Building the Capacity of the State.

This component would put in place key mechanisms at the state level to enhance the states capacity to monitor, facilitate and guide the *Panchayat* system. It would include a Decentralization Cell in the Department of Finance, a *Panchayat* Monitoring System at the State level, special policy studies, strengthening ANSSIRD and Technical Assistance for the Restructuring of State Line Agencies.

The **decentralization analysis cell (DAC)** would be responsible for analysis, evaluation, monitoring, and development of the intergovernmental fiscal system. The unit will be essential in providing the basic analysis and intellectual leadership that will allow government to make its decisions about the system. At the time the State Finance Commission is constituted, the DAC may provide technical and data support to State Finance Commissions Secretariats.. This would improve the quality of inputs available to the work of the State Finance Commission, and thereby make its results far more satisfactory and make them more likely to be accepted.

While DAC would initially focus only on rural bodies it would be expected that at a later state it will also oversee the urban local governments. This is necessary because the vertical share of revenues for urban and rural local governments is drawn from the same pool of state funds, there are economies of scale in training and in EDP development, there will be uniform accounting rules, a fiscal information system will need to be maintained for all local governments, etc. Moreover, this would allow the state to think about all of its local governments in formulating expenditure assignments, taxing policies, and intergovernmental transfers. Urban and rural governments might end up receiving separate treatment, but this should be done in the context of the goals of the overall system of government finance. Finally, there is need to have a clear transition that leads to graduation of a local government from rural to urban status.

The DAC would have three tasks: monitoring the fiscal and service delivery performance of rural local governments; evaluating the performance of the intergovernmental fiscal system; and reporting to government and the public. Intergovernmental fiscal system means the finances of local governments (e.g., taxes, charges, expenditures, budgets) and the finances of the state government that effect the fiscal position of local governments (e.g., grants, shared taxes, payment of entitlements, regulatory policies, etc.). Duties of DAC would be as follows:

DAC will be responsible for leading the design of the system, overseeing the submission and correction of data each year, handling questions and providing technical assistance, and organizing the data in such away that it can be used by government agencies and researchers. DAC would carry out annual tracking of the fiscal performance and fiscal health of each local government. This will include budgetary outcomes in terms of spending and revenues raised, budgetary balances and shortfalls, tax effort, and the match between budget projections and actual outcomes. This tracking would rely heavily on data produced by the fiscal information system. This is discussed in detail in the following points:

Formula Evaluation. Whatever formula is put in place to distribute funds among eligible local governments, there is need to continuously assess the efficacy of this formula. For example, the questions that might be asked at every evaluation include whether the system is equalizing, whether there are unacceptable "outliers", whether it is encouraging or discouraging local tax effort, etc. The responsibility of the DAC will be to analyze and to propose adjustments to the formula to better achieve government objectives. This could be done on a regular basis, and could be a much larger effort when done every fifth year as part of the work of the State Finance Commission.

- *Monitoring of Compliance.* The State will lay down certain conditions as part of its fiscal restructurings, and it will be the job of the DAC to track the compliance with these conditions. For example, the state may require that property tax rolls be updated, and the DAC will examine data to determine the extent to which this has been done, etc.

- *Revenue Mobilization Analysis.* An important question that the DAC can help answer is whether local governments in Karnataka are increasing their rate of revenue mobilization. It can also provide analytic work that can point to why some local governments are doing better than others. As decentralization proceeds, local government revenue mobilization will almost certainly move higher on the agenda of policy goals of the state, and detailed information on local government tax effort will be needed. There is much interest in developing revenue sources for rural local governments. The DAC could produce an index of revenue effort and could track the change in tax effort over time. It could also evaluate alternative programs that were designed to improve revenue effort.

- *Best Practice.* Many local governments will be innovative under a decentralization system. The DAC could identify instances of best practice, evaluate these, and disseminate them to the sector.

- *Expenditure Assignment .* DAC could carry out continuing analysis of the efficacy of assigning certain functions to the *gram panchayat* level, relying for information on the monitoring of service delivery outcomes. This might include estimating the cost implications of reassignments of expenditures.

A second major function of the DAC is evaluation of the intergovernmental system. To what extent is the system achieving its objectives? What would be the impact of various reforms that have been proposed? It is a reasonable expectation that *Gram panchayats* will be changing in the future and the intergovernmental fiscal system will likely have to keep up with change. Hard analysis of the impacts of alternative proposed changes would be necessary to inform the decisions that the government must make. The following are some examples of evaluation work that the government will likely ask of DAC.

- *Expenditure Disparities Tracking.* A concern in Karnataka is the disparity in public expenditure levels among the 5,700 rural local governments in the state. The DAC could track this disparity on an annual basis and could model the determinants of these differences. An annual evaluation of fiscal disparities within the state would be an important responsibility of the DAC. For all *gram panchayats*, what is the variation in key indicators of fiscal activity among local governments? This would include per capita expenditures, per capita revenues raised, revenue effort, and the like. The goal will be to track the extent that the equalization grants of the state government and the central government reduces the fiscal disparities.

- *Annual "Intergovernmental Review".* Every year, the DAC could take the lead in preparing an intergovernmental review. It could be circulated widely, and could be the subject of an annual seminar. The basic purpose of this review would be to report on the state of sub national government finances in Karnataka, in a way that this information could be widely disseminated and understood. This would assist the state in building a better understanding of fiscal decentralization, and getting more participation from numerous public and private sector organizations in further developing the decentralized fiscal system. The first such review is scheduled for calendar year 2007.

- *Reporting.* An important function of the DAC is to report to the government and to the public. By increasing the flow of accurate and timely information, the DAC could play an important role in improving pubic policy towards decentralization and ultimately toward improving service delivery. Reports that DAC might issue regularly could include: (i) *An annual review of the intergovernmental system in the state.* This could be a volume that both described outcomes for the entire state, and offered in-depth analysis of particular issues. It would be a compendium of data and explanation. This would increase the transparency of the system, and might stimulate reform discussion both inside and outside government. (ii) *A website.* This could be used to present data for those who would examine the system (government agencies, lending agencies, researchers, etc.). It could also be the place where DAC research, best practice analyses, and assorted fiscal notes would be posted. All *gram panchayats* could not access (because of skill deficiency), but many of them could. (iii) *A research reports series.* This would be a periodic issue, depending on what research had been completed. The DAC would develop a list of "clients" to whom these reports might be made available.

The DAC may provide technical and data support to State Finance Commissions Secretariats., when the latter is functioning. Among the other possibilities are that the DAC could convene periodic seminars to inform government and others about a particular issue on which they have carried out research. It is important, however, that the duties of the DMU be kept within the bounds of policy research and that this unit not be folded into some other department

Staffing of DAC. A large overhead cost in the form of staff that does not have well defined functions needs to be avoided. However, the duties of the DAC could be considerable, especially if the urban as well as the rural sector is included in its mandate. Staffing would be as follows:

- *Director*: A senior person, capable of providing intellectual leadership to the team. Must know the subject matter, and must be very interested in it. He/she must be capable of understanding what every technical staff member is doing, be able to define the work program for the staff, and be research oriented. The Director also must be capable of presenting the work of the DAC in forum with higher-level government officers and political leaders. The success of the DAC will, to a large extent, be determined by the capability of the Director. The director will report jointly to the Departments of Finance and RDPR.

- *Staff members* (4), who will lead the specific projects as outlined above. These would be people trained at the master's level, preferably in public finance or with a graduate degree in a related field and commensurate experience in public finance analysis. These should all be research-oriented people with a background in research.

- *Senior staff* (1) who would be responsible for monitoring and upgrading the fiscal information system, and assuring that appropriate data from the system would be distributed to the FAU and to those in other institutions producing research on this subject. One IT staff will also be needed here.

- *Junior staff assistants* (5) who would be responsible for backing up the seniors. These would be younger people, but would be college graduates with appropriate backgrounds and would be candidates to grow into senior positions. These junior assistants would also be candidates for more training. Their duties in the DAC would be to carry out some of the basic research, under the direction of the senior to whom they are assigned.

The **Monitoring System for *Panchayats*** would cover both fiscal performance and service delivery aspects. The system will change as the needs and performance of local governments change, and as the goals of the state for its intergovernmental system change. But these changes need to be made in a thoughtful and measured way, and therefore need to be led by careful research, such as will come out of a monitoring and evaluation system. Underlying the monitoring system will be a fiscal information system. These are the basic data that will be used to quantitatively assess and update the performance of the system. The performance monitoring can only be as good as this database will allow. The following are likely to be the fiscal behaviors that are monitored:

- *On what functions do local governments spend their funds?* This will lead to an annual compilation of expenditure patterns of local governments. The basic question in which government is interested is whether local governments are actually spending to promote the development of basic services.

- *Assess changes in basic service levels.* This could be done either by setting a minimum per capita level of spending for each function and comparing this to actual outcomes in each GP, or by attempting to establish minimum (measurable) service levels in physical terms.

- *What is the progress of local revenue mobilization*? Have local governments increased revenues, expanded the base for each tax, and increased collection rates? This should be reported each period, based on data from the fiscal information system, and probably supported by data gathered from questionnaires for each GP.

- *Are certain local governments identifiable as being under particular fiscal stress*? This would allow preparing a remedial program for these local governments, and at a minimum would identify them as candidates for special assistance of one kind or another.

- *Have fiscal disparities been reduced, and to what is this reduction (increase) attributable?* The DAC will examine spending patterns for each GP, and will study the pattern of fiscal disparities and their pattern of increase or decrease, with an eye toward whether the intergovernmental transfer system needs adjustment in terms of the formula distribution.

- *Are intergovernmental transfers being distributed according to the formula, and are full entitlements being distributed?* In a sense this is the DAC monitoring the GOK in terms of its following through on distributing grants by the agreed formula.

- *If transfers are being distributed with some conditions, to what extent are the GPs meeting those conditions?* This would be done in conjunction with the line agencies imposing the conditions.

The service delivery monitoring system would complement the fiscal performance monitoring system. The underlying issue related to whether decentralization is "working" is whether citizens are getting better public services. The term "better" is a hard one to define. One could be conventional and ask whether there are improvements in the levels of services offered, quantity or quality, and look for physical measures. The DAC should do an inventory of services provided at the beginning of this period, and look for ways to update these physical measures as a way to identify the progress of service delivery under fiscal decentralization. For this it would make use of the Service Delivery Surveys administered by the District and which would be aggregated to the state level. The measures might include percent of housing units with access to various kinds of water supply, number of streetlights per capita, etc. But "better services" can also mean that people are getting more of what they want. And, this is the essence of fiscal decentralization; local populations are empowered to demand those services that they want.

Finding a systematic way of collecting the data for monitoring. The department of the *Panchayati* Raj in the state of Karnataka introduced a new survey to be administered by the *Gram panchayati* members in January 2004. This survey instrument is used to collect data on income, land holding, type of house, sanitation, assets, education, means of livelihood and debt levels. The purpose of the survey is mainly to create accurate lists of the citizens who are BPL.

This instrument could be used as a platform (means) to improve each *Gram panchayats* own data collection and monitoring as well as providing policy makers with accurate information. Over time, they could build a database (panel data) that would help them understand what their constituency looks like on basic indicators. They could also compare themselves against other neighboring *gram panchayats* on indicators of importance. In addition, more specific questions on standard economic indicators (income and consumption) as well as other human development indicators should be added to the existing questionnaire. This would serve as a powerful statistical tool to analyze causal relations.

It is important to note that the difficulty in the first round of this survey was that the interviewers (mostly *gram panchayat* members) were misinformed about the purpose of the survey. The confusion that this survey would be used to identify those eligible for benefits provided to the BPL must be rectified. Awareness about the purpose of this survey needs to be increased.

- *Conducting quality checks on the data.* The data that is collected by the *Gram panchayati* members should be verified on a regular basis. Since the sample size would be significantly large, random checks on the surveys should be carried out by DAC. A penalty should be instituted if inaccurate data is found. This would set a precedent for the other *Gram panchayats*. The form of the penalty could be monetary or something like publishing this information in the local paper.

- *Setting up a baseline for evaluation.* Given that the objective of the evaluation is to find out whether citizens who have access to block grants make better choices, a vignettes based approach can also be used along with citizen perceptions surveys, i.e., scorecards.

The baseline data will be collected by an independent group at the beginning of the project and at the end of the project thus creating panel data. A difference method can then be used to assess the impact.

This component would also support **policy studies** related to decentralization. These studies would be commissioned by DAC and would cover issues such as (i) strategies for enhancing local revenue generation at the *Panchayat* level; (ii) a review and detailed proposals on expenditure assignments, in particular in separating better the functions of the three tiers of *Panchayats*; and (iii) issue in service delivery in specific sectors.

Annex 5: Project Costs

Project Cost By Component	Local US $million	Foreign US $million	Total US $million
A. Block Grants	113.33	--	113.33
B. Capacity Building & Information Systems for constituents	1.4	0.03	1.43
C. Capacity Building at *Panchayat* Level	14.97		14.97
D. Capacity Building and State Level	3.0		3.0
Total Baseline Cost	132.70	0.03	132.73
Physical Contingencies	0.1		0.1
Price Contingencies	0.5		0.5
Total Project Costs[1]	**133.30**	**0.03**	**133.33**
Interest during construction	--		--
Front-end Fee	--		--
Total Financing Required	133.30	0.03	133.33

Annex 6: Implementation Arrangements

The project will support GoK to strengthen its decentralized systems of governance and improve efficiency of public expenditures and service delivery. In this project, the institutional and implementation arrangements are based on reforms that GoK has been implementing in this area over the past four years. Because of this, the project's institutional arrangements have been designed to utilize the existing structures and processes and avoid Bank project-specific units.

Governance

Key to improved governance is effective participation of constituents in determining the service investment priorities of their communities and, in ensuring that plans and their implementation based on these priorities proceed efficiently. Crucial to effective participation is knowledge about resources and programs available to the community. Also there is a need for an appropriate forum at which the constituents can express their preferences. As a result, the project supports information systems for constituents and ensuring the integrity of the *Gram sabha*. In addition, constituents must have representatives that understand both their roles in representing their constituents and in overseeing the public resources that are placed in their care. The project also supports capacity building for these purposes. The decisions that emerge from the *Gram sabha* provide an important basis for the monitoring program under the project. This ensures the integrity of the decision-making process. At the same time, information provided to constituents enables them to be part of the performance monitoring system on which the project relies.

Implementation arrangements

FC in RDPR Department. The FC in RDPR will assume overall responsibility for day to day project management and coordination. The FC will monitor project implementation, issue project reports, and prepare the Financial Management Reports for submission to IDA. The FC will ensure that project audits are done on time and as per specifications. In addition the FC will contract with the State Environmental Agency to assist with implementation of the transitory Environmental Framework and prepare an Environmental Framework for *Panchayats*. The FC will be staffed with a Project Coordinator, a Financial Management Specialist (with qualifications acceptable to IDA), and a Local Government Specialist. The FC will also monitor *Panchayat* conformity with Government Orders, in particular to those pertaining to the Financial Management and Accounting System and Planning Guidelines. The FC will provide TA to district, *taluk* and *Gram panchayats* on any matters related to the project that might arise beyond the capacity of the *Panchayats*. The FC will also assist *Taluk Panchayats* in assessing their human resources to ensure that at the minimum, each *taluk* is supported in areas of financial management/accountant, computer specialist, and social mobilization expert. Where necessary the FC would assist the *Taluk*s recruit these resources through staff transfers and deputation, or by outsourcing.

Department of Finance and RDPR. The Department of Finance would have overall responsibility over the Decentralization Analysis Cell (DAC). The Decentralization Cell will design and manage the Equalization Formula for transferring funds to *Panchayats*, will design and manage the Fiscal and Service Delivery Monitoring System for *Panchayats*, and also will carry policy analysis of specific aspects such as own revenues and others, and may provide technical and data support to State Finance Commissions Secretariats and will provide assistance to the State Finance Commission when it would start to operate. The Project Coordinator in FC will above would also be a member of the DAC. The DAC role with regard to the quality of service expenditure performance based on assessments of the application of fiscal resources and service delivery performance of *Panchayats* will be crucial to the ongoing improvement of service quality and *Panchayat* performance.

State Institute for Rural Development. The SIRD will have overall responsibility over the capacity building activities. It would run the Satellite Facilities, the distance learning programs, the face to face training, contract out the installation and equipping of the *Taluk* Resource Centers and maintain and operate these centers or ensure that *Taluk Panchayats* assume their O&M through appropriate agreements. The SIRD would also carry out special studies to generate information for the training programs.

District *Panchayats*. District *Panchayats*, through the District Planning Cell, would monitor the planning process of *Panchayats* to ensure that they follow the guidelines and, through *Gram panchayats*, would carry out annual surveys of service delivery and disseminate findings for all the *Panchayats* within the district. It would also collate the fiscal information from *Panchayat* accounts, and transfer the information on service delivery and fiscal performance to the Decentralization Cell.

***Taluk Panchayats*.** Technical support to *Gram panchayats* will be provided by RDPR by creating resource centers at the block/*taluk* level. This will also strengthen the capacity of districts to monitor service delivery at the *Gram panchayat* level. In addition it will conduct or contract out the following critical activities:

- information campaigns for constituents,
- TA to assist poor people's organizations;
- the implementation of the financial management framework and computerization of *Panchayats*;
- monitor the quality of GS and WS.

Taluk Panchayats, where agreed with the SIRD, would assume responsibility for O&M of the *taluk* resource centers. The *taluk* centers would be a space for training activities, for hosting the *taluk* experts, and for receiving *Gram panchayat* members for consultations and business. Each *taluk* would be equipped with services of at least an engineer (to review technically more complicated *Gram panchayat* infrastructure projects and carry out the initial environmental screening), an accountant (to review the extent to which *Gram panchayats* are following the Financial Guidelines, to provide assistance on the matter where needed, and to collate *Panchayat* accounts at the block level for transfer to the district), and a social specialist (to assist *Panchayats* where the planning participatory process and mobilize the poorest and vulnerable groups to attend *Gram sabhas* and Ward *Sabhas*).

***Gram panchayats*.** *Gram panchayats* will make expenditure decisions as per the Activity Mapping and the annual plans to be implemented following the new Planning Guidelines and in a participatory and open manner. The plans would consist of activities related to service delivery and could include both capital expenditures and recurrent costs, but they would need to be consistent with the Activity Mapping. For capital expenditures they would also implement the subprojects (by contracting out or relying on community groups) and where necessary assume O&M responsibilities (if not assumed by communities). GPs would maintain accounts send reports to the *taluk* offices. They would also carry out annual service delivery surveys under the oversight of district *Panchayats*. GPs would undergo extensive training and sensitization to ensure that they have the capacity to carry out their responsibilities under the project.

Gram and Ward *Sabhas*. Gram and Ward *Sabhas* would be the instrument of *consultation and* accountability to the people. These would be carried regularly as per guidelines and would approve plans and budgets of GPs and review the GP performance. The social specialist at the *taluk* level would ensure ample and active participation of the poor and vulnerable in Gram and Ward *Sabhas*.

Annex 7: Financial Management and Disbursement Arrangements

I. Summary Project Description

The Financial Management arrangements envisaged under the project can be said to be satisfactory to meet the requirements of the Bank's OP/BP 10.02. The project will be an IDA credit of US$ 120 million which will be disbursed over 5.5 years. Support under the project will follow a dual approach of programmatic support (for Component A: Block Grants to *Gram panchayats* comprising US$ 113 million) and traditional investment lending (for Component B, C and D comprising US$ 20 million). The four project components will be:

Programmatic A. Block Grants to *Gram panchayats* (GPs)

Investment B. Information Systems for Constituents

C. Capacity Building of the *Panchayats*
- C1. Creation of GP resource centers called *Taluk* Resource Centers (TRC)
- C2. Training programs for GPs through ANSSIRD, Mysore
- C3. Computerized financial management systems for GPs;
- C4. Environmental framework for GPs;
- C5. Establishing SATCOM Centers in North Karnataka and in Bangalore

D. Capacity Building of the State [setting up of a Decentralization Analysis Cell (DAC)]

Implementation of all components will be coordinated through the FC in the RDPR. There will be a Financial Management Specialist (FMS) at the FC who will be responsible for maintaining project accounts and submitting these to audit. Disbursement on both components will be FMR based. These FMRs will comprise AFS for both components and will be maintained at the FC. The FMRs will record actual expenditures for the investment component and transfers for the programmatic component.

In addition, the programmatic component will be governed by a fiduciary framework comprising (i) directives from RDPR instructing GPs to spend BG funds only on eligible activities which will be detailed in the OM, (ii) appropriate approval procedures to ensure that the proposed uses of BGs are approved by the *Gram sabha* and confirmed by RDPR before BG funds are released, (iii) directives from RDPR ensuring roll out of the FM reform program and to address the appropriate accounting of BG funds in the books of the GP and (iii) assurance on use of funds. The primary responsibility for monitoring that BGs are disbursed and accounted for in accordance with the fiduciary framework will be with RDPR while the requirements with regards to audit and assurance on end use will be also be monitored by IDA. Failure to meet assurance requirements will result in disallowances, while inadequacy on other aspects of the fiduciary framework will result in penal action from the RDPR wherein the defaulting GP will be ineligible for receipt of BG funds. Audit of the project's AFS will be done by private auditors under an agreed ToR. In addition, IDA will monitor the KSAD audit of the GPs receiving BGs. An additional internal audit on a random basis will also be undertaken by a private firms of Chartered Accountants which will be selected from amongst a panel of firms created by RDPR in consultation with KSAD.

II. Implementation Arrangements

FC within RDPR will be responsible for overall project implementation. The FC will monitor all project activities, submit claims of expenditures of all the PIAs, prepare FMRs and ensure that these are submitted to audit in a timely manner and ensure that project expenditures are subject to the appropriate controls. The detailed arrangements on the programmatic and investment components will differ and these are set out below:

A. Implementation arrangements on Component A - Programmatic BG Component

The FC will be responsible for implementing this component. FC will recommend transfer of BG funds to GPs, record these in AFS of the project and monitor corresponding GoK transfers. This component will be governed by a fiduciary framework comprising (i) Directive from RDPR to GPs saying the BG funds may only be spent on eligible activities[12] which will be detailed in the OM,. (ii) Approval procedures ensuring that the proposed uses of BGs are approved by the *Gram sabha*. RDPR will confirm that proposed uses were properly approved by the *Gram sabha* before release of BG funds for new works; (iii) Directives from RDPR ensuring roll out of the FM reform which will in turn ensure the appropriate accounting of BG funds in the books of the GP and (iii) Assurance on end use of BG funds through audit and social accountability mechanisms. All the requirements on the fiduciary framework will be monitored by the FC at RDPR which will have overall oversight responsibility for this component. But, it is important to mention that the GPs themselves will be responsible for ensuring that funds received are used for the intended purposes. Intended purposes for use of BG funds will constitute the improvement and expansion of services under any of the 29 items devolved to the GPs by GoK.

Inadequate assurance on the end use of BG funds will result in disallowances. KSAD audit will certify that funds greater than or equal to BGs have been spent on agreed activities. It has been agreed that disallowances will be either adjusted, or deferred or as a last resort, refunded to the Bank. GoK will follow its procedures for recovery in such cases.

Inadequacy on other aspects of the fiduciary framework (inability to adopt FM reforms, account appropriately for BG funds or failure to get the BGs approved by the *Gram sabha*) will result in rendering the defaulting GPs ineligible for receipt of BG funds. It is important to mention that GoK will in turn, use its own transfers of block grants over and above the statutory requirements to GPs as an incentive for ensuring that the following steps have taken place:

(i) Rolling out of FM reforms : New Planning Guidelines, New Accrual Accounting Systems by FY 2007
(ii) Conduct of (two annual) *Gram sabhas* (GS: village meetings) and approval of proposed use of BG funds in each of the GS'

[12] Eligible activities will be improvement and expansion of services as defined by the 29 activities that are devolved by GOK

(iii) Public disclosure of FM and Procurement information

State government will maintain financial commitment to *Gram panchayats* as per formula agreed with IDA and will release funds periodically and in a timely and predictable way in accordance with this commitment. State government will ensure that its own SFC releases to the GPs are transferred each quarter as appropriate. (This is also mentioned in Section 9.6 of the Operational Manual).

For purposes of assurance, IDA will monitor GoK transfers of SFC funds to GPs and end use of BGs. Assurance on GoK transfers will come from audited FMRs which will show block grant transfers from GoK to the GPs[13] while assurance on the end use of BGs (that they were used for the purposes intended) will be evident from the GP wise annual audit reports issued by KSAD. Internal audits on use of BG funds will provide secondary assurance on use of BG funds. Together the KSAD and internal audits will show whether funds equal to the IDA's contribution have been used on the list of activities agreed with GoK. Additionally, the use of social accountability mechanisms (like social audits, regular *Gram sabhas* and publication of GP accounts) will strengthen assurance. The FC will monitor both KSAD and AFS audit will respect to this component. FC will also liaise with KSAD on a regular basis to ensure that the GPs receiving BGs are audited in time. In case there is a shortage of staff at KSAD, the FC will flag this to RDPR and as agreed with Ministry of Finance (GoK) ensure that capacity is augmented through private auditors as has been agreed under the SFAA follow up action plan.

B. Implementation arrangements on Components B, C and D - Investment Components

The FC within the RDPR will be responsible for the implementation of Components B, C and D of the project through PIAs which will be TP which will be responsible for building the *Taluka* Resource Center (TRCs) buildings and empanelling consultants for FM reform, *Gram panchayats* (GPs) which will be responsible for procuring computers for themselves in order to implement new accounting method and ANSSIRD which will be responsible for building SATCOM centers and for equipping these. The FC will be the accounting centre for the purpose of the project. It will allocate spending limits to the TPs, GPs and ANSSIRD on the basis of annual work plans. TPs will make payments through the Treasury while GPs and ANSSIRD will make payments through their respective commercial bank accounts.. All goods, works and services will be paid for and received by the PIAs. Expenditure reports generated by the PIAs will be sent to the FC monthly and based on these the FC will prepare project's annual financial statement.

Control on expenditures will be exercised through the oversight arrangements at the PIAs: the TPs, GPs and ANSSIRD wherein it will be ensured that all payments are approved in keeping with the prevailing delegation of financial powers in the state of Karnataka. All project payments will be made in accordance with the Karnataka Financial Code.

In addition the FMS at the FC will exercise control on the payments, and ensure that the state government financial rules and procedures applicable to that entity are followed. The FMS at FC will be responsible for ensuring that all state government financial rules applicable to the expenditures are followed, a robust control environment is in place expenditure reporting is timely and adequate and the claims are submitted in time.

The roles and responsibilities of the PIAs are laid out below:

[13] GoK transfers to GPs will be considered on a net of deductions and intercepts basis.

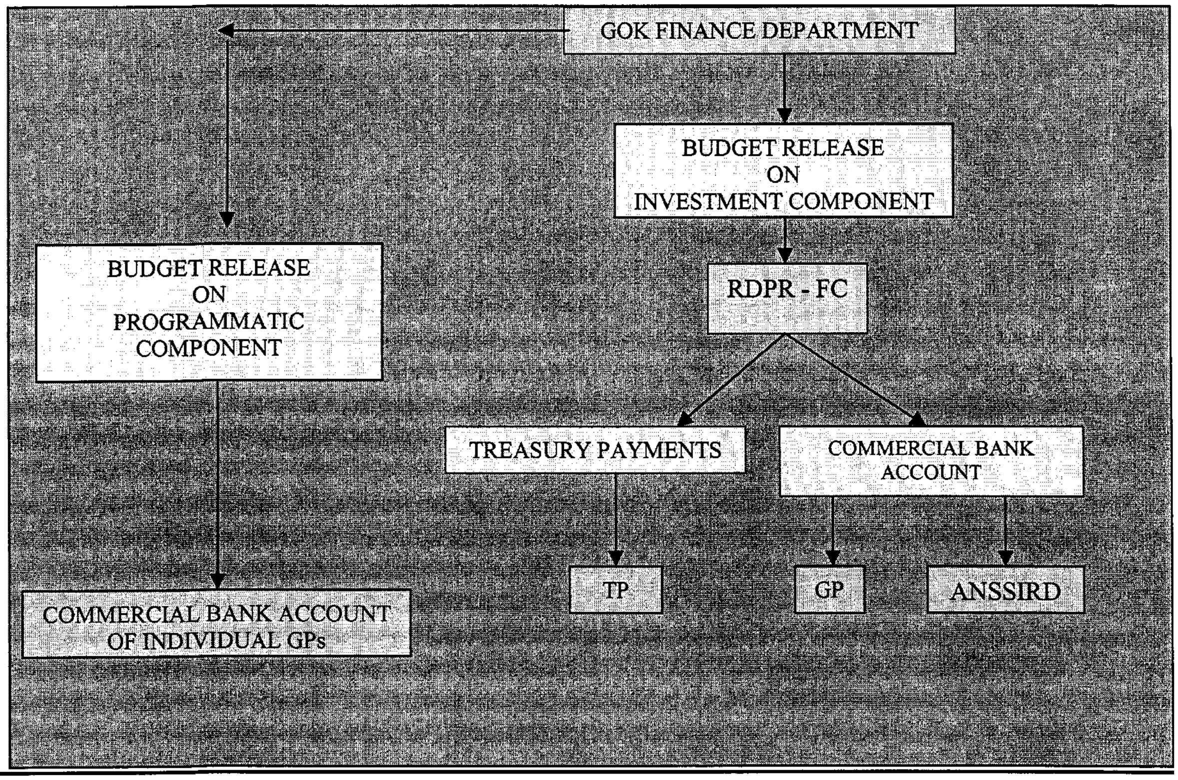
1. TPs will be responsible for civil works expenditures on the construction of TRCs and for the empanelment of consultants to roll out FM reforms. The expenditures on civil works will be made in accordance with the prevailing Public Works Department rules. RDPR envisages no expenditures on account of empanelment of the TRC Accountants. The TPs will be responsible for providing guidance to the GPs on contracting procedures to be used for hiring TRC Accountants. The Accounts Superintendent at the *Taluka* will be responsible for rendering monthly accounts to the FC and ensuring that all the applicable state government procurement procedures are followed.
2. GPs will be responsible for their own computer hardware purchases. A list of empanelled vendors, required specifications and necessary procurement rules will be passed on to the GPs. The GPs will select computers and come to the Chief executive Officer ZP or an officer designated by him for certification. Approval will be accorded within 30 days of the proposal failing which the GPs can purchase as per the guidelines. GPs will make payments through their bank accounts.. The TPs shall maintain and compile accounts of the GPs' expenditures on hardware and report to the FC for consolidation and audit purposes.
3. ANSSIRD will be responsible for construction of the SATCOM centers and procuring equipment for these. The Director at ANSSIRD will be allowed to issue payments from the FC's Bank account to the consultants and contractors for project expenditures. It will also be his/her responsibility to ensure that monthly expenditure statements are submitted to FC and that all procurements are in accordance with state government procedures.
4. The State government officer who is assigned to DAC will be allowed to draw moneys from the FC account for research and other project related expenditures. Control on these expenditures will be exercised by the Secretary Finance or designated authority. The officer in charge at DAC will submit monthly expenditures and supporting documentation to the FC.

The FMS will prepare project accounts (which will also be FMRs) based on expenditure reporting by the PIAs. It will be the responsibility of the FC to liaise with the PIAs on the timing and nature of expenditure reporting required. FMS will submit FMR-based claims on the basis of the expenditure reports. Supporting documentation in respect of project expenditures will be maintained by the individual PIAs. These expenditures and the relevant supporting documents will be examined during the audit of the annual financial statements of the project. It will be the responsibility of the FMS at the FC to ensure that the audit of AFS is timely, that the audit of expenditures at the different PIAs is carried out and that the physical verification of assets created at different levels is carried out.

Implementation and Fiduciary Arrangements						
I. Programmatic (Block Grant) Component						
Implementing Entity	Accounting	Audit	Procurement of goods/ works & services	Controls/ Fiduciary Framework	Reporting to PMU	Reporting to Bank
GPs	Use of BG Funds will be recorded in the book of GPs. Transfers of BGs will be recorded in AFS of project and in the books of GoK	Audit of GP books by KSAD Internal audit of a sample of GP's by a firm of private auditors. Audit of AFS at FC (including the expenditures by PIAs) to be done by private auditors.	GPs responsible for all procurement	RDPR will issue directives about eligible activities that BG funds can be used for which will be detailed in the OM. Proposed uses of BG's must be vetted in *Gram sabha* meetings. KSAD and internal audits will verify uses of BG funds	*Gram panchayat*	FC
II. Investment Component					Reporting	
Implementing Entity	Accounting	Audit	Procurement of goods/ works & services	Controls/ Fiduciary Framework	Reporting to FC	Reporting to Bank
GPs, TPs , ANSSIRD which are Project Implementing Agencies (PIAs)	In the AFS at FC based on expenditure reports submitted by GPs, TPs and ANSSIRD and verification of records at the different PIAs as neccssary	Audit of AFS by private auditors	PIAs	FMS at FC and through controls in place at PIAs	PIAs	FC

III. Funds Flow Arrangements

Brief Overview of Funds Flow



GoI will open a Special Account (SA) in Reserve Bank of India (RBI) to receive disbursements from the Bank. The SA will be operated by the Comptroller of Aide Accounts and Audits. The funds transfer from GoI to GoK will be decided in accordance with the GoI decision on funds transfers for Externally Aided Projects (which has not yet been announced).

At the beginning of year one, the Bank will advance the first six months' expenditure to the SA, thereafter reimbursements will be made every six months based on audited FMRs. On the investment component, the FMRs will report and fund actual expenditures while on the programmatic component transfers will be reported and funded.

The project will be budgeted as two single line items in GoK's budget. The Block Grants will be budgeted as a Capital head of expenditure under appropriate guidance from National Government Accounting Standards Board (GASAB) and the Comptroller and Auditor General (CAG) The budget codes of these expenditure heads will be decided at the time of budget preparation by GoK. The investment component expenditures will be reported another budget line item in accordance with the pattern for other externally aided projects.

GoK will provide advance funds to commence the project. At the beginning of each year, the allocation to the RDPR under the respective heads for the investment and the programmatic components would be made available to the FC. Thereafter, FC shall transfer programmatic funds to the bank accounts of the

GPs, release spending authority to TPs to spend through the Treasury and to ANSSIRD and GPs (for hardware) through their bank accounts.

IV. Staffing

A. At the State Level

The FC at the RDPR will be headed by a Project Coordinator who will report to the Secretary RDPR. In addition, there will also be a Financial Management Specialist (FMS) with qualifications acceptable to IDA. The PC and FMS staffed positions will remain in place throughout the life of the project (This will be a financial Covenant). In addition, the Accounts Superintendent at the TP, Secretaries at GPs and the Accounts Superintendent at ANSSIRD will be responsible for maintaining and submitting expenditure reports and relevant supporting documentation of project funds expended by their respective agencies. The TP- CEO, GP-Sarpanch and the ANSSIRD-Director will be responsible for exercising control on expenditures.

B. At the Village Level

At the village level, the Secretary, who is an official of the State Government is deputed to the GP and is routinely responsible for all the financial and administrative matters will also account for the BG money. All project funds will be in the nature of Block Grants (for the specific purpose of improvement and expansion of services) and will be accounted for within the existing accounting, reporting and audit framework of the *Gram panchayats*.

V. Accounting Policies and Procedures

A. At the State level

<u>In the books of GoK</u>: In respect of the accounting treatment of the proposed Block Grants from GoK to PRIs through the project (capital vs revenue) in the books of the state, a clarification has been sought by GoK from the GASAB, which is housed in the Office of the CAG of India, through the Principal Accountant General of Karnataka. The GASAB and the Principal Accountant General are yet to revert back with an opinion on whether the Block grant can be treated as capital and revenue expenditure in the books of the State government. Pending a final clarification from the authorities concerned, it was agreed that GoK would continue with the existing accounting treatment of such block grants in its Books and thereafter will revise the accounting treatment, if required, on the basis of final advice received.

Other than TRC construction civil expenditures which will be reported with the Block Grants, all other investment component funds will be shown as a separate budget line item in the books of the state. The code under which these will be booked will be decided at the time of budget preparation.

<u>In the Project Financial Statements</u>: At the state level, the FMRs which also will be AFS will be used to account for both the BGs and the investment component funds. The AFS will be Statements of Sources and Uses of Funds prepared on Cash Basis. For the BG component, the AFS will show transfers from GoK to the GPs and also the transfers on account of Bank contribution. For the investment component, the AFS will account for actual expenditures. For the investment component, all expenditures reported in the AFS will be tallied with the expenditures booked in the accounts of the entities receiving project funds. For the BG component, the FMS at the FC will be responsible for ensuring that transfers reflected in the project AFS are tallied with the transfers shown on account of GoK will be tallied with the Transfers as per state accounts. The Bank's BG transfers will be tallied with the relevant account head in the books of the State government.

B. At the village Level

The accounting arrangements at the village will be mainstreamed. The GP accounts as mandated by the Karnataka PRI Act will account for the BG funds received as well.

VI. Internal Controls

Controls on the Investment component expenditures will be exercised by the FMS at the FC and through the prevalent state government controls on expenditures through TPs, GPs and ANSSIRD. The persons responsible for making project expenditures will be the TP-Accounts Superintendent S, GP-Secretary and ANSSIRD Accounts Superintendent, while the responsibility for oversight will be that of the TP-EO, GP-Adhyaksha and ANSSIRD-Director.

Controls on the BG funds will be through the fiduciary framework that is put in place in this project. This framework will ensure that directives from the RDPR regarding the eligible expenditures for use of BG funds, that regular *Gram sabhas* are held to document the proposed uses of BGs; that there are approval procedures in place which ensure that BGs are proposed to be used only for the extension and expansion of services as envisaged under the 29 items devolved to the GPs.

Additional fiduciary reviews of a sample of GPs receiving Block Grants will be undertaken by a firm of private accountants periodically during the implementation phase. The purpose of these reviews will be to provide additional assurance of the controls at the GP level and recommend strengthening actions if required. RDPR will create a panel of CA firms in consultation with KSAD from which the reviewers will be selected. This panel may be either at the district level or at a regional level[14] to conduct these special reviews in which both financial management and procurement will be covered at the GP level.

For the purposes of monitoring, capacity building and assurance on end use of BG funds, the RDPR will monitor the Consolidated audit report of GPs receiving Block Grants audited by Karnataka State Audit Department (KSAD).

VII. External Audit

For fiduciary purposes the following report will be received by the Bank and monitored in audit report compliance system:

Audit of FS)/ FMRs (all components). These will be audited by a firm of private Chartered Accountants.

[14] GoK will develop criteria for selection of the audit firms and TORs describing the scope of the audit to be conducted.

VIII. Risk Analysis

Risks	Risk Rating	Risk Mitigation Measures
The Department of Finance may intercept the entire funds as GP dues	M	a) Transfers to GPs will be monitored by the FC and also by IDA during Supervision Missions; b) RDPR has assured the Bank that SFC transfers to BGs will be effected without intercepts at the Finance Department
Inherent weakness in the accounting and financial reporting systems in the PRIs lead to a risk of misuse of funds that may not be detected and accounts may not be maintained properly	H	c) Ongoing and agreed financial management improvement measures by GoK will be closely monitored over the implementation period to ensure that action plans are followed. d) KSADs annual report on the GPs will be reviewed by IDA and will provide assurance; e) In addition to the KSAD audit of GP, GoK will engage CA firms to conduct annual audits of GPs on sample basis, in 5 selected districts each year; f) Fiduciary risk reviews will be carried out IDA in consultation with GoK in Years 1 and 2 of the project and later if need be.

H – High, S – Substantial, M – Modest, N - Negligible

Overall FM risk is **High**

IX. Strengths and Weaknesses

1. Strengths

The project has the following strengths in the area of financial management:

a) Karnataka being a revenue surplus state there should not be any fund flow problems.
b) New accounts, audit and works manual for GPs has been prepared and approved by GoK.

2. Significant weaknesses

Significant Weaknesses	Mitigation Measures
The capacity of GPs for book-keeping and accounting is limited. They will need support in maintaining the books of account.	The following steps built into the project design will ensure that an adequate financial management system is in place: (i) Proper, simple financial management and accounting manuals are in place; (ii) The TRC which will include a professional accountant will be created at each *Taluk* to provide assistance to the GPs on demand (iii) Institutional arrangements for social audits at the village level will provide the framework needed to ensure that there are checks /balances and transparency in the operations.

X. Country Issues

The generally weak financial management environment at the GP level is a cause for concern. This will be mitigated through the capacity building and FM reform components.

XI. Reporting and Monitoring

The project will provide FMRs on a six monthly basis. These will be the same as the AFS for the project. For the BG component the FMRs / AFS will report on transfers, on the investment component they will contain a break up of sources of funds and uses of funds by project activities.

XII. Disbursement Arrangements

Disbursements from IDA credit will be made based on 6 monthly FMRs. The FMRs will reflect actual expenditures for the investment component while for the BG component they will reflect transfers to the GPs.

On the Investment component, the Bank will finance actual expenditures that are made on project components B, C and D as reported in the FMRs.

On the programmatic component, the Bank will finance transfers to the GPs. In year one of the project, Rs. 800,000 per GP for each of the 1,343 GPs in the poorest 39 *Taluka*s of state will be disbursed as Block Grant. From year two onwards the transfers will be based on a formula that will be determined by the DAC under the guidance of RDPR. The Bank's funding will be contingent on GoK's transfer of Rs. 500,000 per GP per year as mandated by SFC. It is agreed that RDPR will transfer the SFC commitment without any intercepts in four equal tranches. Accordingly, programmatic component BG funds will be released on a quarterly basis. In case the GoK releases are not made for even one of the two quarters, Bank BG funds will also not be released. All program expenditures / transfers reported in the FMRs will be subject to confirmation/certification by the annual audit reports.

Any discrepancies between the amounts of grants in aid reported by the FMRs and those reported in the annual audit reports will lead to adjustments of subsequent disbursements, to be recovered or reimbursed to GoK, through the next disbursement in the following schedule. A tentative disbursement table has been mentioned below.

Tentative Disbursement Schedule

Expenditure Period	FMR Due	Disbursement	Audit Due	Adjustment	GOK Financial Year
Oct '06 - Mar '07	May '07	Advance Sept 06	Sep '07	June '08	2006-2007
Apr '07 - Sep '07	Nov '07	Dec '07	Sep '08	June '09	2007-2008
Oct '07 - Mar '08	May '08	June '08	Sep '08	June '09	2007-2008
Apr '08 - Sept '08	Nov '08	Dec '08	Sep '09	June '10	2008-2009
Oct '08 - Mar '09	May '09	June '09	Sep '09	June '10	2008-2009
Apr '09 - Sep '09	Nov '09	Dec '09	Sep '10	June '11	2009-2010
Oct '09 - Mar '10	May '10	June '10	Sep '10	June '11	2009-2010
Apr '10- Sep '10	Nov '10	Dec '10	Sep '11	June '12	2010-2011
Oct '10- Mar '11	May '11	June '11	Sep '11	June '12	2010-2011
Apr '11- Sep '11	Nov' 11	Dec '11	Sep '12	June '12	2011-2012

Key Disbursement Issues:

1. In order to ensure that BG funds are used appropriately and to allow time for adjustment of used funds or funds that were not properly used, there will be no BG disbursements in the last six months of the project.
2. GoK has opted for a model of disbursement wherein a default by GoK on its statutory SFC grant to the PRIs will freeze the Bank's transfer of BGs completely. Since there have been slippages in the GoK transfers of SFC mandated funds to GPs in the remote past, tying Bank disbursements to the absolute level of transfers places a large responsibility on GoK for timely and committed flows and also predicates Bank disbursements on these. The possibility of preparing a calibrated scale of disbursements (ie. Bank matches % GoK SFC mandated disbursement with proportionate transfers) was also discussed with RDPR but this was not acceptable to GoK.
3. The FC will have to be very stringent in monitoring the fiduciary framework for the BG component. In addition to the fiduciary framework, the GPs are required to fulfill certain other conditions as well on financial management reform, acceptance of planning guidelines and public display of FM and procurement information before GoK funds are released to them. Therefore, if the GPs default on this they will be ineligible for any additional funds from GoK.

XIII. Supervision Plan

From a financial management perspective, the project will need intensive supervision. The focus during the supervision will be on monitoring the timeliness of the fund releases to GPs, improvements in the accounting and financial management systems at the GP level, effectiveness of the capacity building plans, timeliness of the financial reporting by the various accounting centers under the project, adequacy of the financial monitoring reports, timeliness of submission of the audit reports etc.

Annex 8: Procurement

A. General

Procurement for the proposed project would be carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004; and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, and the provisions stipulated in the Legal Agreement. The various items under different expenditure categories are described in general below. The project would mainly finance grants [block grants] to the *Gram panchayats*. More than 80 percent of the project cost is expected to finance the block grants to the *Panchayats*. Another important component is building the capacity of *Panchayats*. The block grants and capacity building of *Panchayats* together account for almost 95 percent of the project cost. The major component being block grants there will not be a procurement plan which is a requirement under investment projects, though the operations manual for the project specifies annual plans to be prepared at the beginning of each year and implemented in a participatory and transparent manner.

However, small amounts of the credit would be utilized for financing consultancies and procurement of goods / equipment for capacity building and other purposes. The procurement plan for the first 12 months is prepared for these activities.

The project would also support construction of *Taluk* Resource Centers (176 Nos.) estimated to cost Rs.2,200,000 per centre and procurement of goods and equipment required for capacity building such as, audio-visual equipment, training materials, office equipment such as computers, copiers, vehicles, furniture, etc. These are very small contracts costing less than USD 100,000 and no ICB contract is expected under the project. However, if needed, ICB contracts and international consultancy would be procured in accordance with the Procurement Guidelines mentioned in Para A above. The threshold for ICB Goods will be USD 2 million per contract.

The procurement procedures would be as follows:

Works and Goods

NCB: The Government of Karnataka has embarked on a programme of reforms in public procurement. In Karnataka, the Government of Karnataka has enacted "The Karnataka Transparency in Public Procurements Act, 1999". The Act prohibits procurement other than by invitation of tenders. As mentioned below the Government of Karnataka has fixed thresholds above which the Act will be applicable. The project has adopted the same thresholds. The Government has also issued rules and circulars under the Act. The Act provides for –

- (i) Open invitation of bids;
- (ii) Adequate time for bidding period;
- (iii) Public opening of bids;
- (iv) Evaluation to be on the basis of responsiveness to the bidding documents;
- (v) Mechanism for handling complaints.

The Government of Karnataka have also issued guidelines for specifying qualification criteria, evaluation of bids etc.

The major difference between the accepted NCB procedures in other Indian projects and the procedures under the Karnataka Act relates to:

(i) Allowing two cover system;
(ii Conducting negotiations; and
(iii) DGS&D Rate contracts are acceptable as substitute of tendering.

In view of above for the purpose of NCB the procedures followed under Karnataka Transparency in Public Procurement Act, 1999 will be followed under the project except the above three provisions which differ from Bank's accepted procedures under NCB. The DGS&D rate contracts will however be acceptable as substitute for shopping procedures. This will have twin advantage – First, the procurement capability and procedures established during the project will be sustained even after the project is over. Secondly, we will be able to align the project with the procurement reforms underway in the State.

GPs using block grant monies, goods estimated to cost more than $2,100 equivalent per contract, and works estimated to cost more than $4,200 equivalent per contract, may be procured under contracts awarded on the basis of NCB using the procedures under the Karnataka Transparency in Public Procurement Act of 1999 (as amended) and the additional provisions agreed between the Borrower and the Association in writing from time to time. Otherwise, goods and work estimated to cost more than $30,000 equivalent may be procured under contracts awarded on the basis of NCB.

The bidding documents developed by the Government of Karnataka, will be used for NCB. These documents are based on the World Bank New Delhi Office documents. There is no reference to World Bank finance in the document. This will be added. However, for contracts above Rs. 5 million, the documents are based on two cover system. Since the two cover system is not acceptable, the W-2 document of the World Bank will be used in case there is any contract above Rs. 5 million.

Shopping: For GPs using block grant monies, goods and work estimated to cost respectively less than $2,100 and $4,200 equivalent may be procured under contracts awarded on the basis of Shopping. Otherwise, goods and work estimated to cost less than $30,000 equivalent may be procured under contracts awarded on the basis of Shopping.

Direct Contracting: Goods and works which the Association agrees meet the requirements for Direct Contracting may be procured in accordance with the provisions of said procurement method. Contracts above $10,000 equivalent will require prior clearance from the Association.

Community Driven Procurement : Works such as Water Supply, Forestry, Plantation, Sanitation, etc., maybe carried out by the community, in accordance with procedures described in Operational Manual.

Force Account: Works which the Association agrees meet the requirements for Force Account may be carried out in accordance with the provisions of said procurement method.

Consultancy Services and Training:

The consultancy services required under the project mostly relate to hiring NGO services and individual experts, services for Monitoring and Evaluation, environmental agency. ANSSIRD will also require some consultancy services for training purpose. The procurement procedures for consultancy services required for the capacity building and other purposes would be procured in accordance with the Consultancy Guidelines mentioned in Para A above. These are Quality and Cost Based Selection, Quality Based Selection, Selection under Fixed Budget, Least Cost Selection, selection Based on Consultants' Qualification, Single Source Selection, Service Delivery Contractors and Individual Consultants.

The short list of consultants for contracts upto USD 500,000 equivalent may comprise entirely national consultants as mentioned in Paras 2.6 and 2.7 of the Consultancy Guidelines.

The project supports substantial capacity building program for *Panchayats* and other stake holders. RDPR is the nodal agency for the implementation of the project. ANSSIRD as a division of RDPR will play a key role in implementing the capacity building component of the program. The Institute has been designing and conducting training programmes, that provide an environment for participants to reflect, share experiences, discuss, debate and analyze situations with a view to creating an openness for change. The ANSSIRD has also satellite centre comprise a studio and earth station. In 2002-2003, ANSSIRD conducted training and communication programmes for *Gram panchayats* using a unique mix of modern satellite technology coupled with participatory training techniques which covered about 1,300 *Gram panchayats*. As such ANSSIRD is uniquely qualified for conducting capacity building programmes for *Panchayats*. The capacity building would include various sectors, such as managing resources, collecting revenues and delivering services. In total, about 5,500 local governments (district, zila and *gram panchayats*) and 100,000 elected representatives would be involved in the capacity building exercise. The ANSSIRD are not acting as consultants, but as in-house mechanism for implementation of training programme. The training would also be imparted to district and *Taluka panchayat* members, *panchayat* engineering staff and other stake holders. A capacity building plan, including that for financial management and procurement will be prepared by Government of Karnataka by August 31, 2006.

B. Procurement Responsibilities and Capacity

Institutional and Implementation arrangements:

The Rural Development and *Panchayat Raj* Department (RDPR) of the Government of Karnataka would be the primary agency responsible for project implementation. There will be Facilitation Cell (FC) in the RDPR department. The FC will be responsible for day-to-day project management and coordination. There will also be Decentralization Analysis Cell (DAC)] in the Finance Department. The DAC will design and manage the transfer of funds to *panchayats*, will carry out policy analysis etc. The Project Coordinator in FC will be a member of DAC. The capacity building will be the responsibility of ANSSIRD. District *panchayats* through the District Planning Cell would monitor the planning process of the *panchayats*. The *Taluk* Resource Centre would be a space for training activities, provide consultations and guidance to *Gram panchayats*. There will be at least one engineer for a cluster of 4-5 *Gram panchayats* (*Panchayat Raj* Engineering Department) to review technically more difficult *Gram panchayat* infrastructure projects. *Gram panchayats* will make expenditure decisions, as per annual plans, to be implemented in a participatory and transparent manner. They would also implement the sub-projects; either by contracting or through communities.

The major procurement activities will be at *Gram panchayats*. This involves contracts for very small works and services relating to minor irrigation, education, forestry, housing for poor, roads, street lights, drains, drinking water, sanitation, etc. The second most important procurement centre is ANSSIRD. The procurement by the institute would relate to training material, audio visual equipment, small consultancies etc. The *Taluk Panchayats* would also construct *Taluk* Resource Centres estimated to cost about Rs.2,200,000 per centre including equipping and furnishing. There will be small procurement activities like purchase of furniture, office equipment, hiring consultants etc. by FC, DAC level.

The procurement capacity of *Gram panchayats* needs strengthening. ANSSIRD, *Taluk* and at least one officer with FC will require training for the agreed procurement procedures. Following action plan is worked out.

- One officer from FC will be identified as nodal officer for overseeing procurement activities under the Project. He will be trained in the procurement procedures either at Administrative Staff College of India (ASCI), Hyderabad or at National Institute of Financial Management (NIFM), Faridabad, or ILO, Turin.
- During the launch workshop of the project, a separate workshop will be arranged for other stake holders from ANSSIRD, *Taluk panchayats* besides FC a procurement manual will be prepared by Government of Karnataka in consultation with IDA by August 15, 2006 and incorporated in Operational Manual. This will be used as a reference manual for implementation of procurement arrangements, as well as for the purpose of training workshops.
- One more workshop will be arranged during the first year of the project. Additional workshops/training programmes will be arranged on the basis of review during supervision missions.
- The training for *Gram panchayats* will be the responsibility of ANSSIRD assisted by *Taluk panchayats*, engineers and other technical staff, NGOs etc.

Oversight:

The major challenge lies in ensuring that the accepted procurement procedures are followed. Considering the fact that as many as 1,343 *panchayats* would be carrying out procurement, the procurement review / audit carried out in normal investment projects would not be feasible. The issue is proposed to be addressed in the following way:

- Social audit through participatory and transparent process – Institutional arrangements for social audits at the village level will provide the framework needed to ensure that there is checks/balances and transparency in the procurement process, including access to information relating to procurement. The information related to procurement under block grants would also be put up to *Gram sabha*. Experience has shown that social audit including participatory and transparent process is the most powerful tool to ensure the funds are used for the intended purpose.
- Annual audits carried out by the Karnataka State Audit Department and sample audit to be done by Chartered Accountants. TOR for both will include procurement review.
- Fiduciary risk reviews will be carried out by IDA in consultation with Government of Karnataka in Years 1 and 2 of the Project, and later, if need be.

The post award reviews for contracts other than *Gram panchayats* would be carried out during supervision mission or through consultants appointed by the Bank.

C. Review by IDA of procurement decisions

Contracts for works, goods and consultancies (with firms) estimated to cost USD 200,000 or more per contract would be subjected to prior review. The contracts for individual consultants estimated to cost USD 50,000 or more per contract would also be subjected to prior review. Other contracts would be subject to post award review on the random selection basis. Frequency of supervision would be once every six months.

The risk in absolute term is high. However, the risk is considered average after considering very low value for open tendering and requirement of participatory process and other safeguards measures prescribed under the project.

Annex 9: Economic and Financial Analysis

In this annex we consider the benefits, costs and risks associated with this project. We also consider some design issues related to the program proposed by the GOK. It is not possible to estimate the rate of return associated with this investment, or even come to a conclusion about the magnitude of the flow of benefits over time. The difficulty in quantifying benefits is because many are very difficult to measure, in particular the efficiency gains that come with a decentralization program that involves the local population more directly in choosing the package of services that they want. Previous studies of Karnataka have emphasized that a major problem in the intergovernmental fiscal structure is the limited fiscal discretion given to local governments. Note that an underlying rationale of this project is to move decisions about public services from the state to the local level. The argument is that the conditions laid down by scheme-based systems have not worked, and that it is time for more public servicing decisions to be pushed down to the local level.

In the sections that follow, we will discuss these benefits, as well as the risks that they may not materialize, but will not try and quantify their magnitude as would be done in a formal cost-benefit analysis.

Project Benefits

There are a number of possible benefits associated with this project. If they materialize, the impacts will be spread out over a number of years. Both economic development and poverty alleviation can be significantly enhanced.

Poverty Alleviation. Karnataka has one of the heaviest concentrations of rural poor populations in India. The development grant funded by this project will be targeted on the 1,000 *Gram panchayats* located in the 39 most backward *taluks* in Karnataka (as identified by the "index of backwardness" from the Nanjundappa report). These GPs have a population of about 5 million. Most of the backward *taluks* in Karnataka are located in the more remote northern region of the state, and are characterized by a different economic structure and by different needs for public services. Thus far, the scheme-wise approach to delivering public services has not been totally successful in addressing the substantial deficits in service quality in these areas.

The development grant allocated to these *gram panchayats* will address this issue. It is expected that the funds will be spent for basic services such as teacher training, market improvements, water treatment, water shed development, drainage projects, and health clinics. The total amount of money involved is significant. If the total project were US$133.33 million, and if US$ 113.3 million were allocated to the development grant spread, evenly over the 5 years, this would average out to Rs 7.6 lakhs per GP, or more one and half times over the present allocation of Rs 5 lakhs. On a per capita basis, the average amount of development grants would increase from Rs 100 to Rs 152 in GPs in these 39 *taluks*.

Public Service Improvements. By moving decisions closer to the local population, this project will improve the quality of public services in low income rural communities. "Improvement" in this case means both (a) upgrading services as a result of a significant infusion of funding and (b) allowing local governments more discretion in choosing their public service package.

The development grant presently is about Rs 5 lakhs per GP, distributed on an equal amount basis for all 5,665 GPs in the state. As noted above, the incremental amount resulting from this project will average about Rs10.5 lakhs per GP for the 1,000 GPs in the target area, or about Rs 210 per capita. The grants will be untied, hence local governments will have discretion in allocating the funds according to where the needs are greatest. Though a hard estimate of the benefits of this development grants program is not easily made, two reasonable propositions are that this would constitute a significant enhancement of public service levels in poor GPs, and that the new funds would be targeted on public service areas that the local population deems to be highest priority.

Full Distribution of Entitlements. In the past, the transfers from the state to the local governments have not always been fully disbursed. In some cases this is because of an intercept of unpaid electricity charges, but in other cases it had to do with an administrative failure to fully distribute the amount promised by the allocation formula. The latter might be a result of a budgetary imbalance at the state level.

As a condition of this project, GOK will distribute the full entitlements to local governments. This will both increase the flow of resources to the local governments and will make the overall system more transparent and reliable. Most important from a point of view of this project, it will guarantee that the new development grant will not be displaced by a reduction of the basic Rs 5 lakh development grant entitlement.

Revenue Mobilization. The new development grant will be distributed by a formula that is based on the index of "backwardness" and the amount of revenue mobilization by the local government. The weights and exact specification of the formula have not yet been worked out. We can say, however, that the size of the development grant to these GPs is potentially quite large and offers a significant incentive for responding with increased revenue mobilization. To the extent that the GPs do respond with increased revenue mobilization, resources for development will be further increased.

Enhanced Local Government Capacity. For the potential benefits from the development grant to be realized, there must be a significant increase in the capacity of the local governments to absorb the new resources for the purpose of improved service delivery. The enhancement of local government capacity is a key part of the project and a significant benefit to be captured.

The capacity building initiative is meant to be available to all GPs in the state and not just to those in the target population. Provision is made for a technical advisory unit located at each *taluk*, the administration of a service delivery monitoring system at the district level, training programs for *panchayat* level officials, and the development of a computerized financial management system. The benefits from such activities are significant and essential to support the continued decentralized system of governance that is proposed by the Parliament. Note that all three levels of rural local government benefit from this capacity enhancement.

Fiscal Decentralization Cell and Fiscal Information System. The fiscal decentralization cell, to be located in the Ministry of Finance, is dedicated to research on the system of local government finance and to policy advice dedicated to the improvement of the system of intergovernmental fiscal relations in the state.

A number of specific activities of the decentralization cell will offer significant benefits to the state and to the *panchayats*. These include the following:

- The development of a system of fiscal information for local governments that will inform decisions about the impact of grant programs on fiscal disparities, the efficacy of various public programs in generating public service enhancements, and the impact of grant allocations on poverty alleviation and development;

- Support for the State Finance Commission in the development of a formula-based transfer system to replace the present "equal amounts" approach to distributing development assistance, and other general research support for the SFC;

- Monitoring the fiscal performance of rural local governments, and evaluating all aspects of the intergovernmental fiscal system;

- Assisting the RD in preparing a "State of the *Panchayats*" report that will inform government and the public on the operations of the intergovernmental fiscal system.

Costs and Risks

Do the benefits suggested above justify a long term loan of US$120 million, which is the monetary cost of this project? Are there significant risks that the benefits enumerated above will not be realized, and that the ex-post benefit-cost ratio will not be favorable?

Long Term Fiscal Costs are Prohibitive. Costs are an issue. The GOK is trying to reduce a significant fiscal deficit and has put a premium on controlling recurrent expenditures. The question is whether this project might introduce costs that compromise the state's fiscal position.

There are two types of implied fiscal costs to the GOK. The first is any operation and maintenance costs that accrue during the life of the project and must be picked up by GOK at either the state or local government level as the case maybe. In general, most of the costs associated with the new programs are borne by the project funding, but there may be some that are not. These costs will be small but still imply a burden for the state government budget. These "support" costs might include, for example:

- the compliance costs for local governments in terms of building the fiscal information system,

- the cost of merging the new fiscal information system into the broader statistical data base of the state, into the website, etc.,

- general oversight costs associated with the decentralization cell and the *taluk* resource cells,

- increased investment in the quality and capacity of training institutes to support this work,

- operation and maintenance costs associated with local government expenditure from the new development grant, and

- overall guidance and compliance costs associated with managing the new development grant.

The second type of fiscal cost is that which must somehow be built into the state budget at the end of the project to enable continuation of these programs. The policy concern is that this will become an increase in recurrent expenditure and will compromise the budget balance of the state government. The annual cost of the project is roughly Rs 105 crore if the grant monies are allocated evenly across 5 years, which is equivalent to less than 1 percent of the present level of government expenditures. This is roughly the amount that would need to be added to the budget to continue the development grant for poor *taluk*s, the decentralization cell, local government capacity building activities, etc. whenever needs continue to exist.

The state government should take up this contingent liability. There are several justifications for making this commitment. First, the annual cost of picking up all aspects of the project on the state budget would be only 0.67 percent of own source revenue, if 2004-05 data are used as a standard. This seems a nominal amount. If there is significant state government revenue growth, the claim will be even less relative to the overall budget. Second, fiscal decentralization is a priority of the state and is consistent with stated national policy, so additional expenditures in this area would seem appropriate. Third, the project is focused on poor GPs, and an increased effort toward equalization would also seem warranted. Fourth, the permanent decentralization cell and the fiscal information system are investments that are already overdue and called for as priorities by the 12th Finance Commission. Finally, the fiscal position of the state has improved in 2005, making this program more feasible from the vantage of the public finances.

Local Government Waste. One might argue that local governments in the poorest *taluk*s are least able to absorb additional resources in an efficient way and are least able to mount a tax administration effort that can lead to additional resource mobilization. A combination of inefficient delivery of services, unskilled management, and corruption might lead to a waste of these resources rather than to a benefit stream as is envisioned by the project.

The project design does recognize this issue, and attempts to minimize this risk. It provides for a significant input of technical assistance to strengthen the capacity of local governments to deliver services and to manage their finances. In addition, it provides for a continuous monitoring of these local governments. Still, there will be transition costs as the newly empowered *gram panchayats* learn their public service delivery responsibilities.

The State Finance Commission will not make use of the Decentralization Cell. SFC are charged with the design of the intergovernmental fiscal system. The decentralization cell is being created in large part to develop the intellectual structure on which the SFC bases its recommendations. The 12th Finance Commission recommends that this be done in all states. This project follows on to this thinking and proposes a permanent cell that will develop the analytic work necessary for the SFC to do its job, and to serve as staff when the SFC sits. In particular, as the state is ratcheting up its development grant to local governments, there is need to develop a formula allocation to replace the current, arguably outmoded formula that considers neither expenditure needs nor fiscal capacity.

There is a risk that the SFC will not make use of the Cell, and that a new formula will not be developed. We view particularly the former as a low probability risk. The database that SFCs have used in the past to provide recommendations to the states on intergovernmental fiscal policies has been in adequate. It would therefore seem a low probability that the SFC would not make intensive use of the cell or the fiscal information system. There is perhaps a greater risk that a new formula will not be developed in the next few years. This is because with new entitlements there will be pressures brought to hold local governments harmless at the new, higher levels. Reforming the transfer system will bring both winners and losers, and this will make formula reform a difficult policy enhancement. Still, there will be considerable pressure to revise the formula as fiscal decentralization proceeds, and especially when the time draws near to fold the entitlements for development grants from this project into the allocable pool.

Are the Benefits Long Term?

The proposed financing for this project is through a long term loan. A fair question is whether the benefit stream generated by the project matches this repayment schedule. If future beneficiaries cannot be identified, loan financing is not justified because present beneficiaries will be subsidized by future taxpayers. Some have argued that the recurrent expenditure nature of some of the activities to be undertaken (e.g., the cell, the development grant, the data base for local government finance) should cause a questioning of whether this project should be financed by borrowing.

Another view is that the benefits from this project will accrue for many years:

- Rural local governments will be stronger by virtue of the capacity building component of the project. The classification of expenditures made (e.g., the *taluk* cells for technical assistance) may be predominantly of the recurrent nature, but the good governance practices they generate will be lasting.

- For GP in the most backward *taluk*s, the increased services that result from expenditures on development functions will have longer term benefits. These might include the benefits from small infrastructure projects, increased literacy of the population, improved management skills, and increased levels of awareness by the public regarding their citizenship role and responsibility to participate in the process of governance.

- If the local population can influence the package of services received, it will be more willing to pay for these services. The impact could be an increase in the level of local government resource mobilization that will be maintained.

- One major output of this project can be a development of a database which if used could lead to a much more influential and improved State Finance Commission. This can have major long term benefits for the state if the result of its work is a more efficient intergovernmental fiscal system.

- Equalization itself can have long term benefits as the GP in the most backward *taluk*s begin catching up in terms of service level improvements.

Table: 9.1 Most Backward *Taluks* by District

District	***Taluk***
Bagalkote	Bilagi
Bangalore	Kanakapura Magadi
Bellary	Kudligi Sandur
Bidar	Aurad Basavakalyan Bhalki Humnabad
Bijapur	Basavana Bagewadi Indi Muddebihal Sindag
Chamaragnagar	Chamarajnagar
Chitradurga	Hosdurga
Davangere	Channagiri Harapanahalli
Gulbarga	Afzalpur Aland Chincholi Chithapur Jewargi Sedam Shahapur Shorapur Yadgir
Kolar	Bagepalli
Koppal	Kushtagl Yelburga
Mysore	Heggadadevankote
Ralchur	Deodurga Langasugur Manvi Sindhanur
Tumkur	Gubbi Kuniga Madhugiri Pavagada Sira

Source: Ministry of Rural Development and *Panchayat*, 2005

Figure 1. From fixed amount, unpredictable, random transfers...

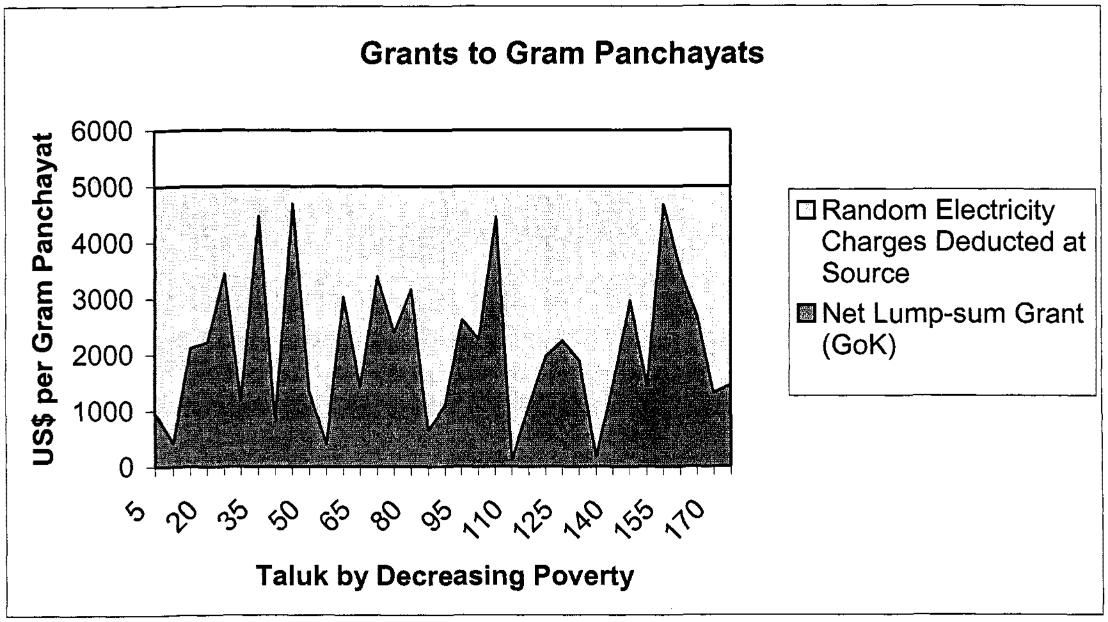
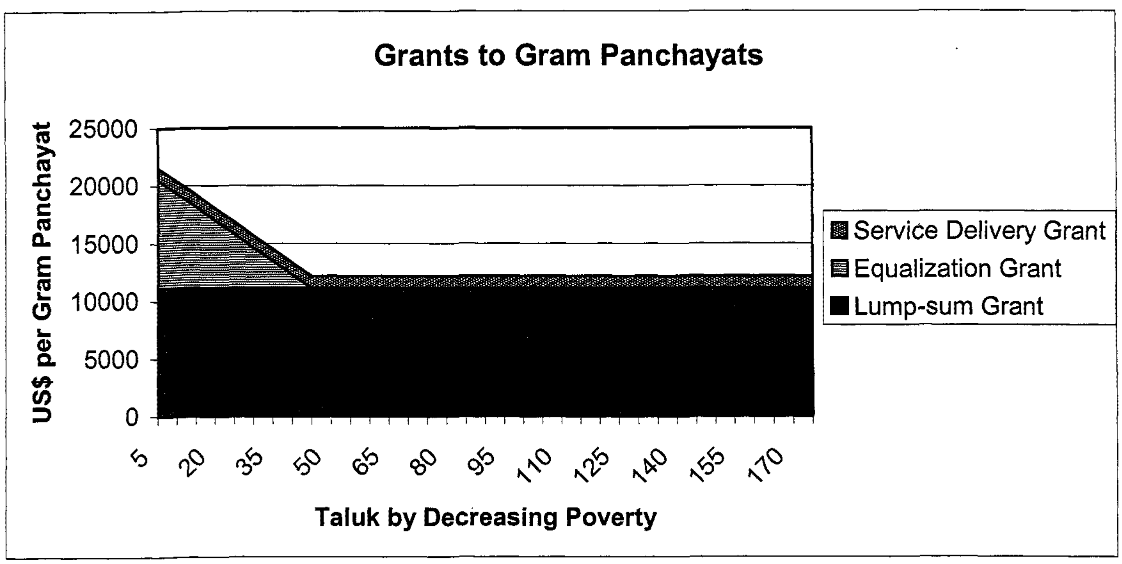


Figure 2. To equalizing, predictable transfers with incentives for service delivery...



Annex 10: Safeguard Policy Issues

Environment

An environmental study was done to understand the environmental issues / concerns prevailing in the *gram panchayats* in order to determine what and how environmental management is to be ensured. The study included (i) a review of *gram panchayat*'s activities from an environmental perspective by analyzing secondary information as well as undertaking field visits to & stakeholder consultations in selected villages, (ii) a training needs assessment to form the basis for developing a training plan, (iii) an analysis of the current legal framework to understand the context and to identify gaps that require to be addressed, and (iv) the development of a monitoring & evaluation framework to ensure that environmental safeguards are addressed during project implementation. The main findings arising out of the study are as follows:

- Only the Bank's environmental safeguard policy, OP 4.01 Environmental Assessment, is triggered. Related to this policy, proposed activities under the project will create minor, site-specific but fully reversible negative environmental impacts.
- The review of legislations revealed many gaps / deficiencies that include (i) environmental legislation does not pertain to issues in rural development, (ii) the Karnataka *Panchayat* Act addresses hygiene & sanitation but not preventive environmental management in an integrated manner, (iii) lack of a role for *gram panchayats* in quarrying activities, solid waste management and in planning infrastructure development projects, and (iv) absence of an integrated water use policy across different applications.
- The review of development activities in *gram panchayats* revealed that there are some environmental issues / concerns arising out of activities in which the *gram panchayats* are not involved and there are others which are caused by the *gram panchayat*'s activities. The concerns / issues include (i) drinking water availability, (ii) exploitation of groundwater, (iii) excessive use of fertilizers and banned pesticides, (v) improper & unstructured quarrying / mining activities, (vi) improper sanitation and sewage system and (vii) improper solid waste management. It was also recognized that there are no environmental safeguards during implementation, sustainability aspects of initiatives are not addressed, and capacity / awareness of the *panchayat*i raj institutions on environmental issues / concerns is non-existent.

As an output of the study, Environmental Guidelines were prepared. These Guidelines include information on applicable national and state government policies, a simple and user-friendly framework comprising screening of *gram panchayat* activities and mitigation measures for those activities that create environmental impacts, training & capacity-building plans for all *panchayat*i raj institutions (not just the *gram panchayats*), monitoring & evaluation arrangements, and analytical studies that need to be done during implementation to address gaps / deficiencies.

To follow the Environmental Guidelines, the implementing agency's capacity requires to be strengthened. Under this project, there will be an Environmental Officer at the state level. This Environmental Officer will provide technical and managerial support in relation to environmental management, for the project as a whole. To implement the Environmental Guidelines on a day-to-day basis, one of the members of the respective *Gram panchayat* will function as an Environmental Coordinator, who will be trained on ensuring that the mitigation measures are adhered with. Training will be given to all *Gram panchayat* members to augment their awareness and competence to identify / address environmental issues. A separate budget has been allocated for implementing these Environmental Guidelines.

In carrying out the environmental study, public / stakeholder consultations were carried out in 13 *panchayats* in 4 *Taluka*s. A questionnaire was used to collect information from these field visits and consultations. Based on the feedback collected, the role of the *gram panchayats* has been determined for identifying environmental issues and adhering with mitigation measures. This will be done as an integral part of their activities during project implementation.

The Environmental Guidelines will be disclosed and made available in RDPR office in Bangalore. The executive summary alone will be translated in the local language - Kannada - and also be disclosed. The Environmental Guidelines will also be disclosed at the Bank's Info Shop in New Delhi and Washington D.C.

Annex 11: Project Preparation and Supervision

	Planned	Actual
PCN review	06/26/2003	06/18/2003
Initial PID to PIC	10/26/2004	10/21/2004
Initial ISDS to PIC	10/26/2004	10/21/2004
Appraisal	05/09/2005	05/09/2005
Negotiations	12/01/2005	05/23/2006
Board/RVP approval	06/29/2006	
Planned date of effectiveness	08/2006	
Planned date of mid-term review	03/2011	
Planned closing date	09/2012	

Key institutions responsible for preparation of the project:
State of Karnataka

Bank staff and consultants who worked on the project included:

Name	Title	Unit
Geeta Sethi	Team Leader	SASAR
Luis Constantino	Sector Manager	MNA
Martien Van Nieuwkoop	C-Task Manager	SASAR
Dhimant Jayendraray Baxi	Sr. Procurement Specialist	SARPR
Priya Goel	Financial Management Specialist	SARFM
Warren Waters	Sr. Social Scientist	SASES
Jeffrey Hammer	Lead Economist	SASES
Sarita Rana	Program Assistant	SASAR
Yoshiko Masuyama	Program Assistant	SASAR
Clydina Anbiah	Program Assistant	SASAR
Prasad.C. Mohan	Lead IEC Specialist	AFTKL
Fitz Ford	Consultant	SASAR
Roy Bahl	Consultant	SASAR
Sally Wallace	Consultant	SASAR
S. Vaideeswaran	Consultant	SASES
Paul Martin	Sr. Environmental Specialist	SASES
Jacqueline Julian	Program Assistant	SASAR
Philip Beauregard	Sr. Counsel	LEG
Thao Le Nguyen	Sr. Financial Officer	LOA
Manoj Jain	Financial Management Specialist	SARFM

Estimated Approval and Supervision costs:
1. Remaining costs to approval: $5,000
2. Estimated annual supervision cost: $90,000

Annex 12: Documents in the Project File

Author	Title	Publisher
Luis Constantino	Overview of Rural Decentralization	World Bank
	Draft Proceedings of Decentralization Workshop	
	Government of Karnataka Working paper on Decentralization	
Government of Karnataka	Report of 2nd State Finance Commission	Government of Karnataka
V.K. Natraj and Kripa Ananthpur	Delegation of Devolution: Working paper no 184	Madras Institute of Development Studies
Government of Karnataka	Reframing the Property Tax	Government of Karnataka
S.S. Meenakshisundaram	*Panchayat*i Raj Institutions in Natural Resource Management, Findings from Karnataka	Magazine "Kurukshetra" (?)
V. Vijayalakshmi	Working paper 125	Institute for Social and Economic Change
	Brief review from Secretary, Rural Development and Reconciliation of Electricity bills	
	Guidelines for preparation of development perspective of the district	
Government of Karnataka	Karnataka transparency on Public Procurement Rules 2000	Government of Karnataka
Government of Karnataka	Excerpt of Budget speech for 2003-2004 increasing internal grants from 3.5 lakhs to 5.0 lakhs	Government of Karnataka
	Belur Declaration – Joint Statement of Karnataka PRIs, upon books and State Government meetings on commitment to decentralization	
	Increase in Property tax	
	Comments received from report of finance regarding Aide – Memoire	
	List of topics for *Panchayat* training	
Government of Karnataka	Property taxes issues faced by GPs	Government of Karnataka
Government of Karnataka	Karnataka Activity Mapping	Government of Karnataka
Government of Karnataka	Proposal of format to intergovernmental transfer	Government of Karnataka
Government of Karnataka	Guidelines for preparation of development report of *Gram panchayats*	Government of Karnataka
Government of Karnataka	Report of the High power committee for Redressal of Regional Imbalances	Government of Karnataka
B.G. Madappa, Joint Controller (Retired)	The Karnataka *Panchayat* Reference (*Panchayats* Accounts and Budget) Rules 2003	Government of Karnataka
Government of Karnataka	The Karnataka local fund authorities fiscal	

	Responsibility Bill, 2003	
Department of Ecology and Environment	State of the Environment Report and Action Plan 2003	Government of Karnataka
Government of Karnataka	Project Concept from the Government of Karnataka	
	Power Point presentation on the Karnataka *Panchayat* Regional	
Department of Economic Affairs	Letter from DEA proposing the project for consideration	
B.G. Madappa	Consultant report on capacity building on Accounting and Financial Management	
Environment Management & Policy Research Institute	Draft Report on "Environmental Report for the proposed Karnataka *Panchayats* Strengthening project".	
Geeta Sethi	Fiscal Decentralization to Rural Governments	Oxford University Press

Annex 13: Statement of Loans and Credits

5/17/2006

Project ID	FY	Purpose	Original Amount in US$ Millions IBRD	IDA	SF	GEF	Cancel.	Undisb.	Difference between expected and actual disbursements Orig.	Frm. Rev'd
P079675	2006	Karn Municipal Reform	216.00	0.00	0.00	0.00	0.00	216.00	0.00	0.00
P079708	2006	TN Empwr & Pov Reduction	0.00	120.00	0.00	0.00	0.00	107.96	-6.75	0.00
P083780	2006	TN Urban III	300.00	0.00	0.00	0.00	0.00	283.68	6.09	0.00
P086414	2006	Power System Development Project III	400.00	0.00	0.00	0.00	0.00	400.00	0.00	0.00
P092735	2006	NAIP	0.00	200.00	0.00	0.00	0.00	200.02	0.00	0.00
P093720	2006	Mid-Himalayan (HP) Watersheds	0.00	60.00	0.00	0.00	0.00	56.12	-3.14	0.00
P077977	2005	Rural Roads Project	99.50	300.00	0.00	0.00	0.00	308.92	-2.48	0.00
P077856	2005	Lucknow-Muzaffarpur National Highway	620.00	0.00	0.00	0.00	0.00	524.23	-55.77	0.00
P075058	2005	TN HEALTH SYSTEMS	0.00	110.83	0.00	0.00	20.06	81.38	4.05	7.56
P094513	2005	India Tsunami ERC	0.00	465.00	0.00	0.00	0.00	393.97	123.37	0.00
P073651	2005	DISEASE SURVEILLANCE	0.00	68.00	0.00	0.00	0.00	62.41	12.54	0.00
P073370	2005	Madhya Pradesh Water Sector Restructurin	394.02	0.00	0.00	0.00	0.00	371.58	27.38	0.00
P084632	2005	Hydrology II	104.98	0.00	0.00	0.00	0.00	104.46	22.53	0.00
P084790	2005	MAHAR WSIP	325.00	0.00	0.00	0.00	0.00	293.21	-23.12	0.00
P084792	2005	Assam Agric Competitiveness	0.00	154.00	0.00	0.00	0.00	142.94	9.16	0.00
P086518	2005	IN SME Financing & Development	120.00	0.00	0.00	0.00	0.00	19.40	-2.27	0.00
P073776	2004	ALLAHABAD BYPASS	240.00	0.00	0.00	0.00	0.00	176.04	84.84	0.00
P073369	2004	MAHAR RWSS	0.00	181.00	0.00	0.00	0.00	154.50	19.98	0.00
P078550	2004	Uttar Wtrshed	0.00	69.62	0.00	0.00	0.00	62.92	-1.60	0.00
P055459	2004	ELEMENTARY EDUCATION PROJECT (SSA)	0.00	500.00	0.00	0.00	0.00	98.45	-105.68	0.00
P079865	2004	GEF Biosafety Project	0.00	0.00	0.00	1.00	0.00	0.79	0.74	0.00
P050655	2004	RAJASTHAN HEALTH SYSTEMS DEVELOPMENT	0.00	89.00	0.00	0.00	0.00	78.58	33.79	0.00
P082510	2004	Karnataka UWS Improvement Project	39.50	0.00	0.00	0.00	0.00	29.61	15.60	0.00
P076467	2003	Chatt DRPP	0.00	112.56	0.00	0.00	20.06	88.45	31.42	0.00
P075056	2003	Food & Drugs Capacity Building Project	0.00	54.03	0.00	0.00	0.00	44.57	21.23	0.00
P073094	2003	AP Comm Forest Mgmt	0.00	108.00	0.00	0.00	0.00	60.66	-1.91	0.00
P072123	2003	Tech/Engg Quality Improvement Project	0.00	250.00	0.00	0.00	40.11	173.09	57.95	-19.48
P071272	2003	AP RURAL POV REDUCTION	0.00	150.03	0.00	0.00	0.00	53.42	8.68	0.00
P050649	2003	TN ROADS	348.00	0.00	0.00	0.00	0.00	278.72	62.09	0.00
P067606	2003	UP ROADS	488.00	0.00	0.00	0.00	0.00	364.55	155.05	0.00
P050668	2002	MUMBAI URBAN TRANSPORT PROJECT	463.00	79.00	0.00	0.00	0.00	386.82	151.18	0.00
P050653	2002	KARNATAKA RWSS II	0.00	151.60	0.00	0.00	15.04	88.84	55.86	0.00
P040610	2002	RAJ WSRP	0.00	140.00	0.00	0.00	15.04	89.23	47.95	0.00
P050647	2002	UP WSRP	0.00	149.20	0.00	0.00	40.11	105.69	101.73	0.00
P074018	2002	Gujarat Emergency Earthquake Reconstruct	0.00	442.80	0.00	0.00	80.23	151.00	157.77	10.10
P069889	2002	MIZORAM ROADS	0.00	60.00	0.00	0.00	0.00	34.60	8.78	0.00
P071033	2002	KARN Tank Mgmt	0.00	98.90	0.00	0.00	25.07	61.69	46.66	-8.22
P072539	2002	KERALA STATE TRANSPORT	255.00	0.00	0.00	0.00	0.00	144.50	28.17	0.00
P035173	2001	POWERGRID II	450.00	0.00	0.00	0.00	0.00	48.37	44.90	0.42
P010566	2001	GUJARAT HWYS	381.00	0.00	0.00	0.00	61.00	84.63	142.41	116.74

P050658	2001	TECHN EDUC III	0.00	64.90	0.00	0.00	0.00	16.10	9.00	-2.59
P055454	2001	KERALA RWSS	0.00	65.50	0.00	0.00	12.27	19.49	17.54	2.43
P071244	2001	Grand Trunk Road Improvement Project	589.00	0.00	0.00	0.00	0.00	239.72	230.38	0.00
P070421	2001	KARN HWYS	360.00	0.00	0.00	0.00	0.00	108.33	76.47	0.00
P067216	2001	KAR WSHD DEVELOPMENT	0.00	100.40	0.00	0.00	20.06	55.64	62.49	0.00
P038334	2001	RAJ POWER I	180.00	0.00	0.00	0.00	2.02	36.04	38.06	17.78
P059242	2001	MP DPIP	0.00	110.10	0.00	0.00	20.06	17.44	21.62	14.94
P055455	2001	RAJ DPEP II	0.00	74.40	0.00	0.00	0.00	27.33	16.93	0.00
P059501	2000	IN-TA for Econ Reform Project	0.00	45.00	0.00	0.00	12.03	19.06	26.72	2.72
P050657	2000	UP Health Systems Development Project	0.00	110.00	0.00	0.00	30.09	38.32	59.16	-1.24
P049770	2000	REN EGY II	80.00	50.00	0.00	0.00	18.00	45.11	61.73	60.73
P045049	2000	AP DPIP	0.00	111.00	0.00	0.00	0.00	19.57	9.48	0.00
P010505	2000	RAJASTHAN DPIP	0.00	100.48	0.00	0.00	0.00	41.69	33.57	26.34
P009972	2000	NATIONAL HIGHWAYS III PROJECT	516.00	0.00	0.00	0.00	0.00	168.24	168.24	41.57
P050646	1999	UP Sodic Lands II	0.00	194.10	0.00	0.00	0.00	11.30	7.83	-7.50
		Total:	6,969.00	5,139.45	0.00	1.00	431.25	7,289.38	2,118.40	262.30

INDIA
STATEMENT OF IFC's
Held and Disbursed Portfolio
In Millions of US Dollars

		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic.	Loan	Equity	Quasi	Partic.
2005	ADPCL	40.78	7.00	0.00	0.00	0.00	0.00	0.00	0.00
2006	AHEL	0.00	5.08	0.00	0.00	0.00	5.08	0.00	0.00
2005	AP Paper Mills	35.00	5.00	0.00	0.00	10.00	5.00	0.00	0.00
2005	APIDC Biotech	0.00	4.00	0.00	0.00	0.00	1.24	0.00	0.00
2002	ATL	15.72	0.00	0.00	10.77	15.72	0.00	0.00	10.77
2003	ATL	1.08	0.00	0.00	0.00	0.76	0.00	0.00	0.00
2005	ATL	9.69	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2003	BHF	10.64	0.00	10.64	0.00	10.64	0.00	10.64	0.00
2004	BILT	0.00	0.00	15.00	0.00	0.00	0.00	15.00	0.00
2001	BTVL	11.80	5.00	0.00	0.00	11.80	5.00	0.00	0.00
2003	Balrampur	13.96	0.00	0.00	0.00	13.96	0.00	0.00	0.00
2001	Basix Ltd.	0.00	0.98	0.00	0.00	0.00	0.98	0.00	0.00
2005	Bharat Biotech	0.00	0.00	4.50	0.00	0.00	0.00	0.00	0.00
1984	Bihar Sponge	6.15	0.00	0.00	0.00	6.15	0.00	0.00	0.00
2001	CCIL	6.75	0.00	0.00	6.71	6.75	0.00	0.00	6.71
2003	CCIL	1.50	0.00	0.00	0.00	0.59	0.00	0.00	0.00
1990	CESC	7.86	0.00	0.00	0.00	7.86	0.00	0.00	0.00
1992	CESC	11.45	0.00	0.00	25.53	11.45	0.00	0.00	25.53
2004	CGL	15.00	0.00	0.00	0.00	8.00	0.00	0.00	0.00
2004	CMScomputers	10.00	10.00	2.50	0.00	10.00	0.00	0.00	0.00
2002	COSMO	5.00	0.00	0.00	0.00	5.00	0.00	0.00	0.00
2005	COSMO	0.00	3.73	0.00	0.00	0.00	3.73	0.00	0.00

1995	Centurion Bank	0.00	0.69	0.00	0.00	0.00	0.69	0.00	0.00
2005	Centurion Bank	0.00	0.07	0.00	0.00	0.00	0.07	0.00	0.00
2005	DCM Shriram	30.00	0.00	0.00	0.00	15.00	0.00	0.00	0.00
2003	DQEL	0.00	1.50	1.50	0.00	0.00	1.50	1.50	0.00
2005	Dabur	0.00	15.10	0.00	0.00	0.00	15.10	0.00	0.00
2003	Dewan	10.76	0.00	0.00	0.00	10.76	0.00	0.00	0.00
2001	GTF Fact	0.00	1.20	0.00	0.00	0.00	1.20	0.00	0.00
2006	GTF Fact	0.00	0.00	0.99	0.00	0.00	0.00	0.49	0.00
1994	GVK	0.00	5.00	0.00	0.00	0.00	5.00	0.00	0.00
2003	HDFC	100.00	0.00	0.00	100.00	100.00	0.00	0.00	100.00
	HENKAL LTD	0.00	0.16	0.00	0.00	0.00	0.16	0.00	0.00
1995	HENKAL LTD	0.00	0.14	0.00	0.00	0.00	0.14	0.00	0.00
2000	HENKAL LTD	0.00	0.44	0.00	0.00	0.00	0.44	0.00	0.00
1998	IAAF	0.00	0.47	0.00	0.00	0.00	0.30	0.00	0.00
2006	IAL	0.00	9.69	0.00	0.00	0.00	0.00	0.00	0.00
1998	IDFC	0.00	10.82	0.00	0.00	0.00	10.82	0.00	0.00
2005	IDFC	50.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	IHDC	7.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2006	IHDC	8.15	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2001	IIEL	0.00	3.16	0.00	0.00	0.00	2.06	0.00	0.00
1990	IL & FS	0.00	0.49	0.00	0.00	0.00	0.49	0.00	0.00
1993	IL & FS	0.00	0.84	0.00	0.00	0.00	0.84	0.00	0.00
1998	IL & FS	0.00	0.84	0.00	0.00	0.00	0.84	0.00	0.00
1992	IL&FS VC	0.00	0.14	0.00	0.00	0.00	0.14	0.00	0.00
1995	IL&FS VC	0.00	0.18	0.00	0.00	0.00	0.18	0.00	0.00
2006	Indecomm	0.00	2.57	0.00	0.00	0.00	2.57	0.00	0.00
1996	India Direct Fnd	0.00	1.10	0.00	0.00	0.00	0.64	0.00	0.00
2001	Indian Seamless	6.00	0.00	0.00	0.00	6.00	0.00	0.00	0.00
1996	Indus II	0.00	0.22	0.00	0.00	0.00	0.22	0.00	0.00
1992	Indus VC Mgt Co	0.00	0.01	0.00	0.00	0.00	0.01	0.00	0.00
2005	K Mahindra INDIA	22.00	0.00	0.00	0.00	22.00	0.00	0.00	0.00
2005	KPIT	11.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2003	L&T	50.00	0.00	0.00	0.00	50.00	0.00	0.00	0.00
1990	M&M	0.00	0.07	0.00	0.00	0.00	0.07	0.00	0.00
1993	M&M	0.00	0.01	0.00	0.00	0.00	0.01	0.00	0.00
2002	MMFSL	9.23	0.00	7.76	0.00	9.23	0.00	7.76	0.00
2003	MSSL	0.00	2.29	0.00	0.00	0.00	2.20	0.00	0.00
2001	MahInfra	0.00	10.00	0.00	0.00	0.00	0.79	0.00	0.00
1996	Moser Baer	0.00	0.39	0.00	0.00	0.00	0.39	0.00	0.00
1999	Moser Baer	2.00	6.24	0.00	0.00	2.00	6.24	0.00	0.00
2000	Moser Baer	14.90	9.68	0.00	0.00	14.90	9.68	0.00	0.00
2001	NIIT-SLP	8.41	0.00	0.00	0.00	0.04	0.00	0.00	0.00
	Nevis	0.00	4.00	0.00	0.00	0.00	4.00	0.00	0.00
2003	NewPath	0.00	9.31	0.00	0.00	0.00	8.31	0.00	0.00
2004	NewPath	0.00	2.79	0.00	0.00	0.00	2.49	0.00	0.00
2003	Niko Resources	31.12	0.00	0.00	0.00	31.12	0.00	0.00	0.00
2001	Orchid	0.00	2.62	0.00	0.00	0.00	2.62	0.00	0.00
1997	Owens Corning	6.83	0.00	0.00	0.00	6.83	0.00	0.00	0.00
2004	Powerlinks	75.35	0.00	0.00	0.00	58.51	0.00	0.00	0.00

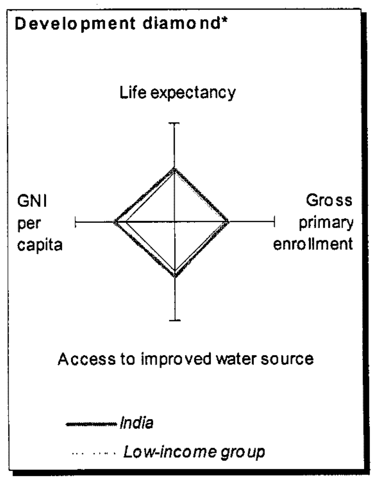
1995	Prism Cement	9.03	0.00	0.00	2.45	9.03	0.00	0.00	2.45
2004	RAK India	20.00	0.00	0.00	0.00	20.00	0.00	0.00	0.00
1995	Rain Calcining	0.00	2.64	0.00	0.00	0.00	2.64	0.00	0.00
2004	Rain Calcining	10.00	0.00	0.00	0.00	10.00	0.00	0.00	0.00
2005	Ramky	3.86	10.61	0.00	0.00	0.00	0.00	0.00	0.00
2001	SBI	50.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1997	SREI	4.29	0.00	0.00	0.00	4.29	0.00	0.00	0.00
2000	SREI	7.00	0.00	0.00	0.00	7.00	0.00	0.00	0.00
1995	Sara Fund	0.00	3.71	0.00	0.00	0.00	3.71	0.00	0.00
2004	SeaLion	4.77	0.00	0.00	0.00	4.77	0.00	0.00	0.00
2001	Spryance	0.00	1.90	0.00	0.00	0.00	1.90	0.00	0.00
2003	Spryance	0.00	0.95	0.00	0.00	0.00	0.95	0.00	0.00
2004	Sundaram Finance	44.33	0.00	0.00	0.00	44.33	0.00	0.00	0.00
2000	Sundaram Home	0.00	2.18	0.00	0.00	0.00	2.18	0.00	0.00
2002	Sundaram Home	8.31	0.00	0.00	0.00	8.31	0.00	0.00	0.00
1998	TCW/ICICI	0.00	0.80	0.00	0.00	0.00	0.80	0.00	0.00
2005	TISCO	100.00	0.00	0.00	300.00	0.00	0.00	0.00	0.00
2004	UPL	16.48	0.00	0.00	0.00	16.48	0.00	0.00	0.00
1996	United Riceland	6.25	0.00	0.00	0.00	6.25	0.00	0.00	0.00
2005	United Riceland	8.50	0.00	0.00	0.00	3.00	0.00	0.00	0.00
2002	Usha Martin	19.43	0.72	0.00	0.00	19.43	0.72	0.00	0.00
2001	Vysya Bank	0.00	3.66	0.00	0.00	0.00	3.66	0.00	0.00
2005	Vysya Bank	0.00	3.51	0.00	0.00	0.00	3.51	0.00	0.00
1997	WIV	0.00	0.57	0.00	0.00	0.00	0.57	0.00	0.00
1997	Walden-Mgt India	0.00	0.01	0.00	0.00	0.00	0.01	0.00	0.00
	Total portfolio:	957.54	174.28	42.89	445.46	597.96	121.89	35.39	145.46

		Approvals Pending Commitment			
FY Approval	Company	Loan	Equity	Quasi	Partic.
2004	CGL	0.01	0.00	0.00	0.00
2000	APCL	0.01	0.00	0.00	0.00
2005	KPIT	0.00	0.00	0.00	0.00
2004	CIFCO	0.00	0.00	0.02	0.00
2001	Vysya Bank	0.00	0.00	0.00	0.00
2001	GI Wind Farms	0.01	0.00	0.00	0.00
2004	Ocean Sparkle	0.00	0.00	0.00	0.00
2005	Allain Duhangan	0.00	0.00	0.00	0.00
	Total pending commitment:	0.03	0.00	0.02	0.00

Annex 14: Country at a Glance

May 2006

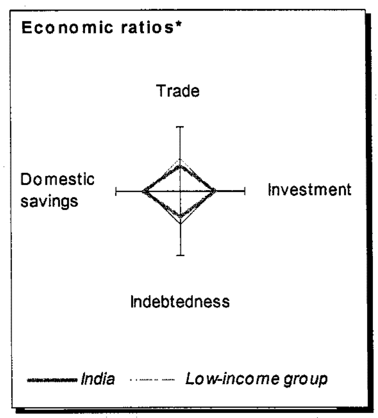
POVERTY and SOCIAL	India	South Asia	Low-income
2004			
Population, mid-year *(millions)*	1,079.7	1,448	2,338
GNI per capita *(Atlas method, US$)*	620	590	510
GNI *(Atlas method, US$ billions)*	672.8	860	1,184
Average annual growth, 1998-04			
Population *(%)*	1.6	1.7	1.8
Labor force *(%)*	2.1	2.1	2.1
Most recent estimate (latest year available, 1998-04)			
Poverty *(% of population below national poverty line)*	29	..	..
Urban population *(% of total population)*	29	28	30
Life expectancy at birth *(years)*	63	63	58
Infant mortality *(per 1,000 live births)*	65	66	79
Child malnutrition *(% of children under 5)*	47	48	44
Access to an improved water source *(% of population)*	84	84	75
Illiteracy *(% of population age 15+)*	39	41	39
Gross primary enrollment *(% of school-age population)*	99	97	94
Male	107	105	101
Female	90	92	88



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

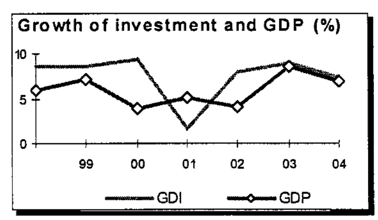
	1984	1994	2003	2004
GDP *(US$ billions)*	206.5	322.6	600.7	688.7
Gross domestic investment/GDP	21.6	23.4	23.0	24.6
Exports of goods and services/GDP	6.5	10.0	15.1	16.2
Gross domestic savings/GDP	18.8	24.8	28.1	22.8
Gross national savings/GDP	19.4	26.0	30.8	24.9
Current account balance/GDP	-1.4	-1.2	1.4	0.3
Interest payments/GDP	0.5	1.3	18.4	16.9
Total debt/GDP	16.5	31.8	19.2	17.6
Total debt service/exports	18.3	26.6	12.9	8.7
Present value of debt/GDP	..	..	16.7	..
Present value of debt/exports	..	..	89.3	..

	1984-94	1994-04	2003	2004	2004-08
(average annual growth)					
GDP	5.4	5.8	8.6	6.9	6.1
GDP per capita	3.3	4.1	7.0	5.4	4.8
Exports of goods and services	9.0	12.8	4.9	8.0	15.8

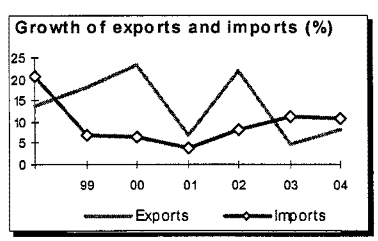


STRUCTURE of the ECONOMY

	1984	1994	2003	2004
(% of GDP)				
Agriculture	35.2	30.4	22.8	21.2
Industry	26.2	27.1	26.4	27.0
Manufacturing	16.4	16.9	15.6	16.1
Services	38.7	42.5	50.7	51.8
Private consumption	69.0	66.2	66.7	64.5
General government consumption	10.8	10.7	11.3	12.7
Imports of goods and services	7.9	10.3	16.1	18.0



	1984-94	1994-04	2003	2004
(average annual growth)				
Agriculture	3.4	2.0	9.6	1.1
Industry	6.3	5.6	7.0	7.7
Manufacturing	6.2	5.6	6.9	7.7
Services	6.7	8.2	8.9	8.9
Private consumption	5.7	4.7	11.3	8.0
General government consumption	4.8	5.9	3.7	3.9
Gross domestic investment	5.0	6.9	9.0	7.3
Imports of goods and services	8.4	9.6	11.2	11.0

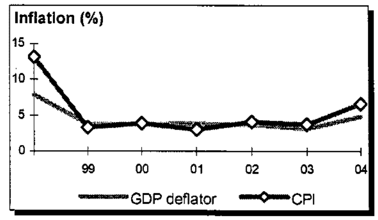


Note: 2004 represents 2004-05 and data are preliminary estimates and staff projections.

*The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

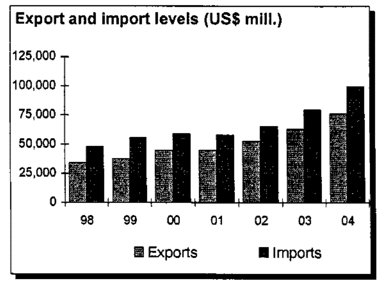
PRICES and GOVERNMENT FINANCE

	1984	1994	2003	2004
Domestic prices				
(% change)				
Consumer prices	4.3	7.6	3.7	6.6
Implicit GDP deflator	7.4	9.7	3.2	4.9
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	18.0	18.7	19.9
Current budget balance	..	-3.7	-4.9	-5.8
Overall surplus/deficit	..	-7.5	-9.3	-10.6



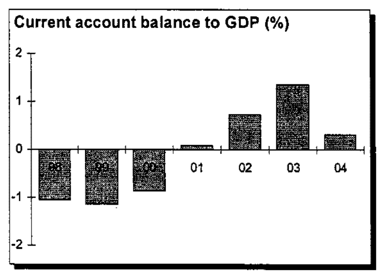
TRADE

	1984	1994	2003	2004
(US$ millions)				
Total exports (fob)	10,061	26,855	62,952	76,345
Tea	321	1,126	1,321	..
Iron	453	988	2,341	..
Manufactures	5,614	20,404	47,616	57,898
Total imports (cif)	15,715	35,904	79,658	99,836
Food	1,384	1,144	3,059	..
Fuel and energy	4,596	5,928	20,570	..
Capital goods	2,546	7,638	17,132	20,915
Export price index *(1995=100)*	99	109	93	104
Import price index *(1995=100)*	119	104	100	113
Terms of trade *(1995=100)*	83	105	94	92



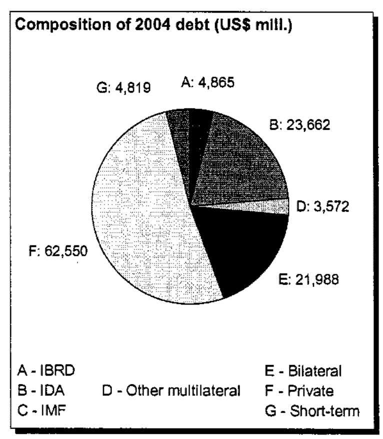
BALANCE of PAYMENTS

	1984	1994	2003	2004
(US$ millions)				
Exports of goods and services	13,508	32,990	90,568	108,948
Imports of goods and services	18,065	41,437	96,590	121,250
Resource balance	-4,557	-8,447	-6,022	-12,302
Net income	-838	-3,431	-4,703	-4,800
Net current transfers	2,496	8,093	18,885	19,243
Current account balance	-2,899	-3,785	8,160	2,141
Financing items (net)	2,516	9,526	8,820	19,655
Changes in net reserves	383	-5,741	-16,980	-21,795
Memo:				
Reserves including gold *(US$ millions)*	5,952	25,186	111,648	133,441
Conversion rate *(DEC, local/US$)*	11.9	31.4	46.0	44.9

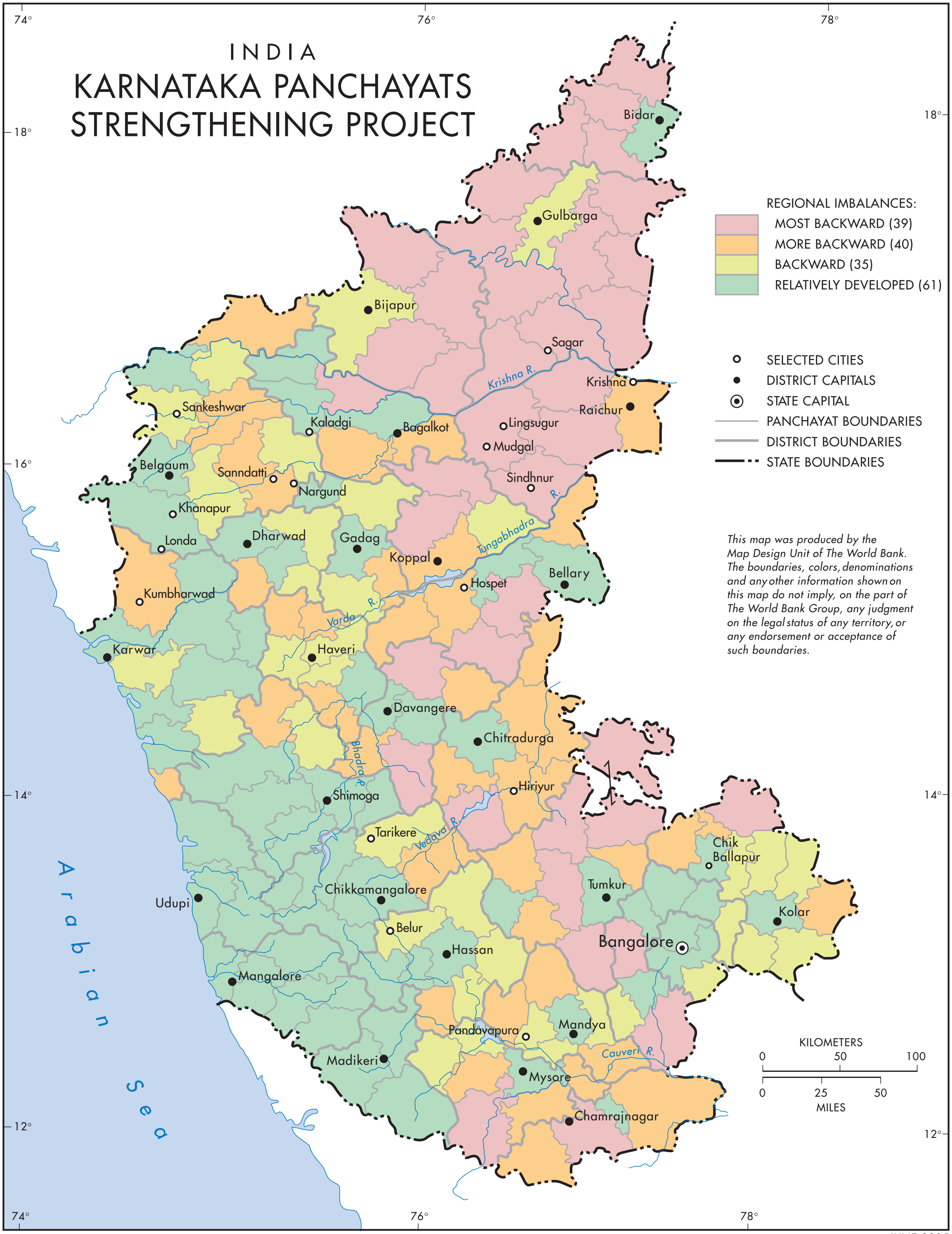


EXTERNAL DEBT and RESOURCE FLOWS

	1984	1994	2003	2004
(US$ millions)				
Total debt outstanding and disbursed	34,036	102,483	115,277	121,456
IBRD	1,688	11,244	4,126	4,865
IDA	8,545	17,758	22,351	23,662
Total debt service	2,973	10,951	14,469	11,337
IBRD	257	1,641	2,079	288
IDA	109	325	771	755
Composition of net resource flows				
Official grants	483	416	559	646
Official creditors	1,363	970	2,231	..
Private creditors	1,895	1,438	8,565	..
Foreign direct investment	0	983	3,137	4,020
Portfolio equity	0	3,824	11,355	8,996
World Bank program				
Commitments	2,651	2,064	1,600	2,705
Disbursements	1,114	1,783	1,717	1,835
Principal repayments	129	1,062	2,468	784
Net flows	985	721	-751	1,051
Interest payments	237	904	381	259
Net transfers	748	-183	-1,133	792



IBRD 34095



JUNE 2005