



<b>1. Project Data:</b>		<b>Date Posted :</b> 08/05/2003	
<b>PROJ ID:</b> P059149		<b>Appraisal</b>	<b>Actual</b>
<b>Project Name:</b> Karnataka Structural Adjustment Loan II	<b>Project Costs (US\$M)</b>	100	100
<b>Country:</b> India	<b>Loan/Credit (US\$M)</b>	100	100
<b>Sector(s):</b> Board: PS - Sub-national government administration (73%), General industry and trade sector (18%), General education sector (3%), Health (3%), Roads and highways (3%)	<b>Cofinancing (US\$M)</b>		
<b>L/C Number:</b> C3617; L4652			
	<b>Board Approval (FY)</b>		2
<b>Partners involved :</b>	<b>Closing Date</b>	09/30/2002	09/30/2002

<b>Prepared by :</b>	<b>Reviewed by :</b>	<b>Group Manager :</b>	<b>Group:</b>
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**2. Project Objectives and Components**

**a. Objectives**

Support the Government's efforts to stabilize its fiscal position, improve governance, and foster an enabling environment for structural reforms and sectoral investments under the Karnataka Economic Restructuring Program . KERL2 was the second in a series of programmatic loans, fulfilling the balance of an identified financing requirement of US\$250 million (KERL1 was in the amount of US\$ 150 million).

**b. Components**

**1. Fiscal reform and public expenditure management :** (a) Improved framework for fiscal sustainability and transparency. (b) Policy and administrative reforms to raise additional revenue, improve efficiency, and reduce compliance costs. (c) Improve composition of public spending . (d) Strengthen public expenditure management--institutionalize medium-term perspective into budgetary process; tighten link between expenditure composition and budgetary priorities; provide greater focus on performance of expenditure programs . (e) Strengthen public financial management and accountability . (f) Reform public procurement.

**2. Administrative reforms :** (a) Define governance strategy . (b) Reform civil service and public administration . (c) Improve delivery of public services . (d) Enhance effectiveness of decentralization . (e) Enhance freedom of information. (f) Use electronic governance to improve efficiency and transparency . (g) Implement and monitor anti-corruption program.

**3. Private Sector Development :** (a) Restructure and privatize public enterprises . (b) Deregulation and improved business environment.

**4. Poverty Monitoring and Statistical Strengthening :** (a) Strengthen poverty and human development monitoring system. (b) Strengthen program evaluation. (c) Improve macroeconomic forecasts.

**c. Comments on Project Cost, Financing and Dates**

The project provided the state with US\$ 100 million equivalent, half on IBRD and half on IDA terms . A proposed follow-on adjustment loan was not approved by the Bank in FY 03 due to inadequate power sector reforms .

**3. Achievement of Relevant Objectives:**

**1. Fiscal reform and public expenditure management :** Satisfactory

(a) Establish framework for fiscal sustainability and transparency . Fiscal targets were met: Number of days with overdraft from Reserve Bank of India was zero (meeting target); consolidated deficit (including power sector) was 6.2% of GSDP in 2001/02, compared to program target of 5.7%, but met target in 2002/03 by falling to 5.4% of GSDP (estimate). Transparency was increased by placement of more information on taxes and borrowing on the agency website (although it was not updated as frequently as it was in 2001/02), as well as providing data to the Centre for Monitoring the Indian Economy .

(b) Reform revenue system--Policy and administrative reforms to raise additional revenue, improve efficiency, and reduce compliance costs. Targets were generally met: Tax revenue grew 9.2% in 2001/02 and an estimated 10.2% in 2002/03. Own-tax/GSDP ratio rose from 8.6% in 2000/01 to 9.0% in 2001/02, then falling to 8.9% in 2002/03 (targets had specified "growth" in these areas). Tax arrears were low in nearly all departments. Extensive VAT preparations were made, but implementation awaits action at national level.

(c) Improve composition of public spending. Targets were broadly met: High-priority sectors were funded at same level in real terms (target was to "protect" these sectors); public hiring and pay restraint remains in place, and salaries as a % of GSDP fell; power sector deficit monitored monthly (as required); however, subsidy expenditures in 2002/03 exceeded targets due to drought, and identification of beneficiaries and cost recovery in public housing programs remained poor.

(d) Strengthen public expenditure management--institutionalize medium-term fiscal plan (MFTP) into budgetary process; tighten link between expenditure composition and budgetary priorities; provide greater focus on performance of expenditure programs. Targets were largely met: Pilot departments utilize MFTP; independent evaluation undertaken on limited basis, with some recommended reforms implemented; number of supplemental budget allocations reduced to 2.

(e) Strengthen public financial management and accountability --improve transparency, enable better financial monitoring, address weaknesses in internal control and accountability. Targets were largely not met: the state's payment system was computerized; monthly GOK finances were posted on the website, though with delays; less progress was made than envisioned in implementation of stronger internal controls, in clearance of audit backlogs, and in more timely public release of finance and audit accounts

(f) Reform public procurement. Achievement was mixed: there has been an increased number of tender bulletins on the internet, and some progress has been made toward revising procurement guidelines to be consistent with the Transparency Act. However, progress has been slow. GoK extended exemptions to the Act, which hinders progress.

## **2. Administrative reforms** : Satisfactory

(a) Define governance strategy. The governance strategy is defined in terms of implementation of the second Governance Strategy and Action Plan (GSAP), which was passed in August, 2002, and is comprised of items 2 (b) through 2 (g) below.

(b) Reform civil service and public administration--improve transparency, reduce corruption, improve efficiency. Targets were not met, as goal was "drastic reduction in transfers;" increased transfers of teachers caused rise in overall transfers; survey to document reduced corruption and improved employee motivation was not undertaken; stability and increased tenure for key positions was not achieved; rationalization of departments was not achieved.

(c) Improve delivery of public services (on a demonstration basis). Objectives were met: Computerized land records provided better service and less opportunity for corruption; performance of public transport, police, stamps, and registration improved. However, surveys to document improvement have not yet been performed.

(d) Enhance effectiveness of decentralization--strengthen accountability at local levels while enhancing autonomy. Targets have been largely met: some financial power has been delegated to local government, amendments have put forth to enhance local accountability and transparency, and most urban local bodies have expanded their revenue base. However, survey to document improvement of service delivery has not been implemented.

(e) Enhance freedom of information: Targets have been largely met: The Right to Information Act has been passed, and while this was a positive step, there has not been enough time to assess its impact.

(f) Use electronic governance to improve efficiency and transparency. Achievement has been substantial: Significant progress has been made in computerization of government functions, including land records and payment systems. Computerization efforts are underway in transport, agricultural prices, and other areas.

(g) Implement and monitor anti-corruption program. Achievement has been substantial: Anti-corruption agency has been aggressive and raised awareness of its efforts; limited survey data available indicate improvement; major increase in number of complaints filed.

## **3. Private Sector Development** : Unsatisfactory

(a) Restructure and privatize public enterprises. Achievement was mixed: Of the target of privatizing or restructuring 20 SOEs, action was taken on 12 (9 for closure and 3 for privatization). In this regard, it is appropriate to review

progress against the Government's original objectives (which specified 20).

(b) Deregulation and business environment--Decrease bureaucratic interference; increase FDI . Achievement was unsatisfactory:

Progress toward business deregulation has been slower than expected; legislative action was also slower than envisioned; no data available yet to indicate progress on changes in FDI .

**4. Poverty Monitoring and Statistical Strengthening** : Moderately Satisfactory .

(a) Strengthen poverty and human development monitoring system . Satisfactory: Poverty and Human Development Monitoring System has been developed and implemented; however, no evidence thus far of use by policy officials .

(b) Strengthen program evaluation--more extensive use of evaluation to improve program design . Satisfactory: Funds have been earmarked for evaluation and audit function; more than 30 evaluation studies have been prepared, with promulgation and discussion in workshops .

(c) Improve State Output Estimation . Unsatisfactory: While output and inflation estimates have become more timely, it is too early to judge improvement in their accuracy . At the same time, state economic estimates have been utilized more, e.g., in the MTFP .

**4. Significant Outcomes/Impacts:**

- The state substantially met its fiscal targets
- Tax revenue grew 9.2% in 2001/02 and an estimated 10.2% in 2002/03
- The MTFP was institutionalized into the budgetary process
- Substantial progress was made in launching electronic governance and improving transparency
- Substantial progress has been made in implementing and monitoring anti -corruption campaign

**5. Significant Shortcomings (including non-compliance with safeguard policies):**

- Less progress than envisioned was made in strengthening public financial management and internal controls, in the timely release of finance and audit accounts, and in clearing the backlog of audits
- Progress in procurement reform was slower than planned, with the GoK extending exemptions to the Transparency Act
- In civil service reform, "drastic reduction in transfers" was achieved in the first year of the program, but transfers doubled in the next year, reversing roughly half of the progress
- Viewed against the original targets set by the Government, fewer SOEs were privatized or restructured than envisioned
- Progress toward business deregulation was slower than expected
- Uncertainty prevails about the overall impact of measures designed to improve the accuracy of state output estimation

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
<b>Outcome:</b>	Satisfactory	Moderately Satisfactory	Project achieved most major relevant objectives, but with significant shortcomings (described in Section 5).
<b>Institutional Dev .:</b>	Substantial	Substantial	
<b>Sustainability:</b>	Likely	Likely	
<b>Bank Performance:</b>	Satisfactory	Satisfactory	
<b>Borrower Perf .:</b>	Satisfactory	Satisfactory	
<b>Quality of ICR:</b>		Satisfactory	

**NOTE:** ICR rating values flagged with '\*' don't comply with OP/BP 13.55, but are listed for completeness.

**7. Lessons of Broad Applicability:**

- The fiscal target utilized in the project was the consolidated fiscal balance, which includes the power sector financing requirement. This was an appropriate and meaningful indicator of the state's fiscal situation
- The project included a very large number of conditions and components, which makes supervision and monitoring of project achievement more difficult

**8. Assessment Recommended?**  Yes  No

**9. Comments on Quality of ICR:**

The ICR is satisfactory, and presents a great deal of information on project achievement . However, the report is long--31 pages-- not including annexes or a 10-page assessment of "recent development outcomes." The most concise, and valuable, part of the report is Annex 1, Key Performance Indicators, which arrays project objectives, performance benchmarks, and achievement .

