I. Introduction and Context

1. India follows a federal system of Parliamentary form of government. Public expenditures in India may be made at the national (Union level), or through 29 states, or 687 districts. Up to 80% of spending at the Union level in India is in the form of transfers to lower levels of government; accordingly, most public spending in India occurs at sub-national levels. The fiscal relationship between the Union and the States is reflected in the sharing/devolution of central taxes and additional assistance in the form of grants from the Union to the States.

2. PFM framework emanates from the Indian Constitution and is guided by Central policies and processes. To a large extent, Public Financial Management (PFM) framework in the States is guided by the policies as laid down at the Centre. Consequently, in some areas of PFM, the reforms at the state level are necessarily guided by and intrinsically linked to initiatives taken at the Union level. These include budgetary reforms - transition to program budget with an Medium Term Expenditure Framework/ Medium Term Budget Framework; reforms in the chart of accounts, which follows a uniform classification system across the union and states; responsibilities for accounting & financial reporting at the State level vested to the Accountant General, and the basis of accounting and financial reporting is guided by the Constitution and Controller and Auditor General/ Controller General of Accounts.

3. Within this framework, however there have been notable instances of States taking up public finance initiatives and reforms especially in the use of Information Technology to strengthen core treasury information (budget execution) systems, development of budget preparation modules, Human Resources Management Information Systems and linking it to core treasury systems, cash
management, e-collection/ e-payments; pension payments processes and systems and electronic interfaces with commercial Banks/ RBI. In the area of revenue mobilization & management (including VAT & Excise), states are moving towards consolidation of rates and bringing about improvement through e-Governance (e.g. Karnataka, Maharashtra). In the area of procurement some states (including Karnataka, Rajasthan & Tamil Nadu) strengthened the procurement framework by passing Procurement Act and framing rules therein. In fact, the systems in some of the states are considered to be more advanced than at the Union level.

4. **Himachal Pradesh (HP) is a Special Category state in recognition of its constraints.** It is a relatively small state, with a hilly terrain, a supply of perennial rivers, and significant forest cover. On one hand, the salubrious climate, abundant water resources, and natural touristic ambience can contribute to the expansion of important sectors like horticulture, tourism, and hydropower. On the other hand, HP faces specific development challenges arising from its high elevation, topography, resource dependence, and ecological vulnerability, as well as from a changing and more competitive international environment. The Government of India (GoI) has given HP the status of a "Special Category" state, under which the state is the recipient of special central grants and incentives that have been instrumental to its development.

5. **The State faces fiscal stress and has witnessed revenue deficits and substantial increase in public expenditure over the last few years.** The key reasons for fiscal stress include a slowdown in the growth of tax revenues; implementation of the 6th Pay Commission’s recommendations (which has resulted in substantial increase in salary payments); volatile non-tax revenues; and fiscal support to the public sector undertakings. The recent three years (2012-13 to 2014-15) have witnessed higher fiscal deficits as a consequence of growing revenue deficits. Committed expenditure on salaries, pensions, interest and subsidies account for about 65-70% of total expenditure of the state. The state has slipped in its compliance of the FRBM legislation over the last several years.

6. **GoHP has committed to improve the overall governance environment of the state and has a history of initiating PFM Reforms.** In the past several reform initiatives have been undertaken. These include a continuous and long engagement with the World Bank, including a Development Policy Loan (in 2007) that provided the state with $200 million in budgetary support to implement much-needed fiscal reforms. HP is one of the few states in India that have completed a PFM Assessment (World Bank Report # 48635-IN of 2009). The State was engaged with the Bank through a NLTA which closed recently.

II. **Program Description**

7. **Over the last few years, the GoHP has initiated a series of PFM reforms which has led to PFM reform and modernization.** These include modernization of State Treasuries, revision of the Financial Rules, pilot of a Contract Management System (CMS) in the Irrigation and Public Health Department (IPH), introduction of e-Procurement, and increase in e-payments. HP has already ratified the GST bill and is looking forward to initiate the implementation of the new tax structure once the Parliament approves the GST law. In order to ensure quality of service delivery and maximize revenue potential, the State plans to further modernize its revenue administration and expenditure management systems and build capacity of the respective departments to manage and roll-out the envisaged reforms.
8. The Government’s PFM Reform Program is defined through the following three pillars:

a. Improving efficiency of the FD in an enhanced control environment: Under this pillar, the State will continue to reform the FD and modernize its entire payments systems (Treasuries) with the objective of improving the efficiency of expenditure and reduce the turn-around time in delivering services. The activities under this pillar will include advisory on cash/ debt management; revision of Treasury Rules and other guidelines; establishing IT enabled budget preparation systems; establishing IT enabled commitment control systems; strengthening IT security; and establishing an automated interface between the Treasuries and some 4700 departmental officials. These will address the issues of compliance and control as well as focus on automation of processes to achieve optimum “paperless” and “cashless” payment systems. The basic systems are already in place and running satisfactorily; the state now wants to move towards the second generation of PFM reforms;

b. Increasing efficiency and performance through better contract management: The GoHP intends to integrate public procurement and contract management into a well-defined PFM system. The government’s PFM reform strategy proposes an approach that will focus on integrating procurement with planning, budgeting, accounting and auditing. The reforms under this pillar would focus on increasing the coverage of the e-Procurement system to all State departments and the design and roll-out of a Contract Management Solution (CMS) to improve program monitoring and expenditure efficiency;

c. Unlocking revenue potential through modernization of the Excise & Taxation Department: To augment its revenue collection capacity and reduce leakages, the Government intends to strengthen the excise and VAT/ GST administration through strategic organizational reforms and roll-out of new IT platforms. The reform initiatives under this pillar would involve design and implementation of an e-Governance system for the Excise function to augment the tax assessment capacity of the department, organizational and human resource management reforms to ensure acceptance and sustainability of the proposed reforms and targeted technical assistance and capacity building for the department to enable the roll-out of the new GST regime.

9. The Bank is financing the entire PFM Reform Program of GoHP. The Program supports initiatives in the Finance Department, Department of Treasuries and Accounts, Excise and Taxation Department and the Irrigation and Public Health Department. The Program size is USD 45 million and the Bank will finance this to the extent of USD 36 million. It will be implemented over five years starting April 2017 and ending March 2022. The underlying activities will be consultancies, IT hardware, connectivity, software development, training & other capacity building activities, M&E, civil works, staff salaries, operational expenditure etc.

10. All the components would contribute in significantly improving the PFM environment in the state and result in improved revenue realization and expenditure management. Specific activities under the support areas include:

- Strengthening Treasury functioning and implementing next generation Treasury/IFMIS reforms which among other activities includes building missing functionality in IFMIS, capacity building of
Treasury officials and DDOs, improving Treasury infrastructure, and establishment of facilitation centres across the state.

- Strengthening the PFM reform architecture by implementing cash management and debt management systems.
- Establishing/strengthening the enabling IT infrastructure systems and their maintenance for rolling of e-governance reforms state wide.
- Rollout of e-procurement system across all state departments.
- Rollout of a CMS in IPH.
- Institutional reforms including training in ETD for better revenue management and clearing of backlog assessments;
- Strengthening Business intelligence and analytical capabilities of the ETD;
- Implementing e-governance in the Excise function of ETD including a software for HP Breweries Corporation Limited.

III. Institutional and Implementation Arrangements

11. The FD is responsible for overall management of the Program. The Directorate of Treasury ensures coordination between different stakeholders and directly facilitates implementation of Program activities. A Program Steering Committee under the leadership of the Additional Chief Secretary (Finance) and Secretaries of participating departments exists, to provide strategic leadership and inter-departmental coordination for Program implementation. A Public Financial Management Reforms Division provides the necessary administrative support and operates under the ACS (Finance) as the Program Director; Director Treasuries as the Additional Program Director and the Additional Director Treasuries as the Program Nodal Officer. Further, the PRD provides the necessary support for budgets, procurement, approvals, and co-ordination. Each of the participating departments is responsible for their respective Program pillars and associated activities.

IV. Initial Environmental and Social Screening

12. Assessment of Environmental Systems: The Assessment of Environmental Systems indicates that (i) the capacities of the key institutions and coordination between the institutions on environmental aspects is good, except for the need for few changes in procedures (eg: architect from PWD should be part of land inspection team); (ii) clear and stringent procedures exist for selection of land, inspections, transfer or diversion of forest land; (iii) existing legal and regulatory framework and policies are adequate to govern the environmental sustainability of Program activities; (iv) guidelines and codes of practice exist for environment friendly and disaster proof constructions. However, there is a need for improvement in awareness, monitoring and convergence with other Departments and Institutions.

13. Assessment of Social Systems: With regard to social systems, the Program activities are expected to have overall positive benefits owing to enhanced efficiency and effectiveness of PFM systems. New construction of treasury and sub-treasury offices, and refurbishment, renovation and upgradation of existing treasury offices will be done on Government land in possession of the nodal department. Also the Program would not fund construction on any land for which clear title is not available with the nodal department, or where it impacts livelihood and living of residents, or where any resettlement is required. The State makes special effort by preparing and implementing Tribal Sub Plan and Scheduled Castes Sub Plan adhering to revised national guidelines to ensure proportionate flow of plan resources for the development of SCs and STs.
V. Program Financing

14. Following is the Program financing pattern:

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government</td>
<td>9.00</td>
<td>20%</td>
</tr>
<tr>
<td>IBRD PforR</td>
<td>36.00</td>
<td>80%</td>
</tr>
<tr>
<td><strong>Total Program Financing</strong></td>
<td><strong>45.00</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
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