PD-ABH-588
ISN 86052

SANITIZED VERSION

FINANCIAL INSTITUTIONS REFORM AND EXPANSION PROJECT

PROJECT PAPER

PROJECT 386-0531

Date: October 1, 1993

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete)

Amendment Number:

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: India

3. PROJECT NUMBER: 386-0531 386-HG-IV

4. BUREAU/OFFICE: ASIA 04

5. PROJECT TITLE (maximum 40 characters): Financial Institutions Reform and Expansion

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM DD YY 09 30 98

7. ESTIMATED DATE OF OBLIGATION (Under 'B:' below, enter 1, 2, 3, or 4)

A. Initial FY 93 B. Quarter 4 C. Final FY 97

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 1993			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total	21,490	510	22,000	139,000	6,000	145,000
(Grant)	(1,490)	(510)	(2,000)	(14,000)	(6,000)	(20,000)
(Loan) Housing Guarantee-Loan	(20,000)	(-)	(20,000)	(125,000)	(-)	(125,000)
Other U.S. 1.						
Other U.S. 2.						
Host Country	-	20,700	20,700	-	132,000	132,000
Other Donor(s)						
TOTALS	21,490	21,210	42,700	139,000	138,000	277,000

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1) DAF				-	-	2,000*		20,000	
(2) HG				-	-		20,000		125,000
(3)									
(4)									
TOTALS				-	-	2,000	20,000	20,000	125,000

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

To improve the legal/regulatory framework and the operational environment of India's capital market, and to assist in developing the debt component of that market by demonstrating the commercial viability of selected urban infrastructure projects.

14. SCHEDULED EVALUATIONS

Interim MM YY 08 95 MM YY 08 96 Final MM YY 08 98

15. SOURCE/ORIGIN OF GOODS AND SERVICES

[X] 000 [ ] 941 [X] Local [ ] Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment)

* HDVA-93-27386-KG-13($1,300) and HDVA-93-27386-EG-13 ($700)

Clearance: Co: WCGraham

17. APPROVED BY

Signature

Title: Walter G. Bollinger
Mission Director
USAID/INDIA

Date Signed: MM DD YY 09 17 93

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION

MM DD YY

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PROJECT AUTHORIZATION

Country: INDIA
Project: Financial Institutions Reform and Expansion
Number: 386-0531

1. Pursuant to Sections 103 through 106 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Financial Institutions Reform and Expansion (FIRE) Project for India (the "Cooperating Country") involving planned obligations of not to exceed Twenty Million United States Dollars ($20,000,000) subject to the availability of funds in accordance with the annual OYB allotment process, to help in financing the foreign exchange and local currency costs of the Project. The planned life of the Project is five years from the date of initial obligation.

2. The Project is designed to assist the Government of India (GOI) to improve the legal and regulatory framework, and the operational environment of India's capital market and to assist in developing the debt component of that market by demonstrating the commercial viability of selected urban infrastructure projects. It will assist India's capital markets by improving: 1) trading practice transparency; 2) time required for the settlement and clearance of transactions; 3) disclosure norms for market participants; 4) investor services; and 5) capacity to mobilize resources for urban infrastructure that will be designed to assist, in large part, households below the median income level.

3. Goods and services financed by A.I.D. under the Project shall have their source, origin and nationality in the United States except as indicated below. Local source procurement is authorized pursuant to Handbook 1, Supplement B, Section 5D10a(1)(e) for approximately Six Million U.S. Dollars ($6,000,000) for local training and consultancy costs, and audit/payment verification costs because success in the achievement of project objectives requires that we substitute expatriate for local expertise as little as possible. In addition, local source procurement is authorized for those categories of goods and services listed in Handbook 1, Supplement B, Section 18A1c.

Signature Walter G. Bollinger
Name: Walter G. Bollinger
Title: Director
USAID/ India
Date: 9-17-93

GUARANTY AUTHORITY
Program No.386-HG-IV
(Authorization No.386-HG-015)

Provided From: Housing Guaranty Authority

For : The Government of India

Pursuant to the authority vested in the Mission Director by the Foreign Assistance Act of 1961, as amended (FAA) and the Delegations of Authority issued thereunder, I hereby authorize the issuance to eligible U.S. investors (Investors) acceptable to A.I.D. of guaranties pursuant to Section 222 of the FAA of not to exceed United States Dollars Twenty Million Only (U.S. Dols 20,000,000) in face amount. The Guaranties shall assure against losses as provided in the Housing Guaranty Standard Terms and Conditions (22 C.F.R. Part 204) with respect to loans including any refinancing thereof. These Guarantied loans shall be made to the Government of India or a financial institution satisfactory to A.I.D. (Borrower) to support the improvement of the operating environment of the capital market and to assist in the development of the debt component of that market with special emphasis on infrastructure finance as a means for stimulating debt market development and that benefits shelter-related infrastructure for the urban poor.

These Guaranties shall be subject to the following Terms and Conditions:

1. Terms of Guaranty

The Loans and any refinancing thereof shall extend for a period of up to thirty (30) years from the date of each disbursement of the loans and may include a grace period of up to ten (10) years on repayment of principal, during which the interest shall accrue and be payable, and contain such other terms and conditions as are agreed to by the Borrower and the Investor, subject to the approval of A.I.D. The Guaranties of the loans shall extend for a period beginning with the first disbursement of the loans and shall continue until such time as the Investor has been paid in full pursuant to the terms of the loans.

2. Interest Rate

Interest rate or rates of interest payable to the Investor pursuant to the Loans shall not exceed the allowable rate of interest prescribed pursuant to Section 223(f) of the Foreign Assistance Act of 1961, as amended (FAA), and shall be consistent with the rates of interest generally available for similar types of loans made in the long-term U.S. capital markets.

3. Government of India Guaranty

Prior to disbursement of any loan amounts pursuant to this Guaranty Authorization, a written guaranty to indemnify A.I.D. against all losses arising by virtue of A.I.D.'s guaranties to the Investor or from non-payment of the A.I.D. fee shall be provided in a form satisfactory to A.I.D. by the Government of India (or a financial institution authorized by the Government of India to provide such a guaranty and approved by A.I.D.).

4. Fee

The Fee of the United States shall be payable in U.S. Dollars and shall be equal to one-half of one per cent (1/2 percent) per annum of the outstanding guarantied amount of the loans plus a fixed amount equal to one percent (1 per cent) of the amount of the loans authorized or any part thereof, to be paid as A.I.D. may determine upon disbursement of the loans.

5. Other Terms and Conditions

The Guaranty shall be subject to such other terms and conditions as A.I.D. may deem necessary.

In accordance with the provisions of the Federal Credit Reform Act of 1990, I hereby authorize the obligation of United States Dollars Two Million Five Hundred and Seventy-Two Thousand) (Dols 2,572,000) to cover the subsidy of Authorization No.386-HG-IV and for use of United States Dollars Twenty Million (Dols 20,000,000) in Guaranty Authority, action must be taken to obligate these funds by no later than September 30, 1993 by receiving from the Government of India the countersigned Letter of Advice. The Guaranteed Loans must be disbursed by no later than September 30, 1998 after which time the obligated funds expire.

Walter G. Bollinger

Walter G. Bollinger
Director
USAID/India

9-17-93

Date

I. BACKGROUND

A. Introduction

India's economic recovery following the crisis of mid-1991 has been swift. This is due to good economic management and adherence to a sound stabilization program along with the implementation of broad ranging structural reforms and market liberalization. Real GDP, which dipped below two percent in 1991/92, is projected to grow at four percent in 1992/93.

To increase the rate of growth to 5-6 percent in the medium term, the Government of India (GOI) plans to raise investment from the present level of 24 percent of GDP to 27 percent and to improve the overall efficiency of investment. Attaining this goal will require increased domestic savings, though it is expected that an immediate gain in investment will be realized through the more efficient use of existing savings. The Government has been liberalizing the country's financial markets and modifying regulatory controls in order to create an environment conducive to the efficient allocation and use of investment resources.

Jettisoning antiquated controls is the easier half of market liberalization. Liberalization places great reliance on markets to allocate financial resources efficiently so that their performance of this function is sustainable in the long term. Markets can do this only if they are set up to operate properly. Without transparency and full disclosure, for example, the capacity of capital markets to serve as sustainable vehicles for mobilizing savings will remain constrained.

The Financial Institutions Reform and Expansion (FIRE) Project will support the GOI in its efforts to revamp India's capital markets to enable them to serve as efficient and reliable sources of development finance. The Project will have three components: 1) the Regulatory Environment Improvement Component; 2) the Operating Environment Improvement Component; and 3) the Debt Market Development Component. Funding to be provided under the Project will include $US 20 million in Development Assistance (DA) and US $125 million in Housing Guaranty (HG) assistance over a five-year period.

The Project will help reduce India's poverty by accelerating market-led growth through the increased mobilization and more productive use of capital resources. The Debt Market Development Component will contribute directly to improving environmental conditions and the standard of living in selected low-income urban areas, and will provide a broader capital base for the country to expand its infrastructure facilities over the medium to long-term.

B. BACKGROUND

Until the early 1980's, financial intermediation in India was predominately performed by India's 28 public sector commercial banks, 52 private sector commercial banks, and eight Development Finance Institutions (DFIs). Whereas the commercial banks and DFIs have historically been the principal sources of capital for India's corporate sector, during the 1980s the securities markets dramatically expanded and became an important source of capital for the corporate sector. For example, whereas US $200 million was mobilized for India's corporate sector through the primary markets during 1981-82, US $2 billion was mobilized in 1991-92: a ten-fold increase over a period of ten years.

Even though both the equity and debt components of the market have grown in absolute terms, equities have clearly dominated the scene. A review of the Reserve Bank of India's "Report on Currency and Finance" suggests that debt accounted for no more than 20 percent of the total resources mobilized through the securities markets in any of the five years starting 1986 to 1991. At the end of March 1992, the market capitalization for equity was Rs 2,000 billion (US $66 billion) and the market capitalization for debt was Rs 300 billion (US $10 billion). The low share of debt in the total resources mobilized through the securities market is an indicator of the fact that, historically, long-term finance was available through the DFIs at below market rates administered by the Government. This coupled with low interest yields on debentures, the absence of an exit mechanism for commercial enterprises and no tax concessions (unlike tax concessions on Public Sector Unit (PSU) bonds, bank deposits and dividend income) rendered private sector debt instruments unattractive to investors at the retail level.

Stock markets are not new to India. Records show that transactions in government securities and in East India Company debt securities took place in Dalhousie Square in Calcutta toward the end of the 18th century. The Bombay Stock Exchange (BSE) was founded in 1875, and since then Bombay has been known as the financial capital of India. The BSE currently handles about two-thirds of the country's equity trading.

There are 22 other exchanges in India, including the Over the Counter Exchange of India (OTCEI) which is India's first electronic exchange. The other main exchanges are located in Calcutta, Ahmedabad, Delhi and Madras. The development of India's stock markets has evolved independently of foreign participation and despite a persistent anti-market bias of post-colonial governments.

India's equity market is surprisingly large, has considerable depth, and is not, in many respects, an "emerging" market. The market's capitalization stood at US $5 billion ten years ago, and it had an annual turnover at that time of approximately US $5 billion. The markets in Taiwan, South Korea and Brazil were roughly the same size, while Turkey, Indonesia, and Thailand had markets with capitalizations of US $1 billion or less.

The decade of the 1980's witnessed accelerated growth in India's equity market. Although the rate of growth was not as dramatic as in other countries, it was consistent with global trends. Between 1980 and 1992, the number of companies listed on the stock exchanges increased tenfold; the number of share-holders soared from around two million to over 15 million; market capitalization increased from US $5 billion to US $50 billion; and by the close of 1992, the annual volume of trading had reached US $37 billion.

India's debt market has developed more slowly and has not yet become a major source of finance for India's private corporate sector. Historically, the market has been driven primarily by public sector requirements for capital resources. The Reserve Bank of India's (RBI) Statutory Liquidity Requirement (SLR), a system that requires Indian banks to invest a specified percentage of their liabilities in government-designated instruments, has virtually transformed India's debt market into a captive market for government debt. Under liberalization, however, the SLR requirement is being phased down, and a progressively larger share of government debt is being subjected to auction.

Overall, the securitized debt market in India is not small. The market for government securities is large, and the value of outstanding government securities is estimated to be over US $30 billion. The government introduced the sale of government securities through auction in 1992 and the auction is undertaken with a ceiling on auction coupon rates. Financial institutions, commercial banks, insurance companies and provident funds and other non-bank financial institutions subscribe to these securities. Financial institutions and commercial banks, however, subscribe to the government securities primarily to meet the Statutory Liquidity Requirement. Therefore, even though the primary market is large, it is also captive, and there is a very non-liquid secondary market.

Public sector corporate entities began issuing bonds in 1985-86, and the current amount outstanding is estimated to be Rs 205 billion. The bonds carry a maturity of seven-years and a coupon rate not exceeding ten percent for tax free bonds and 14 percent for taxable bonds. The bonds are normally placed with banks, mutual funds, large companies and Public Sector Units.

Private corporate entities issue debentures to meet roughly 1/3 of their debt capital needs. As noted above, the interest rates on these debentures are now market driven and range between 16-19 percent. The debentures are placed privately with financial institutions, and, even though they are mandatorily rated and listed on the stock exchanges, they are not actively traded. Large private companies (i.e., all companies with a net worth of Rs 50 million or more) are also permitted by the RBI to issue Commercial Paper (short-term loans) with maturities of between 3-6 months for which the interest rate is market determined.

Private corporations have been able to secure a substantial share (approximately 2/3) of their capital requirements through subsidized, long-term financing from India's Development Finance Institutions. Access to these funds, coupled with low interest rates and the lack of liquidity for Non-Convertible Debentures, the primary private corporate debt instrument, has kept the private corporate debt market at a relatively undeveloped stage.

One of the key factors influencing the demand for debt financing in India has been the prevailing rate of interest. Until recently, the interest rate structure was basically a system of government administered rates. In 1991, companies were given the freedom to set their own rates of interest on debentures. On average, the rates have varied between 14-17 percent, but still are not as yet considered by investors to be competitive with returns on equity investments.

The 1980's witnessed several innovations in the debt market in terms of the types of instruments available. Convertible Debentures [Debentures that are convertible to equity after a specified period of time (CDs)] were introduced in the mid-1980s, and Partially Convertible Debentures (PCDs) in 1989. The quasi-debt nature of both of these instruments offered investors the lure of access to equity upon conversion, often at a price below the prevailing market price. Additional instruments are being tested in the market, e.g., Convertible Preference Shares which provide a fixed return for the first three to five years followed by conversion to equity.

In its efforts to promote the privatization of municipal services (especially water supply, sewerage and solid waste management systems), the GOI is seeking to obtain finance for urban infrastructure projects from the country's long-term debt markets. As indicated earlier, the market has not yet developed the capacity to mobilize capital in the amounts needed to meet these requirements. Debt instruments that are attractive to investors will need to be developed and bond market operations improved dramatically in order for funds from this source to become available.

C. The Regulatory Environment

India's regulatory environment is characterized by a plethora of regulations and a variety of regulating authorities. In an attempt to rationalize the prevailing regulatory environment, the GOI, in 1992, repealed the Control of Capital Issues Act of 1956, thereby abolishing the Office of the Controller of Capital Issues (CCI).

With the abolition of the CCI, the regime wherein the government determined the price of public offers came to an end and a new era of freer pricing was ushered in. The Securities Exchange Board of India (SEBI) was set up under the SEBI act of 1992 as a statutory body for the development and regulation of the securities markets. Under the present arrangement, SEBI has statutory control over only the secondary market, whereas the Department of Company Affairs is the concerned agency for approving company prospectuses and has direct jurisdiction over issuers.

In the past, certain government regulations, including GOI control over pricing of primary equity issues, led to gross underpricing of new issues and consequently to serious price distortions. However, with the abolition of the Office of the Controller of Capital Issues, the Government has attempted to usher in an era of free pricing. The system, in principle, now relies on market pricing of equity and debt issues, but the existing system has limitations. These include significant overpricing of issues by the issuers, long time lags between the date of price determination and the opening date of the issue, and the limited role of underwriters and merchant bankers in determining/negotiating prices.

A further consequence has been the emergence of an investor community that is accustomed to assured profits and government protection against risk of loss. One often hears that India has developed an "equity cult." The term is misleading, because it implies that a sizable group of investors has learned to participate in a true market-driven securities market. This has not as yet been the case in India.

The practice of closely controlling market operations, generally labelled as the "merit review" approach, was adopted some years ago by a number of Asian countries to accord with their efforts to "protect" the public and redistribute wealth. Most of these countries are now finding that conversion to a "full disclosure" basis of market operation is preferable.

Under a full disclosure system, investors have equal opportunity to obtain sufficient information about particular securities and about the persons engaged in the securities business to enable them to make their own informed investment decisions. The government does not attempt to protect the investors, either individually or as a group, from the results of their decisions. There are, however, penalties for fraudulent practices such as deceit, misrepresentation and market manipulation.

India is among the countries that have begun the process of converting to a full disclosure system. It will take time to bring the system to fruition because the establishment of effective deterrents to unlawful practices is essential to the proper functioning of such a system. The development of efficient methods for investors to recover losses due to illegal behavior (as distinguished from losses due to market and business risk) is also a prerequisite.

In addition, the completely different market environment that a full disclosure system provides will require that a major educational process be undertaken to inform the investor community of the risks and opportunities inherent in such a system. Particular efforts are needed to redirect small investors to investment funds (e.g., mutual funds and pension funds) that provide professional portfolio management.

Several significant problems exist in India's current regulatory framework that will make the transition to a full disclosure system difficult. These include the considerable fragmentation of authority among the government agencies involved in regulating market operations (e.g., the current fragmentation between the primary and secondary markets); the weak enforcement of regulations by agencies that do have regulatory authority; and a general lack of efficiency and transparency in market operations.

1. Fragmentation of Authority

Although the Securities and Exchange Board of India (SRBI) was created to oversee the country's capital markets, significant overlaps in authority remain between the Ministry of Finance (MOF), the Department of Company Affairs (DCA), the Reserve Bank of India, and SEBI. This fragmentation of authority has resulted in a regulatory system which is less effective than it could be.

Whereas the MOF regulates exchanges, the RBI regulates money market funds and oversees merchant banks that are operated by banks. SEBI regulates mutual funds and merchant banks, as well as other market intermediaries. The DCA is involved in disclosure and other corporate matters that affect the securities markets and has authority for the prosecution of any actions affecting the market operations of corporations, including those that would normally be brought by a securities regulatory body like SEBI.

2. Absence of Effective Enforcement

The fragmentation of authority has led to a virtual absence of enforcement efforts. The lack of enforcement is compounded by the fact that enforcement powers generally associated with a capital markets supervisory authority have not yet been delegated to SEBI. For example, SEBI has no authority over prospectuses and corporate disclosure, or the distribution of securities by issuers, a key focus of most securities regulatory bodies. Further, it does not have the authority to impose civil penalties or to participate actively in the process of instituting criminal actions.

3. Lack of Consistent Legal Framework

In addition to the problems of fragmented authority and the absence of effective enforcement is a more fundamental problem: the laws governing India's capital markets [principally, the Companies Act, the Securities (Contracts) Regulation Act, and the Securities and Exchange Board of India Act] do not provide a framework for market regulation that accords with international standards. A complete overhaul of the laws is needed to simplify and streamline them and to permit the proper allocation of regulatory jurisdiction.

D. The Operating Environment

1. Deficiencies in Market Operations

The principal complaints about capital markets in India at present relate to certain rigidities in the way in which the markets are structured and to deficiencies in the way in which they operate. These problems expose the investing public to manipulation by the securities industry and could, accordingly, hamper efforts to improve market operations. The particular deficiencies which give rise to and perpetuate these complaints are discussed below.

a. Lack of Transparency

The lack of transparency in investor trades is, perhaps, the main deficiency in the way capital markets operate in India. Lack of transparency means that a person who deals in a market does not have access to sufficient information about the market, the issuers of a security, or the security itself, to determine whether he is making a proper investment decision.

The lack of transparency is evident at three levels. There is little transparency in terms of the prices at which securities trades are negotiated; company disclosures are not adequate; and, being manual, trade reporting at most of the exchanges is less efficient and, consequently, less transparent. Furthermore, brokers operate both on their own account as well as on the account of their clients for which no separate books of accounts are maintained. This leaves tremendous scope for manipulation of books of record and less than the best price for the investor. Also, because of the absence of a national market system, investors do not have access to information regarding the prices for stocks on different exchanges thereby preventing them from executing trades at the best price. Whereas this lack of connectivity among the exchanges and the consequent lack of price transparency is disadvantageous for the investor, it allows brokers to take advantage of the situation through arbitrage arrangements.

The way corporate disclosure is handled in India (which includes prospectuses that provide information relative to a public offering, as well as annual and periodic reporting and reporting of material events) also constitutes a major deficiency. There is no adequate filing system for corporate disclosure by public companies, and no centralized public reference facility. Due largely to the lack of enforcement, information is exchanged informally, and hence, unevenly across investors.

b. Lack of Interconnected Trading Systems

A major structural problem affecting market operations is the lack of a single market or interconnected trading systems. This problem is exacerbated by the inability of the country's various stock exchanges to function cohesively, not only in terms of legal and regulatory policies, but also in terms of trading practices and settlement procedures. The establishment of a National Stock Exchange (NSE), which is expected to help circumvent and avoid the many deficiencies present in the existing exchanges, has been put on a fast track by the Ministry of Finance. Establishment of the NSE is proceeding rapidly despite strong resistance from vested broker groups and from the existing exchanges.

c. Lack of Automation

The absence of automation, first at the level of the individual stock exchange and second at the level of the interconnection of all exchanges, prevents an individual order from receiving exposure to the greatest number of buyers and sellers qualified to compete for the business. The lack of automation at an individual exchange also inhibits the rapid dissemination of price information. In addition, it makes it difficult to establish an audit trail that can help assure investors a fair price.

An efficient market regulatory system can, without automation, assure dissemination of the rules of the game in an orderly and fair manner and can assure that corporate data is reasonably accurate. It can also, without automation, provide for an audit trail that can be used to trace violations of "best price" and assure that other rules designed to protect investors in the trading process are effectively implemented. This has been done in many other countries. However, automation enhances significantly the ability of regulators to accomplish these goals. In India, because of high trading volumes and a pervasive lack of trust in brokers, automation is essential to enable them to do so.

d. Lack of Investor Access to Brokers

In India, an estimated 80 percent of individual investors must go through one or more sub-brokers in order to process their securities transactions. Sub-brokers are estimated to be in excess of 100,000 while member-brokers of recognized exchanges number only about 5,000 - or one for every 170,000 people. The sub-broker seems to be India's current substitute for a retail brokerage industry. They also keep brokers from having to deal directly with the investing public.

Each sub-broker adds to the cost of a transaction in the form of either an increased purchase price or a reduced sales price. These additional costs are not transparent and add to the general problem of price transparency. The situation is exacerbated in some markets by systems which allow and encourage brokers to speculate in transactions.

e. Inefficient Clearance and Settlement Systems

India's existing clearance and settlement procedures require tremendous paperwork related to the physical handling and movement of certificates. The system is grossly outdated and simply inadequate to the task of handling a rapidly growing volume of business.

The industry's standard fortnightly settlement period is too long by any measure, and too loosely applied. This has led to delays in settlement, pay-outs and delivery; "bad deliveries" (i.e., trades of bonds and stocks which fail); and a general loss in market liquidity.

(1) Lengthy Settlement Periods

The Bombay Stock Exchange, which handles the bulk of India's trading and settlement volume, divides the year into twenty-five fixed settlement periods of two weeks duration. Each settlement period begins on a Friday and ends a fortnight later on a Thursday. All transactions entered into during a particular settlement period are to be settled by the end of that period. This requirement falls far short of the international standard for settlement of T+3 (the trading date plus three days).

Settlement procedures in the Bombay and three other leading exchanges divide listed shares into two groups, viz., specified (or forward listed shares) and non-specified (or cash listed). A special privilege given to shares included in the specified list is that transactions in those shares may be carried forward in the form of "badla." In practice, the bulk of outstanding positions in specified shares at the end of a settlement period (about 75 per cent) get carried forward to the next fortnightly settlement period, thereby delaying settlement and heightening the speculative nature of the transactions.

Actual settlement, i.e., pay-out, usually takes 15-20 days from the end of a settlement period. It usually takes 3-6 weeks between a transaction date and the delivery of the securities to the buyer, and it usually takes 3-8 weeks between the transaction date and the payment date. Once the securities are received, the buyers have to register the securities with the company concerned, or with the company's registrars or transfer agents, to finalize the transfer of the ownership of the securities. This requirement involves considerable additional time, often months. Furthermore, the company reserves the right to refuse transfer of shares.

Undue delays in settlement may also be caused by "bad delivery." Currently, some 8-10 per cent of total deliveries are "bad." The most frequent reason for bad delivery is the lack of a match between a transferor's signature on a transfer form and the copy of his signature on file in a company's records. A second is the frequent number of times that the one year time limit imposed on a transfer form's validity is exceeded.

(2) Excessive Paperwork

For non-specified shares, settlement periods are generally of one week duration. In the case of the BSE, however, the settlement period is two weeks, and no carry forward is allowed, i.e., all outstanding positions at the end of a settlement period are required to be settled by actual delivery. While member payments are effected through the clearing house by checks, securities traded between members must be delivered physically on the basis of delivery orders issued by the computer center of the exchange. The paperwork required under the existing system is enormous and has grown to a choking point in the brokers' back offices.

2. <u>Structural Problems in the Market</u>

a. Lack of Tradable Debt Instruments

The bond market in India is essentially dominated by government securities, for which the market is a captive one. Banks and financial institutions constitute the primary market for these securities which are subscribed in compliance with the Statutory Liquidity Requirement described above. This coupled with the fact that thus far the return on these bonds has not been market determined and consequently vastly misaligned, best explains the absence of an active secondary market for government securities.

The primary private and public corporate debt instrument, i.e., fixed coupon debentures, is effectively the only debt instrument available in the Indian market. However, the lack of liquidity and adequate trading mechanisms has rendered it unpopular at the retail level. Furthermore, there are no specialized mutual funds that invest their resources in debt securities of the public or the private corporate sectors. This has clearly limited the investment choices for investors who wish to invest in secure, fixed-yield instruments.

b. Absence of Instruments to Hedge Investments

Options and other futures instruments which provide an investor a means to hedge his investments are not permitted in India. As India's capital markets grow in size and market participants increase, the level of investment will also grow. The absence of these vehicles could inhibit the desired growth of the markets.

3. <u>Institutional Deficiencies</u>

India has already established a multitude of the various institutions commonly found in securities markets around the world. These include brokerage firms, merchant banks, venture capital firms, credit rating agencies, custodians, mutual funds, stock exchanges, and accounting firms. Nevertheless, there is still an absence of several important and useful institutions.

a. Absence of Strong Self-Regulatory Organizations

In many markets, market participants are charged with regulating themselves, which they normally attempt to do through the establishment of self regulatory organizations (SROs). Several such organizations are presently operating in India's markets (primarily the stock exchanges), but they are weak and not well-managed. Other types of SROs, such as the National Association of Securities Dealers (NASD) in the U.S., have not yet been established in India.

SROs can contribute significantly to regulating market operations, primarily because the persons involved in such organizations have generally had market experience and are likely to be aware of recurring abuses and violations. The establishment of SROs is also important because increasingly limited budgetary resources have made it difficult for government regulatory agencies to provide adequate oversight.

SROs are most effective in situations in which (a) those participating in market activities are interested in assuring that violators are penalized so that business can be conducted fairly; (b) the Government oversees the operations of SROs to ensure that they are in fact fulfilling their regulatory mandates, and (c) other deterrents to unlawful conduct, such as effective civil remedies, exist and are enforced. The establishment of this kind of a regulatory environment has not as yet been accomplished in India.

b. Outdated Transfer Agents and Registrars

The use of transfer agents and registrars to validate and effect securities transactions is an outmoded practice and constitutes a major obstacle to improving market operations in India. The agents are inefficient and are often the cause of delays in the transfer of securities. This problem will likely be resolved if a national depository is established as has been proposed.

c. An Underdeveloped and Unregulated Brokerage Industry

A professional brokerage industry capable of servicing the needs of individual investors has not yet been developed in India, in part because corporate members have been excluded from the exchanges. Tax and bank lending policies have made it difficult for corporate brokerage firms to obtain and retain capital, and for individual brokers to transfer their memberships to corporations. The present commission structure makes it disadvantageous for brokers to service retail investors in secondary markets.

Brokers have been allowed to operate in an environment that has been largely unregulated and one that has provided easy profits. Competition has not evolved to help correct these problems primarily because of the "closed club" nature of the Bombay Stock Exchange. Trading on the basis of privileged information has been the standard.

d. The Absence of Private Institutional Investors

Government and government-owned institutions have to date been the country's most significant market participants. These institutions have taken substantial positions in the market and in some cases control it exclusively. Clearly, such actions have not been conducive to the development of a fair, orderly and efficient market.

As a result of the government oligopoly, little effort has been made to date to encourage efficiency and competition or to create an environment that would lead to the development of a fair and well-regulated marketplace. In particular, there has been an absence of private institutional investors, e.g., mutual funds, pension funds, insurance companies, and especially foreign institutional investors, who collectively could have a significant impact on the development of a sound market.

India is beginning to address the need for the participation of private institutional investors, specifically mutual funds. Due to prudential investment rules, pension funds cannot participate in capital markets other than to invest up to 15 per cent of their assets in securities of public sector corporations or financial institutions. Other assets must be invested in Government of India SLR bonds. Foreign institutional investors are permitted to participate in India's capital markets. An effort is being made to reduce the tax requirements for foreign institutional investors in order to further encourage their participation in the market.

E. Urban Infrastructure and Its Finance

1. Background

India's urban population, broadly defined as the population of mainly non-agricultural settlements of over 5,000 persons, has been growing rapidly. Over the past five decades, while the total population grew from about 360 million to over 840 million, the urban population grew from about 60 million to nearly 220 million, or twice as fast as the national population. Urban population growth is expected to continue unabated in the 1990s. According to the National Commission on Urbanization, India's soon to be population of over one billion is likely to contain 350 million city dwellers by the end of this century. The Commission also envisioned that there would be forty cities with a population exceeding one million, compared to twelve such cities in 1981. The continued rapid growth of the urban population will pose a major challenge to urban authorities over the next decade and beyond.

India's burgeoning population has placed growing strains on the nation's infrastructure, especially in the cities and towns. In 1985, it was estimated that more than a third of the urban population did not have access to safe drinking water while more than three fourths did not have access to hygienic methods of excreta disposal. The serious and growing inadequacy of urban infrastructure continues to be a key constraint to overall growth of the economy. The costs of deteriorating infrastructure are hampering India's economic growth. Waterlogged streets and poor drainage add to the costs of transportation, while inadequate public water supply, power, sewerage and drainage poses significant health problems and adds to the costs of operating businesses, running homes or managing offices. These factors inhibit both foreign and domestic investment and, to that extent, reduce the possibility of success in achieving a buoyant financial market.

The organization, provision and maintenance of urban infrastructure in Indian cities has been mainly the responsibility of the public sector. A variety of institutions, with the municipal governments being at the core, are involved in the development of urban infrastructure. By and large, these local bodies depend on financial allocations made by the central government or state governments. While these allocations have remained at average levels, the state of local finances has neither improved nor kept up with the needs for both population and economic growth. Thus, one of the major problems of urban infrastructure has been the continued dependency on public government funds.

Although the public allocation of infrastructure finance has slightly improved with the loan financing approach implemented by the Housing and Urban Development Corporation (HUDCO), this dependency on government capital makes it impossible for local governments to meet all but a fraction of their infrastructure needs. It is clear that not only is this total dependency on the public sector counterproductive, but it will ensure that the need will continue to grow. There is an urgency, therefore, for local governments to create a conducive urban environment for urban infrastructure and to seek out alternatives to financing urban infrastructure projects which can tap private capital through the development of commercially viable projects that will ensure the recovery of investment capital and the recycling of funds. Although the challenge of urban infrastructure needs to be met in a variety of ways, including new and improved technology, organization and management, innovative finance is the major area that will ensure that adequate urban infrastructure is provided.

2. Changes in the Operating Environment

In the last two years, India has witnessed a dramatic liberalization in its financial and economic systems. From an insular, inward looking and centrally planned system, it is being restructured rapidly to meet global competitive challenges. This liberalization is reflected in actions such as the reduction of the allocated system of credit, the entry of foreign investment institutions in the Indian capital markets and the progressive decontrol of the financial system. Government reforms include making a wider choice of financial instruments accessible to investors and issuers through various means. For example, the GOI envisages a complete ban on generalized loan waivers, improved recovery and recycling of public savings, continuation of the phased reduction in the Statutory Liquidity Ratio, phasing out of ceilings and floors on bank deposit and lending rates, and the strengthening of institutions and procedures for bank supervision.

The role of the different government bodies--central, state, local--are being transformed not only because of the financial changes as indicated above but also by the 1992 enactment of Amendment 74 to the Indian Constitution. This Amendment has now secured the requisite approval from a majority of the states and is an integral part of the Constitution. In general, the purpose of this Amendment is to begin the process of devolution of powers to the people at the grass-roots level. It is expected to have a profound impact on how the different governments carry out their responsibilities and functions as well as how they relate to each other.

This Amendment recognizes that the nature of rural India has changed noticeably since Independence. Today, about one-quarter of the population, approximately 220 million people, lives in urban settlements. Insofar as these urban areas contribute substantially to the economic development of the country, it is necessary for the people and their representatives to be fully involved in the planning and implementation of programs at the local level. If democracy in Parliament and the state Legislatures is to remain strong and stable, its roots much reach down to the villages and cities where the people live.

Unfortunately, the Constitution did not make local self-government in urban areas a clear-cut constitutional obligation. As a consequence, democracy in municipal government has not been stable. While the municipal legislative acts of states provide for regular elections in municipalities, they are frequently suspended and superseded for indefinite periods of time, thereby contributing to the general weakness of municipal bodies. Moreover, the general position with regard to financial resources of municipal bodies is unsatisfactory. Over the years, there has been a steady encroachment on the assigned functions and revenues of local urban bodies by specialized agencies of the state governments. As a result, many urban local bodies have become debilitated and are not able to perform effectively.

3. Problems in Developing an Active Debt Market

The inability of exchanges to develop a secondary market for debt due largely to private placements underscores the very serious problem of the incapacity of the debt market to service the country's expanding needs. This is particularly true and acute now that central and state budgetary expenditures are shrinking relative to the needs of India's population for basic urban infrastructure services. There are several constraints to the development of the debt market, other than the overall market deficiencies that affect both the equity and debt markets.

a. Institutional Problems

Traditionally in India debt has been traded in a distorted environment due to government restrictions and private, non-transparent transactions. For example, under the Statutory Liquidity Requirement of the RBI, Indian banks are required to maintain a certain percentage of their liabilities invested in securities specified by the Government. These are usually either treasury bonds or public sector enterprise bonds. This practice has created a captive market for the sale of government securities and public sector enterprise bonds, and has suppressed the development of a competitive debt market.

The GOI's move to reduce the percentage of liabilities required to be held under the rules of the SLR and to increase the rates of interest on treasury securities will stimulate the development of the debt market. Without a variety of marketable new instruments to meet the demand, however, the market may be unable to adequately respond.

b. Need for New Debt Instruments

The meteoric pace and volatility of the Indian equity market and recent government policy changes are creating a demand for less volatile investment instruments. India has a relatively high household savings rate, much of which is invested in pension funds, mutual funds, and life insurance. These institutional investors require the more stable yields provided through debt markets. The creation of competitive debt instruments will channel this demand by matching the terms and yields of the debt instruments with the investment needs of these institutions.

F. Inadequate Capital Markets Research and Training

The parameters of India's capital markets are rapidly changing and are likely to continue to do so over the course of the implementation period of the FIRE Project. For example, since liberalization of the economy began in 1991 the following important changes have occurred:

1) the rupee has become fully convertible;

2) all but 18 industries have been removed from the stringent licensing requirements previously required by the GOI;

3) privatization plans have been designed for many public enterprises;

4) the private sector has been allowed to enter the mutual fund industry;

5) controls on interest rates on debentures have been removed, and banking interest rates have been liberalized;

6) a National Stock Exchange has been created; and

7) SEBI has been given broad regulatory authority over the capital market.

The need to remain informed of critical new developments in India's capital market and to gather information on problems that are in need of carefully constructed solutions (such as the establishment of a private sector mutual fund industry) is essential to the success of India's emerging system. Not only is research essential, but so is the training of India's capital market personnel in the sophisticated systems necessary to ensure that the new market systems operate efficiently.

II. PROJECT RATIONALE

A. Need for Assistance

India is still recovering from its recent economic crisis, while taking steps to accelerate growth over the next 2-3 years. The growth strategy will require a significant increase in the current level of investment as well as measures to ensure the more efficient use of investment resources. The Government has been liberalizing the country's financial markets in order to create an environment conducive to achieving these objectives.

A key element in the GOI's efforts to create a more favorable investment environment is the need to ensure that the country's capital markets are properly regulated; that the markets are capable of operating efficiently on their own; and that they are generally allowed to do so. This, in turn, will require significant improvements in the legal and regulatory framework governing capital market operations, greater transparency in market operations, increased automation, better trained staff, a higher level of self regulation, and eventually a full disclosure mode of market operation.

India has begun the process of converting to a full disclosure system and is modifying the way in which its markets operate to facilitate this transformation. Several significant obstacles remain, however, to establishing such a system. The Government realizes this, and is seeking outside assistance to help overcome these constraints.

One of the objectives of the Project is to broaden and strengthen the debt market, and a corollary aim is to attack the problem of inadequate urban environment infrastructure in municipalities. The two aims are complementary. Funding for the improvement of infrastructure can only be supplied if the bond market begins to flourish. However, there will only be a demand for the monies generated by the sale of bonds if there are a series of viable infrastructure projects which are identified and executed.

To introduce the concept of financing infrastructure projects through loans and bonds which need to be repaid will not be an easy task. Traditionally, funds for such purposes have come from central or state sources, and they are often not repaid or even accounted for as project expenditures. There is a widespread expectation on the part of local government authorities that these funds will continue to come from central and state sources. However, given the on-going changes in government policies, this flow of funds is not expected to continue at the same level as in previous years. Through the Project, HG loan funds will be made available directly to local agencies on commercial lending terms and conditions, including the requirement that a strict accounting system be established, that the costs for which the funds are used be recovered and that the monies be repaid to the lender, with interest.

For the Project to be successful, it will need to demonstrate to both state and local officials that funds taken under these conditions can ease the existing shortage of funds for infrastructure. But, it will need to do more than that. It will need to find a way to bridge a gap between fundamental attitudes and instill among local leaders an acceptance of the need to recognize and accept values which may be foreign to them. That task cannot be lightly undertaken. It will require imaginative and committed work, over the life of the Project, not only by the Indian people and institutions undertaking the FIRE Project, but also from the Indian technical assistance and training component of this Project, supplemented by the special skills of foreign technical assistance and advisors.

Fortunately, there are a few local authorities and institutions in which the proper climate for using commercially viable loans for infrastructure already exists, and they can be used to demonstrate the technical and financial feasibility of the approach being proposed in this Project. But it will take agile minds and effective techniques to interpret these demonstrations in such a way as to make them persuasive to officials of other local bodies where the proper climate does not yet exist.

B. The U.S. Comparative Advantage

The U.S. has one of the most sophisticated and highly developed capital markets in the world. This is universally recognized and has been cited by Indian officials as the basis for their requests for USAID assistance. USAID/India has provided assistance to India's capital market through the Technical Assistance Support Project (TASP), and this assistance has resulted in demand for continued US expertise in the development of India's market. The underlying rationale of the FIRE Project is to bring U.S. expertise and experience to bear on the market restructuring and development efforts currently being undertaken in India.

will include an operations research and local training capacity strengthening subcomponent.

Approximately 98 percent of the Development Assistance (DA) funds provided for the Project will be allocated to training and consultant activities (including inflation/contingency). The remaining two percent will be used for project audits and evaluations. In addition, there will be a sizable Housing Guaranty (HG) element which will be used to demonstrate the feasibility of raising private sector funds for urban infrastructure projects.

D. Relationship to the Mission's Assistance Strategy

The USAID Mission's strategy in India is to assist in the acceleration of market-led, broad-based economic growth. The FIRE Project is a key element in the Mission's overall strategy, in that it will help strengthen the country's capacity to mobilize the capital resources needed to achieve accelerated, sustainable market-led growth. The Project will contribute to India's sustainable development by assisting in the development of a capital market that efficiently allocates resources for the equity and debt need to finance long-term development. The Project directly supports one of the Mission's main program-level objectives, which is to streamline the financial and regulatory environment governing the country's capital markets. The Project will contribute to the achievement of this objective by (a) strengthening the markets' regulatory institutions and systems, and (b) broadening and deepening private investment in India's long-term debt market.

E. Relevant Experience with Other Projects

The FIRE Project will build on several previous and ongoing USAID-funded capital markets assistance projects. USAID has helped strengthen India's Over the Counter Exchange (OTCEI) by providing technical assistance in key areas such as regulation, market administration, computerization, and communications systems. OTCEI, which began operations in late 1992, is India's first electronic stock exchange and the first exchange designed to operate as a nation-wide network. OTCEI is also the first exchange in India to promote transparency in its trading operations and foster the expeditious settlement of trades.

USAID has been contributing to the development of a central depository and national clearing system in India through its support to the Stock Holding Corporation of India (SHCIL). USAID technical assistance has been directed towards developing a blueprint for a central securities depository and has included support for an in-depth review of the technology and operational architecture needed to establish a dematerialized depository.

USAID, through the TASP Project, has been promoting research in the securities industry, including the development of new instruments and derivatives and the training of both private sector and GOI officials in market functions and issues related to market regulations.

The FIRE Project will build on the Mission's current efforts, in collaboration with the Regional Housing and Urban Development Office (RHUDO), to assist in the development of a long-term debt market in India. RHUDO-sponsored Housing Guaranty (HG) programs have already been used to promote currency swaps and securitization, to assist in the development of a secondary mortgage market, and to provide training in the formulation and structuring of unique project financing and implementation mechanisms.

The Project will also seek opportunities to discuss with concerned parties the identification of mechanisms for private participation in the financing and operating of infrastructure activities in areas other than urban environmental infrastructure. This will be accomplished by continuing the dialogue related to current USAID/India efforts in the private power sector and other sectors as they may arise during the course of project implementation.

FIRE will continue the Mission's efforts to assist the GOI in developing a consensus on the policy reforms needed to increase private financing of urban infrastructure projects. The USAID and RHUDO/Bangkok have sponsored several workshops over the past eighteen months to discuss reform requirements with a group of key Indian policy-makers. This dialogue has resulted in the development of an action plan for state and local governments to implement essential policy reforms, and in a request by the GOI for USAID loan and grant assistance to finance the implementation of trial programs at selected localities.

F. Other Donor Assistance

1. Asian Development Bank

The Asian Development Bank (ADB) is in the process of finalizing a financial sector program loan of US $250 million to India for capital market development. Opportunities for coordination activities to be financed under the ADB sector loan will be explored as both the FIRE Project and the ADB sector loan begin implementation. Thus far, USAID/India and the ADB have agreed in principle to the signing of a Memorandum of Understanding (MOU) that will outline levels of cooperation in the sector. The MOU will at a minimum provide for the same level of cooperation the ADB and USAID/India have agreed to under the Energy Management Consultation and Training Project, which provides for: a) exchange of information and consultation of the two parties during project implementation; and b) the opportunity for the two parties to exchange views if and when agreements are materially altered.

The ADB will focus on five major areas for improvement in the capital market development area. These include the development of an integrated national market system; creation of a central securities depository; an improved regulatory environment; stimulating the increased demand and supply of equity through regulatory and operational improvements; and activating the market for debt instruments.

2. International Finance Corporation

The International Finance Corporation has just completed a major study of India's capital market and plans to participate in market development activities. It will most likely take an equity position in the securities industry. IFC is focusing primarily on basic infrastructure and on housing finance, leasing arrangements, and the establishment of venture capital and brokerage companies.

3. World Bank

The World Bank is developing a Financial Sector Program Loan for India that will be focused on banking. Activities to be funded under the loan are expected to begin implementation in FY 93/94. Preparatory to granting the loan, the World Bank has been doing background work in areas of portfolio assessment; the rehabilitation and recapitalization of banks and the fiscal implications thereof; and the prospects for privatization and entry of new banks.

III. PROJECT DESCRIPTION

The Project will have three components through which resources will be directed to address problems impeding the further development of India's capital markets. Because of the rapidly changing nature of the Indian capital market and the need to continuously gather information and train market participants in new technologies, each component will include a subcomponent for operations research and local training capacity strengthening. The components and the general areas of assistance which they will cover are:

Regulatory Environment Improvement - This component will address changes needed in the regulatory framework governing capital market operations;

Operating Environment Improvement - The Operating Environment Improvement Component will underwrite institutional development and restructuring activities aimed at modernizing

India's capital markets with the intent of increasing the efficiency of market operations; and

Debt Market Development- This component will broaden and deepen the debt market by expanding the capacity of that market to serve as a major source of private sector finance for urban infrastructure projects.

Funding to be provided under the Project will include US $20 million in Development Assistance (DA) and US $125 million in Housing Guaranty (HG) loans over a five-year period. The DA funds will be used primarily to finance technical assistance and training activities. The HG loans will help finance a number of urban infrastructure projects being used by the GOI as demonstration projects to promote increased private sector financing of infrastructure development projects.

A. The Regulatory Environment Improvement Component

India is in the process of converting its capital market regulatory system from one of direct government control to one that attempts to create a fair, orderly and efficient market in which investors will receive a reasonable degree of protection from unfair practices but will be responsible for their own investment decisions and will bear the risks of those decisions. In making this kind of change, transition measures are required until appropriate systems and safeguards are in place so that investors do not lose confidence in the market. However, several problems exist in the Indian regulatory framework that will make the transition difficult. The following areas are especially critical during this transition period: 1) the consolidation of regulatory authority will require a strong professional organization capable of exercising this authority; 2) the creation of effective market regulation and enforcement efforts will require the continued devolution of authority to the market regulatory agency and the creation of Self-Regulatory Organizations (SROs) within the structure of the capital market system; and 3) the need to formulate policies related to emerging issues in capital markets will require the interaction of market participants and market regulators.

1. <u>Consolidation of Regulatory Authority</u>

The Securities and Exchange Board Act of 1992 created the Securities and Exchange Board of India (SEBI). Through the provisions of this act and its interpretation by GOI authorities, SEBI is intended to exercise virtually all regulatory authority (except money market mutual funds and the extent of foreign involvement in the markets which is likely to remain with the Reserve Bank of India) of the Indian capital market.

their creation and development is crucial if the market is expected to perform efficiently in its allocation of resources.

The only functioning capital market SROs in India at present are the stock exchanges and the Institute of Chartered Accountants. In addition, the country's merchant bankers are planning to form an Association of Merchant Bankers.

The Project will provide assistance to groups attempting to establish self-regulatory organizations that are associated with capital market functions. The assistance would consist of one-on-one consultancies by experts from similar self-regulatory organizations in the U.S., e.,g., the National Association of Stock Dealers, and study tours by Indian organizers of SRO to counterpart US organizations.

3. Promoting Interaction Between Market Participants and Market Regulators

Prior to the establishment of policies that govern the actions of capital market participants, it is extremely beneficial to provide avenues for those making the policy and those being affected by it to discuss potential policies. For example, through one of USAID/India's projects, a conference on the policies and operational implications of establishing a central depository for capital market issues created an opportunity for policy makers and market participants to share information that will result in a more carefully designed and implemented depository.

As the Project progresses, many areas of policy consideration are certain to arise in which the stimulation a dialogue between the regulators and the regulated would provide information to both sides that would result in more focused policies that promote greater efficiencies in the capital market. Some illustrative examples of pending policy issues and ones the Project will fund during its initial implementation phase are provided below.

a. Futures and Options

India's present equivalent of a futures' market, the badla system, is in need of restructuring and separation from normal trading. A study group has analyzed requirements for such a market, but comparison of international experience in the design and implementation of futures' markets is needed. Expertise is particularly required concerning the appropriate timing for the introduction of such a market. Even though it may not be appropriate to establish a market at the present time, in view of the continued focus of market participants on this issue, it is important that market participants and GOI officials acquire an understanding of the prerequisites for such a market.

b. The Role of the Small Investor

An educational effort could be mounted to inform both policy makers and the public of the risks of continuing with the present system. Topics for a seminar on this issue could include methods of protecting the small investor in other jurisdictions as compared to those available in India, the advantages and disadvantages of traditional underwriting practices as compared to the allotment system, and alternative methods used internationally to involve small investors in the marketplace.

c. Takeovers

The present legal environment governing takeovers restricts development of the market, particularly the establishment of a central depository. India could benefit from exposure to alternative approaches to takeover regulation from international models.

Other possible topics might include: a) appropriate methods of involving pension funds in a securities market, b) obstacles and solutions to creation of a retail brokerage industry, and c) alternative remedies for investors who are injured by unfair securities market practices.

The Project will fund a series of workshops and seminars to share information on topics of interest to market regulators and participants. This will be done by inviting recognized experts in the topic of discussion and by funding the costs of organizing and presenting the workshop.

4. <u>Operations Research and Local Training Capacity Strengthening</u>

a. Operations Research

The Indian market has evolved significantly during the last decade in terms of its regulatory structure. In order to further improve this structure, and to bring it in line with international standards, continuous research and review of parameters of the system is essential. FIRE will contribute to this process by supporting operations research in capital market regulatory functions.

Many of the parameters that influence the regulatory environment of India's capital market will change over the five-year course of the FIRE Project. For example, the regulatory requirements that the creation of the National Stock Exchange will have on the market is one such parameter. This and other important issues are in need of investigation in order to provide information upon which informed decisions can be made that will not adversely impact the growth of the market. Of immediate interest and concern is the impact of the entry of the private sector in the mutual fund industry.

The first operational research activity under the Regulatory Environment Improvement Component will be research into the changing nature of the mutual fund industry. The principal benefit anticipated from developing a mutual fund industry is stimulation of the growth of the securities markets by introducing vehicles that promote professional investment and encourage investment from diverse sources. It is generally good policy to encourage mutual funds to develop because they are natural holders of stocks, bonds and money market instruments and their presence is likely to stimulate constructive growth in each of the markets in which the underlying portfolio securities are traded.

For mutual funds to succeed in a competitive market, several essential conditions must be satisfied:

- The types of portfolio securities held by the funds must be attractive themselves, as compared to alternative financial assets.
- The attractiveness of the portfolio securities must be enhanced rather than diminished by gathering them together within a fund.
- The fund's structure must be economically sound.
- The funds must be subject to appropriate, but not overbearing, regulation.

India's mutual fund industry has developed to a certain degree through UTI and other public sector institutions even in the absence of some of these factors due in part to the limited alternatives available to investors. However, the concentration of investment power in UTI, governmental investment policies and the lack of competition have limited the potential of the industry to benefit investors and provide a broader institutional base for the market. It has been reported that returns from UTI funds have not even kept pace with inflation, and that the accounting policies used to report the performance of many funds are, at least by international standards, little better than fraudulent. This refers to the reported practice of some of the public sector offered funds of manipulating reported returns through arranging inter-fund transfers of assets at less than market value. The receiving fund, normally a new one still being sold to investors, is thereby able to show higher returns.

In a more competitive environment, it is likely that closed-end funds, which necessarily operate under a handicap, will become less attractive. Closed-end funds, which are not redeemable at net asset value on demand, are unable to provide investors with assurance that fund shares can be bought or sold at prices which are linked closely to net asset value. Thus, an extra layer of uncompensated risk is imposed on the unit holder. This results from the fact that fund shares will be traded in a secondary market at prices that often differ from net asset value by considerable amounts due to the inability of an investor to liquidate his investment. In addition, brokerage fees must be paid on purchase and sale of fund units, thereby further increasing the cost to the investor. As a result, the funds are generally less popular with investors.

The benefit of an open-end mutual fund industry is the greater popularity of this organizational form with investors, and the larger pool of assets which such funds are likely to attract. Of particular concern to development of open-end funds in an emerging market, however, is the limited market liquidity inherent in most such markets. The lack of liquidity makes it difficult for such funds to liquidate their investments at fair value in order to respond to redemption requests. As a result of the liquidity concern some developing countries have not permitted open-end funds to operate. India has decided to allow both closed and open-end funds, but open-end funds are subject to high capital requirements. Private sector management companies believe they will be able to market closed-end funds because of the nature of the investing public in India and that open-end funds are not likely to be introduced in the next few years.

It is also essential to creation of an effective mutual funds industry that tax treatment of funds and their holders be considered carefully. Due to the nature of mutual funds as a conduit for holding investments, it is essential that there be no double taxation of income from the investments (at the fund level and the investor level). Otherwise, purchasers of fund units could instead purchase the securities that would be held by the fund directly and pay tax only once. The character of the income at the fund level (e.g., as capital gain or tax-exempt income) must be retained at the investor level in order to be competitive.

Finally, the funds must be subject to appropriate regulation to assure that the industry as a whole deserves and retains the confidence of actual and potential investors. Scandals in the mutual fund industry can produce negative legacies that can undermine the entire fund industry's development. Regulation must focus on the threats to structural soundness mentioned above, accurate and transparent accounting policies, and also on marketing practices to assure that investors are provided the information they need about the funds, their managements and the portfolios which they offer.

The most important and most difficult of these functions to develop internally are custody of fund assets and shareholder accounting and transfer agency services. Portfolio accounting is a function which often is contracted out to third parties. Legal services and independent accounting services also are necessary for the support of mutual fund operations.

All that remain to be handled internally by investment management companies are portfolio management, product development and marketing. One would expect management companies to be willing and able to develop the staff and facilities needed for these purposes, from both local and foreign sources, provided sufficient profits may be anticipated.

In the future small investors are likely to find that they can best participate in the market through mutual funds. Accordingly, assistance to develop that industry is an important element of an overall capital market development plan. As India transitions from public sector to private sector funds, there is a major need for training in India about operational methods and marketing strategies. This training should be focused on private sector investors, SEBI and public investors.

The Project will fund operational research in the above area and in and additional areas to be determined. The additional areas of operations research may be suggested by the Project Advisory Committee and/or other sources and, upon approval by USAID, will be funded and included in the responsibilities of the Project contractor.

b. Local Training Capacity Strengthening

India has made a great step forward in establishing the necessary infrastructure required for many of the educational needs to support effective capital markets. The basic infrastructure is present to support the education of the capital markets professional in understanding and employing the investment opportunities that exist today in India. There is, however, a great need to modernize and broaden the outlook and orientation of this training resource. In addition, there is an opportunity for USAID through these educational institutions to support important research for strengthening the analytic basis of investment choices and decisions and improving the overall quality of the decision-making process required of the capital market participants ranging from the top decision makers in government and industry to the investing public.

The UTI Institute of Capital Markets (UTI/ICM), located in Vashi, New Bombay, will be one of the institutions to be upgraded to perform the above identified training functions. Analyses performed during data gathering for project design indicate that this institution is the most likely, with the assistance identified below, to be able to provide the training necessary for the capital market regulatory environment to become the evolving foundation upon which an efficient capital market must be based. The physical plant, the library, and the faculty are all highly developed. UTI/ICM management is dedicated to the institution's filling the necessary education and research role required in India to support the growth and diversity of its capital markets. However, upgrading of curricula is needed to accomplish this task.

The Project will provide local and US technical assistance to identify the educational and training needs in the capital markets during the next 7-10 years and to design and implement curricula necessary to meet these needs.

5. Component Inputs

The following inputs will be financed by the Project:

Activity	Input
a. Institutional Strengthening of SEBI	Short-Term Consultancy & Training 1. Regulatory functions 2. Automation design 3. Organizational development 4. Human resources development 5. Other to be determined
b. SEBI Systems	Short-Term Consultancy & Training 1. Records management 2. Investors' associations 3. Brokers' licensing & certification
c. SRO Program	Short-Term Consultancy, Training & Study Tours 1. Assistance to groups attempting to create SRO's

		2. Assistance to SEBI in promoting establishment of SRO's
d.	Market Participant/ Market Regulator Interaction	Short-Term Consultancy & and Workshops 1. Futures & options 2. Role of small investor 3. Takeovers
e.	Operations Research and Local Training Capacity Strengthening	Short-Term Consultancy & Training To be determined

B. **The Operating Environment Improvement Component**

The operating environment of India's capital market is constrained by the problems identified earlier in this paper. The three most important problems, and the ones which the FIRE Project will address, are: 1) the lack of interconnected trading systems; 2) inefficient clearance and settlement systems; and 3) the lack of automation.

1. <u>Interconnected Trading Systems</u>

a. The Development of a National Stock Exchange

The memorandum of understanding and the articles of association of the National Stock Exchange (NSE) have been signed, its regulations have been cleared by SEBI, and its board has been constituted. The documents establish the National Stock Exchange of India, Limited (NSEIL) as the company in charge of implementing the NSE. The NSEIL board has set up three sub-committees with the following responsibilities: 1) to expedite the implementation of the exchange and decide upon its operating systems; 2) to determine its administrative systems; and 3) to establish its membership norms. NSEIL is a company promoted by the following leading financial institutions and banks in India:

- Industrial Development Bank of India
- Industrial Credit and Investment Corporation of India
- Industrial Finance Corporation of India
- Life Insurance Corporation
- State Bank of India

- General Insurance Corporation
- Stock Holding Corporation of India Limited
- Infrastructure Leasing & Financial Services Limited
- SBI Capital Markets Limited.

The NSE will be a truly national exchange which will allow anybody to trade in shares from anywhere in India. The system is expected to provide India with:

- a nation-wide trading facility for the country's money market and capital market;
- the latest in electronic trading systems and book-entry settlement procedures;
- a market that will be easy to monitor, control and regulate;
- an order-driven market that will not require market makers to give two-way quotes continuously; and
- information on quotations and deal prices that will be available over the NSEIL's terminals and broadcast by the Press Trust of India and Reuters, through info-terminals.

In its first phase, expected to be operational on December 31, 1993, the NSE will begin trading in the inter-bank call money market, government securities, and public sector undertaking bonds. Later, private sector debentures will be added with equity trading planned by mid-1994.

NSE has the potential to make the National Stock Exchange and the National Market System one and the same. From the purist point of view it holds the promise of a totally non-fragmented market with the greatest likelihood of best execution price and price transparency. In order to achieve these goals, it would have to eliminate the trading of dually traded securities on the other exchanges. This would have, at a minimum, the effect of reducing the Bombay Stock Exchange to an exchange of regional stature. However, the competitive responses of the exchanges is yet to be seen. It is possible for them to respond by improving their transparency to the investor, or perhaps implementing market maker or specialist services which could attract the investor. The increased competition would only benefit the investor.

The NSE has a strong sense of direction for the next year's activities. As they open their system to trading vehicles beyond those currently specified, additional knowledge of these new trading vehicles and their attendant requirements will have to be absorbed into what will then be a very sophisticated environment.

The Project will support the NSE in its three immediate areas of need during the first 18-24 months of operation. These are: operating systems design and implementation; administrative system design and implementation; and formulation of membership norms. This will be accomplished by providing both consultancy support to NSEIL and by exchange visits between NSEIL executives and executives of organizations such as the Chicago Board of Options Exchange and the Chicago Mercantile Exchange and internships at U.S. exchanges for key staff members of the NSEIL.

Following this initial assistance phase, additional areas of support will be designed and provided to the NSE as appropriate. The majority of project funds for support to interconnected trading systems will go to the NSE; however, because of the unpredictable reaction of the regional exchanges and their continuing need for support, the Project will make available a portion of funds in this component for assistance to the regional exchanges.

b. The Development of a National Market System

The need for a National Market System (NMS) in India is indicated because of the market fragmentation which currently exists between the five major stock exchanges. This inequity borne by the investor will continue until either qualified securities are placed under a NMS or a single stock exchange achieves a monopoly. Because it is unpredictable when or if that will happen, it is important to provide at least the most fundamental assistance to the development of an NMS in anticipation of its eventual integration into the NSE.

The creation of the NSE will force the regional exchanges to upgrade their trading facilities and create greater transparency in their transactions. This is likely to lead to some (perhaps all regional exchanges) cooperating to produce consolidated listings of instruments traded on the exchanges. To do this requires the linking of exchanges through communication and data processing facilities. This linking will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, and contribute to best execution of such orders.

Two major components are required to achieve the above. All trades must be recorded and made available electronically, in sequence for dissemination to all interested parties. And there must be an automated screen-based trading system in place which makes available electronically relevant trade information in keeping with the trading scheme(s) designed into the system.

The Project can play a useful role in assisting the development of the proposed NMS, by modifying a U.S. model to suit India's requirements and by exposing India's regional market participants to the operations of the Securities Industry Automation Corporation (SIAC), the facilities manager for the Intermarket Trading System in the U.S. Technical assistance will be made available to the regional exchanges to assist them, on a demand basis, in the design of consolidated reporting systems to link the participating exchanges.

2. <u>Inefficient Clearance and Settlement System</u>

a. Background

One thing that has remained constant during the last few years is the fact that India's clearance and settlement systems are the major obstacle to further advances in the efficiency and effectiveness of its capital markets. While price transparency is of great importance to attracting investors, an efficient delivery system and a low transaction cost of settlement is critical. Striking the right deal is useless if settlement costs and complications undo or alter the desirability of the deal. Post-trade processing methods currently employed in India do not meet international standards, specifically those of the Group of 30. The most important G-30 standard to be met requires the creation of a central depository system (CDS). This should be followed by the establishment of a delivery facility as part of the CDS and the conversion of all trade settlements to a rolling settlement schedule. These functions essentially require the establishment of three systems: 1) a national clearing system; 2) a national trade comparison and reporting system; and 3) a national depository.

b. The National Clearing and Depository System

One of the operational requirements of the National Stock Exchange is that it fulfills its clearance, settlement and depository need through cooperation with the Stock Holding Corporation of India, Limited (SHCIL). FIRE will provide technical assistance to design and implement the NCDS. This will include expertise in the post-trade settlement area and in evaluating hardware, software and telecommunications platforms. Technical assistance will also be provided to assist SHCIL to design a training plan to provide training to both its staff and to industry users of the NCDS.

Training of personnel who will staff both the SHCIL central office, its additional vault locations, and its branch offices will be provided. This will include, where appropriate, the training of key branch managers and other executives of both SHCIL and other capital market organizations through on-the-job-training in other countries employing similar clearing, settlement, and depository systems. FIRE will also provide training to educate SEBI's staff and market participants (brokers and associated agents) and investors (over 4,000) who will use the system.

3. Automation

Automation of India's capital markets is essential to creating an efficient operating environment and the transparency of trades that is essential to national market growth. The automation process is developing, although unevenly, in the various institutions affiliated with India's capital market and is likely to continue to do so in the foreseeable future.

The FIRE Project will assist the automation process by beginning to provide technical assistance to one exchange, Over the Counter Exchange of India (OTCEI), in its current expansion efforts and will evaluate this effort and any requests for assistance from other capital market institutions after the first 12 months of implementation.

OTCEI is just 14 months old. While it is loosely modeled on the U.S. NASDAQ, it is designed solely to meet the equity and debt capital needs of small and medium companies. The early listings on this exchange demonstrate that it serves as an exit for the venture capital financiers who take the early risks of new start up companies and desire to redeploy their invested capital resources to new start up opportunities.
One of its new initiatives in recent months is to list debt issues on its screen-based market. This raises the prospect of a genuine secondary trading market in corporate debt issues, in the context of a well regulated market. While the OTCEI is only a small player in both the debt and equity markets, it shows much promise as a stronger element of the overall capital markets, and as a factor in the mobilizing of capital for small and medium companies. OTCEI is planning to expand from its current location in Bombay to other cities in India. It needs assistance in operationalizing this plan, especially in the area of automation.

The Project will assist OTCEI by providing technical assistance to design an integrated automation system for its home office and its planned branch locations. Following the design of the plan, the Project will provide training to OTCEI staff members in the operation parameters of the system and in the operation of the automation equipment and programs.

4. Operations Research and Local Training Capacity Strengthening

a. Operations Research

The rate of change in the operating environment of India's capital market has been growing rapidly in the last year. For example, the creation of the National Stock Exchange and the emergence of the Over the Counter Exchange of India have had and will continue to have important effects on the operating environment of the capital market. The need to continue to gather information on these changes is a need the FIRE Project will fulfill by providing funding for operations research. Because on the extremely fluid nature of this topic, the Project will establish annual research agendas that will be targeted on the most pressing questions identified to be in need of further research. These research agendas may be recommended by the Project Advisory Committee and/or other sources and, upon approval by USAID, will be funded and incorporated into the annual workplan of the project contractor.

b. Local Training Capacity Strengthening

As identified above for the operating environment, India has indeed created the infrastructure required for the educational and training needs to support operational improvements in its capital markets. However, there is further need to modernize and broaden this training.

The Institute of Chartered Financial Analysts of India (ICFAI) is India's primary institution for training professionals in capital market operations. ICFAI is a specialized institution of learning and fills a very necessary role in India. In addition to its regular course offerings, it has a Correspondence School through which practicing Indian professionals can obtain a CFA while still holding a full time position in the markets. With the entrance requirements for students with degrees or actively matriculating candidates, this affords the working student the opportunity to further his studies in the capital markets without giving up his current employment. The ICFAI in collaboration with the Institute of Chartered Financial Analysts located in Charlottesville, Virginia, USA, set up the Chartered Financial Analyst Program at the ICFAI. As yet, a national certification program has not been established.

ICFAI had once come close to establishing an exchange program with the Wharton School at the University of Pennsylvania in the United States. It fell through because the government-owned university which was sponsoring the program lost the necessary government support. ICFAI indicated a strong desire to resurrect the idea of an exchange program with a distinguished American university and would be most pleased if such an arrangement could be fostered under FIRE. The Wharton School has already indicated a willingness to participate, but other Universities mentioned were the University of Virginia, Dartmouth MIT, and Harvard.

Local and US technical assistance will be provided to identify the educational and training needs of professionals involved in capital market operations during the next 7-10 years and to design and implement curricula necessary to meet these needs.

5. Component Inputs

The following inputs will be financed by the Project:

Activity	Input
a. National Stock Exchange*	Short-Term Consultancy, Training & Study Tours 1. Operating systems design and implementation 2. Administrative system design and implementation 3. Formulation of membership norms 4. Other to be determined
b. National Market System*	Short-Term Consultancy & Training 1. Consolidated reporting system 2. Other to be determined
c. NCDS	Short-Term Consultancy & Training 1. Design & implement NCDS 2. Train SHCIL staff and 4,000 plus system users

* Note: Following this initial assistance phase, additional areas of support will be designed and provided to the NSE as appropriate. The majority of project funds for support to interconnected trading systems will go to the NSE; however, because of the unpredictable reaction of the regional exchanges and their continuing need for support, the Project will make available a portion of funds in this component for assistance to the regional exchanges.

d.	Automation	Short-Term Consultancy & Training 1. Design System 2. Train users
e.	Operations Research and Local Training Capacity Strengthening	Short-Term Consultancy & Training To be determined

C. The Debt Market Development Component

The Debt Market Development Component will stimulate the development of the debt market through the use of demonstration projects for the design and implementation of urban infrastructure projects to be developed in selected municipalities in two or three states. These projects will provide various debt instruments, to be sold to the private sector through transparent channels and credible institutions, to finance urban infrastructure projects.

In order to accommodate this market, which will include a majority of the projects targeted at below median income households, Housing Guaranty funds will be used to facilitate their access to funds through an institutional intermediary. However, the ultimate goal of all infrastructure interventions in FIRE will be to move infrastructure project financing into the debt markets, either directly or indirectly through an intermediary institution, and the Project will have a bias toward using the discipline of the market to promote increased project viability.

In providing assistance to promote the growth and development of competitive debt systems, the Debt Market Development Component will provide HG funds to promote the issuance of project-based revenue bonds for the development of urban environmental infrastructure. Through the development of these debt instruments, local public/private ventures will access the funds to provide needed urban infrastructure and services (i.e., water, sewer and solid waste management).

1. How it Will Work

The development of a market-oriented infrastructure finance system is designed to support the development of the debt market by using Housing Guaranty (HG) funds to complement the issuance of debt instruments to finance urban infrastructure projects. A financial intermediary (FI) will channel the HG funds, along with a matching amount of locally raised funds or debt, to municipalities or private sector entities ("Eligible Borrowers") to finance selected infrastructure projects which meet the eligibility criteria. The FI will borrow US $125 million in tranches of US $12.5 million to US $25 million under the HG authority from a qualified US investor, which will be used to generate an equivalent value in rupees. The FI will raise a matching amount of rupees or more, thereby creating a lending pool of at least US $250 million to be used to make loans for eligible infrastructure projects.

The FI will finance viable infrastructure projects that are designed and developed by either the public sector (i.e., a municipal corporation, authority, board, etc.) or a mixture of private and public sector entities. Eligible borrowers are further defined as borrowers which develop projects meeting the criteria for an eligible project as stipulated by the financial intermediary. Eligible projects will focus on water, sewer and solid waste projects. All projects must be financially viable to qualify for a loan from the financial intermediary. Urban infrastructure projects which are also commercially viable, meaning they meet all the criteria to be financed in the debt market at market rates, will be given preference under FIRE. Such projects may be developed through a private sector entity using limited financing, including some of the techniques such as Build, Operate, Transfer (BOT) or Build, Own, Operate (BOO).

Municipal governments, or private sector companies acting in a cooperative arrangement with a municipal government, as mentioned in the previous paragraph, or a special vehicle created for this purpose, will develop, design and build eligible urban projects, either directly or through contractual arrangements with third parties. The construction of these projects, including acquisition of goods and services, will be financed either by the developing agency using its own or borrowed funds or by underwriting a public debt issue, or by combining resources from several sources.

Selected municipalities, state development agencies and private sector entities will be eligible to participate in this Project, insofar as they meet the eligibility requirements set forth by the financial intermediary. Illustrative projects have been identified in the States of Maharastra, Karnataka, Gujarat, and Tamil Nadu. During the initial phase of implementation, two to four municipalities in one or two states will be selected to participate in the demonstration program. In practice, it is recognized that initially only a few of the larger municipalities have the wherewithal to fulfill the expected eligibility requirements to develop a project or to act in collaboration with a private sector entity to develop commercially viable projects.

The development of the debt market program requires that two actions be initiated in parallel. On the one hand, commercially viable projects must be prepared so that the debt market will have a physical object or project to finance. On the other hand, the debt market, along with its appropriate instruments, procedures and institutions, must be developed and in-place so that the projects can be financed. The following procedures attempt to show how this will occur.

The financial intermediary or FI is responsible for pulling these two disparate operations together and as such it is the centerpiece institution of the Project. Once USAID authorizes the HG Loan, the MOF, the FI and USAID will sign a HG Implementation Agreement which stipulates the terms and conditions under which the program will be implemented, including conditions precedent to subsequent HG authorizations, borrowings and disbursements. After this Agreement is signed and the requisite conditions stipulated in the Agreement are met, the financial intermediary will enter into negotiations to borrow up to US $25 million (the first annual tranche) from a US investor, under current market terms and conditions, with the full faith and credit guaranty of the U.S. Government. The FI will sign a loan agreement with the US investor to complete this transaction. The GOI or its designated institution will counter-guaranty USAID against any losses resulting from the latter's guaranty. The FI will arrange the matching counterpart funds, the source of which may be derived from a bond placement, private or otherwise, or from any other source that the FI might be able to tap.

At the same time, the FI will identify projects that satisfy its eligibility criteria. Based on these criteria, the private or public sector agency or group that is promoting the project will prepare all the documentation necessary to bring the project to the development stage where the FI can assess its feasibility. Like any other commercially viable project, commercial engineer designs, construction technology, long-term investor commitments, myriad risk assessment and coverage contracts, and provision for other contingencies must be in place before the project is underway.

Depending on the financial engineering techniques applied, project construction or acquisition can then begin. In cases where the developer has used its own funds or borrowed funds to finance construction, the project can be underwritten, i.e., bonds issued and sold, only after construction has been completed. It may be necessary in some cases for the project to demonstrate its feasibility by generating a flow of income that demonstrates, inter alia, project viability before a public offering can be made. It is expected that the project will be commercially viable from income generated from user fees or charges.

The proceeds from the public offering must be sufficient to retire the project funding or the construction loan, where one exists, and these recycled funds will then be available to fund additional infrastructure projects, which in turn will be underwritten when those projects are considered viable.

Depending on the size of the project, more than one project may be packaged in a public offering to reduce underwriting costs.

When market conditions are appropriate, the financial intermediary will originate and issue bonds which will be sold by brokers and bankers to both individuals and institutions. The financial intermediary and its financial advisor, plus brokers and bankers, will structure the bond offering to raise the maximum amount at the lowest cost, contingent on government regulations. Ideally, the bonds will be sold on the open market at market rates, terms and conditions. However, initially, they may be privately placed, with the possibility of trading in the secondary market. In the event that the financial intermediary is able to obtain a government guaranty for the bond issue, then the interest rate and other lending terms and conditions will reflect the current rate for government PSUs.

A trustee arrangement will be made with a qualified institution to collect the loan repayments and make payment to the US investor. The financial intermediary may also undertake the role of trustee.

The various public offerings will test a number of different debt instruments and mechanisms tailored to the needs of specific kinds of projects, including but not limited to, zeros coupon bonds to guaranty high risk issues, swaps to increase investment choices, stand-bys to cover short-term shortages, forfeiting convertibles to straddle export credits, etc. To ensure the replicability of these debt instruments, they will be applied to several different types of infrastructure projects. Therefore, in all probability, the capital available for this Project will be spread over a number of different project types and entities to utilize the entire financial program proceeds. As with the previous HG housing finance programs in India, it is expected that the availability of a relatively small amount of HG authority will be the catalyst for increasing investments over time in infrastructure projects through the issuance of varied debt instruments by the financial intermediary and, in the future, other financial institutions which recognize the potential and worth of this type of financial transaction. This process is expected to develop an urban infrastructure finance system in India.

2. <u>The Identification and Development of Commercially Viable Infrastructure Projects</u>

Two to four municipalities in one to two states will be selected to participate. The selection will be based on their willingness to promote four basic policies:

a) the development of a commercially-viable infrastructure finance system;

b) increased private sector participation in the delivery of municipal services;

c) improved local government capacity to plan, operate, maintain and recover the costs of urban environmental infrastructure projects; and

d) decentralization of authority for urban development and management from state to local government.

HG funds will be used as an incentive for achieving benchmarks related to the implementation of these basic policies.

HG funds, combined with technical assistance and training, will be used to achieve policy change benchmarks related to implementation of the four basic policies. An illustrative policy change matrix which describes policy objectives, conditions precedent to HG investor selection, and required technical assistance and training support needed to achieve the conditions precedent, is described in Annex I.

3. Demonstration and Replication

The purpose of the demonstration projects will be to encourage the supply of debt securities, to strengthen the channel of distribution, and to test the level of demand. A more general purpose will be to demonstrate the policy reforms required to establish a replicable system.

The selected demonstration projects will be supported by a flexible package of highly specialized, short-term technical assistance that can be made quickly available to maximize targets of opportunity as they are identified. An important and substantial component of the Project will be formal and informal training for senior GOI financial policy makers, senior state and municipality officials, regulators, underwriters, brokers, and those involved in restructuring selected institutions.

Significant technical assistance and training funds will also focus on promoting innovative infrastructure financing methods such as the BOOs and BOTs options referred to earlier. Assistance will also be provided in the areas of public/private partnerships, and financially viable methods for local governments to operate, maintain and recover the costs of basic urban services. The training program will include short-term training, group study tours, workshops and conferences, both in the US and in India.

Once demonstration projects have been successfully designed and sold on the debt market, case studies will be prepared and used in training future market participants in the techniques that were successfully used in the project.

4. Environmental Factors

It is estimated that approximately 60 percent of India's Gross Domestic Product is produced in urban areas with poor access to infrastructure and municipal services. The lack of adequate road access, intermittent power supply, the absence of solid waste collection and inadequate systems for removal and treatment of sewage represent serious productivity constraints.

Approximately 70 percent of India's urban households currently reside in costly, unplanned and under-serviced municipalities. India's urban population is expected to double over the next twenty years. Without an adequate supply of additional land with infrastructure and basic municipal services, new household and employment formation will be forced to seek land in new informal settlements primarily on the periphery of India's urban centers. This unplanned growth will consume premium locations with strategic importance for future economic development and expose ever larger segments of the population to onerous health and environmental risks. Ultimately, the increased cost of servicing these informal settlements will place an enormous additional burden on already scarce central, state and local public sector resources.

Unless the rate of employment formation can keep pace with population growth, India's economic recovery is in question. The lack of land with infrastructure and basic municipal services is a major constraint to expanded productivity. Even with new national policies which promote economic growth, sufficient quantities of business capital and trained staff, good research and development, and improved access to foreign and domestic capital and markets, an inadequate supply of land with access to infrastructure and municipal services will severely constrain increased productivity.

The informal settlement pattern is one of mixed land uses: households reside side-by-side, within and above commercial and industrial establishments. While this represents certain efficiencies in land use, commutation, and access to the labor force, there are onerous health and environmental costs. Households exceed both commerce and industry as the leading urban environmental polluter: 60 to 80 percent of surface water pollution; 60 to 80 percent of solid waste generation; 20 to 50 percent of hazardous waste generation; and 70 to 90 percent of groundwater contamination are contributed by households. The impact of concentrated household, commercial and industrial pollution on the informal sector population results in increased morbidity and mortality rates, loss of productive work force, increased productivity cost, and decreased economic competitiveness.

The FIRE Project will address these major environmental issues by providing a sustainable private sector source of financing for urban environmental infrastructure projects. The provision of urban infrastructure will remove the pressures mentioned above and provide the stimulus necessary to promote increased productivity in the urban workforce.

5. The Financial Institutions

The eventual aim of the Project is to create an environment in which financial institutions will compete in the development of commercially viable projects. In order to do this, the Project will concentrate its resources on those institutions that are the most capable of implementing successful projects in urban infrastructure.

Two institutions have been identified as capable of performing this task, although one is more immediately capable than the other: the Housing and Urban Development Corporation, and Infrastructure Leasing and Financial Services Limited. During the preparation of this Project, both institutions were analyzed to ascertain their capability to function as the FI. Their operations were analyzed from several perspectives, including an assessment of their strengths and weaknesses, and the technical assistance and training needs they would require to carry out the role as FI.

The Project proposes to work with both institutions. The initial focus will be on the Infrastructure Leasing and Finance Services (ILFS) and thereafter it will shift to the Housing and Urban Development Company (HUDCO). Since ILFS has the potential to quickly develop some infrastructure projects, it will act as the initial borrower. HUDCO will need institution building before it has the ability to put together financeble projects. Technical assistance and training will be provided to build this capacity in HUDCO.

The following two sections provide a general assessment of the two institutions.

a. The Housing and Urban Development Corporation (HUDCO)

HUDCO is a public corporation in the portfolio of the Ministry of Urban Development, whose main objective is to finance or undertake housing and urban development and related programs. In operation since 1970, it has a strong track record of loaning money to public agencies for housing and urban projects, with an increasing emphasis in more recent years on urban environmental infrastructure projects. Financial and operational reports indicate that it has had some degree of success in recouping its loans and it continues to report profits each year.

HUDCO was established under the Companies Act of 1956 and is wholly-owned by the Government of India (GOI). Acting through the Ministry of Urban Development (MOUD), the GOI appoints the Chairman/Managing Director and the five other directors who make up the governing board of the corporation. The corporation charter does provide for annual and extraordinary general meetings of all those holding corporate shares, but for all practical purposes, the effective control of the organization is in the hands of its board of directors, all of whom are government civil servants. There is no legal barrier that would prevent HUDCO from undertaking the role and activities of financial intermediary, as contemplated by the proposed Project.

The organizational structure of HUDCO has evolved and developed in response to the demand for projects it is responsible for funding. In 1989, the GOI directed HUDCO to increase its lending for urban projects and as a result, a separate wing was established to focus on urban environmental infrastructure programs. This wing, under the charge of an executive director, has developed extensive guidelines and criteria for appraising infrastructure projects, and assists potential borrowers in designing projects that satisfy those requirements. The infrastructure wing officials take the position that projects which they finance must be self-supporting and that the cost-recovery aspects of loan administration constitute an important element in their lending practices. Through its housing and infrastructure loan programs, it has established strong relationships with municipal and State bodies throughout the nation, resulting in a thorough understanding of the needs and functions of municipal entities.

Much of HUDCO's loan resources have been derived from borrowing from public institutions, such as banks, the Life Insurance Corporation of India and other large institutional investors, and equity contributions from the GOI. In the past, these financial institutions have been required by law to invest their Statutory Liquidity Reserve in agencies, such as HUDCO, which are engaged in activities that are deemed to be socially desirable. This requirement has ensured HUDCO a ready supply of below market rate funds. But the GOI, in the process of liberalizing its controls on the economy, has pledged to decrease the Statutory Liquidity Reserve from a high of 38 percent to 25 percent by 1996-97 (it is 36.5 percent today). The consequence to HUDCO will be the possibility that it will find it harder to raise money and the funds it does raise may be more expensive due to competition for loan funds.

In the future, state governments will be increasingly short of funds, as they, too, feel the effects of economic liberalization. They may be unable to continue the same level of grants to local authorities for municipal infrastructure projects. Moveover, as States tighten their belts, they may be less willing to provide guaranties to Municipal borrowing. Without a state guaranty, lending to HUDCO will be a riskier proposition, and therefore, lenders may raise interest rates, adding to HUDCO's cost of borrowing. Of course, HUDCO can continue to counter this potential problem, in part, by a rigorous insistence upon the design of self-sufficient projects and a direct connection between project costs, cost recovery and loan repayment.

A proposal was made some years ago to separate the infrastructure wing from HUDCO and constitute it as an independent national infrastructure finance company or bank. In the event that HUDCO faces a financial crisis in future years, this would help to isolate the infrastructure operations from any separation associated fallout. If this separation were to occur, it is likely that all performing infrastructure loans in the existing portfolio would also be transferred to this wing; however, since the facility has been operating as a semi-autonomous body for such a short time it is probable that the number of non-performing loans, if any, would be limited or remain with the main HUDCO operation. Furthermore, the lending practices of the infrastructure wing have been relatively rigorous in demanding real cost recovery and loan repayment. It is likely that an independent infrastructure bank would be able to ride out any financial crisis that could affect its parent company for the reasons mentioned above.

There would, however, be costs involved in creating an independent infrastructure institution as described above. Some of the organizational costs of the infrastructure unit might be defrayed, for instance, by arrangements with HUDCO to contract for the services of its regional offices or for covering its administrative support. Nevertheless, some costs would be incurred if the infrastructure wing were spun off, which would have to budgeted and allocated, presumably by the central government. Approval for such an action would have to go through a government sanctioning process which could be expected to require considerable time. A thorough and detailed assessment of this possibility would be needed prior to making any decision.

To participate in this HG program, HUDCO needs assistance in two specific areas. First of all, it would require some technical assistance and training to upgrade its internal operations and management, including the possibility of reorganization and spin-off of an infrastructure operation to carry out the Project. Concurrent with its organizational changes, it must develop financial engineering skills the capacity to provide assistance to municipalities to design commercially viable projects--not just financially feasible projects--thereby ensuring that the municipal bodies which will participate in the Project can design projects that will be accepted for financing in the open market. Given the requisite assistance in selected areas, and from the point of view of designing and implementing effective infrastructure projects, HUDCO is qualified to carry out the role of financial intermediary.

Secondly, it would need considerable technical assistance to develop an internal capability to structure and negotiate the underwriting of project-specific bonds. At the present time, it does not have a financial operation or department with the ability to design and market commercially viable infrastructure projects through the sale of bonds to the investing public to be traded in the open market. Nor does it have staff members with knowledge of this type of financing, and of how to develop the financial instruments and procedures necessary to carry out this type of financial operation. A World Bank financed study of HUDCO by the National Institute of Public Finance and Policy will provide much more information about HUDCO's financial condition and needs, when it is completed next spring.

In summary, HUDCO strengths lie in its ability to develop and finance financially viable municipal infrastructure projects, its good relations with municipalities and States which trust HUDCO, and its understanding and in depth knowledge of the infrastructure sector. Its weaknesses consist of its lack of knowledge and capacity in the development of commercially viable projects and its lack of understanding and capability of the capital and debt markets. Given the dedication of its staff and sufficient time, HUDCO could gain the necessary expertise to develop commercially viable projects for sale in the debt market. It is expected, however, that a minimum of one year, and more likely two years, of specific technical assistance and training as mentioned above, coupled with some reorganization and restructuring of the institution, for HUDCO to reach the level where it could operate effectively to develop commercially viable urban environmental infrastructure projects.

b. Infrastructure Leasing and Financial Services, Ltd (ILFS)

ILFS is a publicly held corporation, with 51.7 percent of its shares held by public institutions and corporations and the remainder held by private companies in India and foreign investors. It was created initially as a joint venture by the Central Bank of India, the Unit Trust of India and the Housing Development Finance Corporation Ltd (HDFC). A recent inflow of new equity has led to a redistribution of ownership as shown below:

SHAREHOLDER	PERCENT OF SHARES
• Central Bank of India, & Affiliates	32.2
• Unit Trust of India	19.5
• HDFC Ltd	11.9
• IFC, Washington DC	11.4
• ORIX Corporation, Japan	20.0
• Employees, others	5.0
TOTAL	100.0

Of the fifteen current board members, seven represent the public sector, while another seven represent the private sector and foreign investors, with the 15th member being the firm's Managing Director. All the institutions listed above have representatives on the board, while other directors have been named from the Industrial Development Bank of India, the Birla Group, Maruti Udyog Ltd, the Ministry of Transport and the Ministry of Information and Broadcasting.

ILFS is a non-banking financial institution whose business purpose is to provide a comprehensive range of financial services in a number of areas including: corporate finance, consisting of leasing, asset financing, financial advisory services, project financing and capital markets; market operations, including securities trading and brokering; management of mutual funds; venture capital; and finally, the commercialization of infrastructure projects. Since its beginning ILFS has attempted to develop a string of international relationships to obtain additional financial resources and technical knowledge which it uses to improve its finance products and expand and development new services.

During its five years of operation, ILFS has focused its attention on developing financial products that bring a more immediate return, ensuring that the company is profitable while permitting it to diversify. This too has given the company the time required to organize itself to undertake the financing of commercially viable infrastructure projects, including the development of the appropriate legal, financial and operational structures needed to support these kinds of projects, arrange for putting such structures in place and finally implementing the projects. This developmental work has meant that ILFS has been the pioneer in this critical segment of the financial market. But, it has only been in the last two years that the economic and financial environment has been suitable to the introduction of debt backed by commercially viable projects of the type ILFS is putting together.

In the infrastructure commercialization area, ILFS is directing its efforts to four sub-areas: power, telecommunications, surface transport and serviced land, including urban environmental infrastructure. Only the last sub-area is considered appropriate for financing under the HG Program. At the present time, ILFS is implementing its first infrastructure project in the area of surface transportation. The Rau-Pithampur Link Road in Madhya Pradesh State is a 11 km toll road which will provide an alternative to a 34 km non-toll road linking the two towns. Not only will this be ILFS's first infrastructure project of any nature, it will also be the first toll road in the country. Its cost is Rs 80 million, of which ILFS is providing equity for Rs 20 million, with bonds being issued for Rs 60 million to five institutional investors. ILFS has fully guarantied the bonds.

This project will be completed and in operation in August of this year, at which time ILFS will learn whether its financial and economic assumptions and structure were accurate and the operation will truly work. ILFS has set up a trust to own the project and issue the bonds, the first time that such a financial instrument has been used for an infrastructure project in India. In addition to this project, ILFS has a number of other transportation projects in its pipeline, such as city by-passes, a city light rail system, bridges and highways. The self-financing features of toll systems, coupled with the lower probable risk element, are clearly the reasons why ILFS has focused its first efforts in the transportation area.

ILFS is also working on a number of serviced land projects, which it defines as projects in the areas of water and sewer, solid waste and land development. Although ILFS has identified a number of projects of this nature, it is going ahead with the planning of only a few, apparently hesitating until the feasibility of commercially viable transportation projects is more evident. The most advanced of the land development projects is the Tirrupur Development Program in Tamil Nadu State, which consists of the development of a comprehensive water and sewer cum roads project for a city with a large number of export oriented textile manufacturing plants.

As a Bombay based company with a highly educated and sophisticated staff, ILFS realizes that it needs to improve its capacity to relate to municipal governments and officials. The ability to communicate requires a basic level of shared experience and, between the average municipal official and the highly educated employee of ILFS, there is a considerable gap that needs to be narrowed. ILFS needs to devise a strategy and devote considerable effort in its implementation in order to become an effective vehicle to "spread the gospel" of debt financing of infrastructure among the municipal bodies of India. It has received a large number of requests for financing from municipalities and other organizations. Currently, it can respond only selectively to those which are large enough, or well enough presented, to suggest that the proposal is commercially viable.

As the pioneer in this field and the consequent need to minimize risk in order to demonstrate feasibility, ILFS is currently financing and will continue to finance only the most viable of commercial projects. Although it is the only player in town, ILFS has not been able to respond to the majority of the loan requests it receives because of its limited resources.

Finally, ILFS is a new institution and in spite of its impressive array of backers from the public and private sectors as well as from abroad, it still is in the process of making its reputation in the financial and business sectors. Moreover, it will have to work hard to gain the confidence of the vast majority of municipal bodies, those same bodies that it will have to work with if it is going to generate the commercially viable projects it needs to make the bond market work, which in turn will make a measurable impact on the infrastructure finance system. In addressing these perceived needs, technical assistance to ILFS will need to be focused on assisting the institution to develop a wide array of financial instruments, on how to reach and communicate with municipalities, and on ensuring that ILFS develops and implements the kind of projects that result in widespread benefits.

ILFS is the only institution in India in a position now to develop commercially viable infrastructure projects. From the standpoint of making sure that demonstration projects in the area of urban environmental infrastructure are also commercially viable, using marketable financial investments, ILFS appears to be more qualified, at this time, than any other institution in the country to be the financial intermediary for this Project. Not only does the institution have the capability, but it is desirous of undertaking a selected number of such demonstration projects. It has developed a pipeline of project proposals, some of which appear to be appropriate for financing projects under the HG program.

The Project will begin implementation with ILFS as the Financial Institution and will provide assistance to HUDCO to enhance its capabilities to perform this function later in the Project. Following assessment and decision that HUDCO is capable of performing as a project Financial Institution, consideration will be given to providing loan funds to HUDCO to package identified urban infrastructure projects.

6. <u>The Implementing Agency</u>

The National Institute of Urban Affairs (NIUA) will work with USAID in the development and implementation of the technical assistance and training program of the Debt Market Development Component of the Project. It has no institutional interest in the Project itself and, furthermore, is the institution designated by MOUD for developing into an apex institution to conduct research and provide training on urban policy issues such as privatization of municipal services and implementation of infrastructure projects with private/public partnerships. Moreover as a disinterested party, it will be able to carry out its role in an unbiased manner. A through assessment of the institution indicates that it is fully qualified to carry out its role under the Project.

The role of the NIUA in this Project will be to act as the institutional advocate for the policy changes to be demonstrated through the Project. This will include the following:

- act on behalf of the MOUD as the agency for development of urban policy, including the preparation of studies and analyses leading to reform and changes in urban environmental infrastructure policy and programs;

- promote the Project's policy change agenda with the state and local governments, and the private sector;

- through the preparation of case studies, evaluate the impact of the policy reforms vis-a-vis the urban environmental infrastructure projects at the demonstration locations through the application of case studies;

- disseminate the Project's policy and programmatic findings and conclusions through publications such as a project news letter, periodicals, and books; workshops, seminars, and documentaries; and

- as required, provide input into the annual implementation plan for the management support services contractor.

NIUA, a non-profit public institution, is the policy research arm of the Ministry of Urban Development. It also has a close relationship with the states, the municipalities and financial institutions working in the urban sector. Since its creation in 1976, it has developed a wealth of relevant practical, scholastic and research experience principally in the areas of urban planning and development, municipal finance and development, urban studies and environmental planning. NIUA has had many years of experience in working with USAID and other international agencies and consulting firms.

NIUA is experienced in carrying out training programs, seminars, conferences and networking with an array of Indian and international institutions. NIUA will continue this role and strengthen its training and networking capacity through the Project. Through contracts with clients, it carries out studies and other consulting assignments, utilizing its own staff as well as outside consultants. Its professional staff is of a high caliber, and it will be able to hire or contract other professionals to fill any part or full-time staffing gaps necessary to carry out this Project. NIUA has already identified additional resources required to carry out its role in this Project.

NIUA will move early next year to a new institutional complex being built solely for institutions and companies working in the housing and urban sector. In its new facility, NIUA will be able to coordinate more closely with other institutions in related fields, including the financial intermediary for this Project, which will also have space in this institutional complex. The new facilities will provide NIUA with about double its existing space, and because of this it will be able to accommodate the needs of its expanding operations and staff, part of which will be required to meet the needs of this Project. It will also provide more adequate teaching, research and library facilities, as well as better and more appropriate equipment.

7. The Role of Technical Assistance and Training in the Debt Market Development Component

Technical assistance and training are important components of this Project. A portion of the technical assistance and training will be channeled directly through the National Institute for Urban Affairs, through a cooperative agreement with USAID. The role of NIUA will be to provide policy promotion, evaluation and dissemination through related research and studies, publications and workshops. A competitively bid contract will also be awarded by USAID to a US consulting firm to provide project management support services as well as the delivery of TA and training in all functional areas. The US consulting firm will also be able to contract Indian consultant services, both individual and institutional, in specialized areas of expertise. As required, NIUA will work with USAID in the preparation of annual implementation plans for the management support services contractor.

Technical assistance and training under the Debt Market Development Component is divided into the following three categories:

- to the financial intermediaries to ensure that these key institutions are able to fulfill the mandates as the HG borrowers, and to develop the appropriated financial techniques and instruments;

- to local governments to gain the expertise to design, develop, implement and maintain commercially viable infrastructure projects for financing by the FI; and

- to NIUA to assist it in preparing local governments to create the proper policy environment to develop the Debt Market Development Component of this Project and to replicate the success generated by the FI in other public and private institutions.

Technical assistance and training will be provided under this component only to those financial intermediaries and local governments who meet criteria developed under the Housing Guaranty program and establish a reasonable presumption that the recipients will be capable of identifying, packaging and implementing urban infrastructure projects through FIRE financing techniques.

8. <u>Operations Research and Local Training Capacity Strengthening</u>

a. Operations Research

The development of India's debt market is beginning to accelerate and is likely to increase it rate of development through the stimulation of that market that the FIRE Project will provide. The parameters that influence the shape and operations of that market must be understood if the Project is to successfully stimulate its development. Again, because of the extremely fluid nature of this market, the Project will establish annual research agendas that will be targeted on the most pressing questions identified to be in need of further research. These research agendas may be recommended by the Project Advisory Committee and/or other sources and, upon approval by USAID, will be funded and incorporated into the annual workplan of the project contractor.

b. Local Training Capacity Strengthening

The National Institute of Urban Affairs is a public entity, supported in part by an annual grant from the Ministry of Urban Development (MOUD). NIUA performs research related to infrastructure construction and financing in the Indian market. There are, at the present time, 15 professional full-time staff members, encompassing the disciplines of urban and regional planning, economics, municipal finance, social planning and environmental planning. Although NIUA is involved in practical and scholastic research and analysis in relevant areas of urban affairs, given the growing need of India's local municipalities to raise urban infrastructure financing in the private sector and NIUA's relative lack of expertise in this area, it is in need of strengthening its training capabilities in issues related to the private financing of urban infrastructure.

Training provided to demonstration states and municipalities will be delivered through a central training institute, with regional training facilities, such as the Human Settlement Management Institute (HSMI). The Project will support the development of training materials, training for trainers, and development of Indian and U.S. training networks in areas such as: plan, operate, maintain and recover costs for basic urban services; environmental, physical and economic impact analysis and mitigation strategies; and private/public partnerships. During the initial phase of project implementation, a short-term US consultancy will undertake an institutional analysis, a training needs assessment, and the preparation of a training plan.

Training to financial professionals other than ILFS and HUDCO, will also be examined during the initial phase of project implementation. The US consultant will identify the educational and training needs of professionals involved in infrastructure financing/debt market operations and include recommendation in the training plan. The Operating Environment Improvement Component will also provide broad based training to financial professionals. The US consultant will examine the issue of coordination between training provided under these two components, and recommend a strategy to ensure that duplication and gaps are avoided.

9. Component Inputs

The following inputs will be financed by the Project:

Activity	Input
a. Institutional Strengthening	Short-Term Consultancy & Training
1. ILFS	1. Financial, negotiating partnerships with local governments, identify US joint-venture partners
2. HUDCO	2. Institutional, legal regulatory, and financial
3. NIUA	3. Policy reform and training
b. Local Governments	Short-Term Consultancy & Training
	1. Project feasibility and financial packaging

	2. Physical, economic & environmental impacts; identify US joint-venture partners
	3. Solicit, negotiate, contract and manage private sector providers
	4. Maintain, operate and recover costs including capacity building and technical innovations
c. Operations Research & Local Training Capacity & Strengthening	Short-Term Consultancy & Training
1. Central/regional training organization such as HSMI	1. Course materials, training for trainers and networking for state and local governments

IV. MANAGEMENT OF THE PROJECT

A. The Implementation Strategy

The FIRE Project will involve the participation of a significant number of Indian institutions that are involved in all aspects of the operation of India's capital markets. A number of market-related institutions will also be involved in project-funded activities to provide forums for policy discussions, to serve as channels for directing technical and training assistance to proposed beneficiaries, and to ensure that project resources are properly used. Both public and private sector institutions will be heavily involved in the implementation of project activities.

In addition to varied and wide-ranging institutional participation, a key factor in the design of the FIRE Project was the underlying market operations improvement orientation of project-supported activities. Even those elements of the Project aimed at reforming regulatory structures, automating securities documentation and handling systems, designing new marketable instruments, and expanding indigenous research and training capacities have as their end purpose, the development and expansion of more active and efficient securities trading systems.

B. Coordination of Project Implementation

The Project will receive policy guidance, advice and direction from a senior-level board to be known as the FIRE Advisory Board (FAB). The membership of this advisory board will include representatives from the Ministry of Finance, the Ministry of Urban Development, the Securities and Exchange Board of India, the National Institute of Urban Affairs, USAID and selected private sector representatives who are nationally and internationally recognized as capital markets experts. A Ministry of Finance or private sector representative will chair the board, and the Ministry of Finance will convene the board as soon as possible after the Project Agreement is signed.

Ad hoc subcommittees of the board may be established to deal with specific project issues as they arise in the course of project implementation. The board will meet not less than annually and in the initial years of the Project, as often as semi-annually.

The purpose of the advisory board will be to provide a high-level forum for the discussion of overall project policy and direction and to review and recommend to USAID project officials specific implementation plans and actions necessary to meet project objectives. The Management Services Support Contractors (described below) which will be responsible for the overall implementation of the Project, will act as the secretariat for the board, preparing various issues and background papers for each meeting and making all administrative arrangements for those meetings.

The Debt Market Development Component of the Project will receive implementation assistance from a Project Implementation Unit to be located in the National Institute of Urban Affairs (NIUA). Under the terms and conditions of a Cooperative Agreement with USAID, the NIUA, acting through the PIU, will promote, analyze, and disseminate basic policy changes needed for project success at the state and local government level. Based on the lessons learned, and in collaboration with a central/state training institute, NIUA will develop relevant curriculum and training materials, and provide training for trainers in the above areas.

C. Project Implementation

1. Management Services Support Contracts

Technical assistance and training will be delivered through two management support services (MSS) contractors: one for the Regulatory Environment Improvement and Operating Environment Improvement Components, and one for the Debt Market Development Component. Each MSS contractor will provide an on-site management support coordinator, with home office back-stopping and coordination of state-side activities. The contractors will be responsible for the delivery of all technical assistance and training including studies, study tours and workshops.

Working with USAID and the Indian counterpart institutions as required, the contractors will develop annual implementation plans to be approved by USAID, for the delivery of technical assistance and training. The implementation plans will be amended annually during the life of the contract to ensure that technical assistance and training activities remain current and appropriate for the goals and objectives of the Project. The implementation plan amendments will result from annual evaluations, which will assesses the impact of the previous year's planned activities and incorporated recommended activities in the following year's plan.

The specific activities to be undertaken in the approved implementation plans will be generated through Requests for Services (RFSs). The implementation plans will include a brief description of technical assistance and training activities and a schedule for implementation. For each activity, the contractors will prepare a scope-of-work and budget to be approved in advance by USAID. USAID will issue an RFS to each contractor for each activity which will serve as the order to proceed. The contractors shall ensure that scopes-of-work are generated in sufficient time to meet the implementation schedule.

At the conclusion of each year's activities evaluations, by an institution or individual other than the MSS contractors, will be performed for each MSS contract. The evaluations shall assess the impact of the technical assistance and training activities towards achievement of the goals and objectives of the Project; assess the impact of the overall program on the Project's proposed policy change agenda; and make recommendations on activities to be undertaken during the following year which, as required, will bring the Project back on target.

2. Start-Up Activities

Prior to the competitive award of the MSS contracts, (likely to take nine months) several activities have been identified that will be funded in order to accelerate the momentum of project implementation and provide start-up project actions until the MSS contractors are in place. These activities will be implemented directly by USAID by accessing consulting services through Indefinite Quantity Contracts, Buy-ins, Purchase Orders, Invitational Travel Orders, Project Implementation Letters and other appropriate mechanisms. The activities will be planned so as to be completed by the time the MSS contractors arrive at site.

The following represents an illustrative list of start-up activities that may be funded (through funding mechanisms appropriate to the legal status of the institution being assisted) prior to the arrival of the MSS contractors.

a. Short-term technical assistance and training to HUDCO in the following areas: organization development; methods of tapping capital markets for infrastructure finance; innovative infrastructure finance methods; and workshop on debt instruments/commercial viability/pricing of infrastructure projects.

b. Short-term technical assistance and training to ILFS in the following areas: design of debt instruments for infrastructure finance; tendering, contracting and evaluation of infrastructure projects; innovative infrastructure finance methods; and a workshop for municipal/local officials on resource mobilization for infrastructure finance and designing commercially viable infrastructure projects.

c. The OTCEI will require technical assistance in the analysis of its hardware, software, telecommunications, business and regulatory strategies for its planned expansion.

d. The Industrial Credit and Investment Company of India will use the services of the Chicago Mercantile Exchange to perform a feasibility study for the establishment of stock options and futures exchange in India.

e. SEBI will begin the development of its organizational and human resources development plan.

f. The Unit Trust of India/Institute of Capital Markets will be provided funding to begin researching the operating requirements, and regulatory and institutional framework for the functioning of a derivatives market for foreign exchange in India.

D. Mission Management of the Project

The FIRE Project will be managed by the Program Office (PRO) within USAID/India, with representation from the South Asia Regional Housing and Urban Development Office on the project committee. There will be no additional U.S. Direct Hire or FSN staff required to manage the Project. One USDH officer in the Program Office will be the FIRE Project Officer. The Regulatory

Environment Improvement and the Operating Environment Improvement will be managed by one FSN in PRO; the Debt Market Development Component will be managed by one USDH in the RHUDO/South Asia Office.

V. IMPLEMENTATION SCHEDULE

Activity	Date
• Approval of PP and HG authorization	September 15, 1993
• Grant Agreement signed	September 30, 1993
• Draft HG Implementation Agreement prepared by USAID and sent to FI	September 30, 1993
• PIO/T for MSS contract issued	October 31, 1993
• Financing arrangements for start-up activities completed	October 31, 1993
• RFP for MSS contract issued	November 30, 1993
• HG Implementation Agreement signed	November 30, 1993
• Contract with US consulting firm signed	March 31, 1994
• FI certifies first projects for financing	March 31, 1994
• Contract team arrives	June 1, 1994
• FI seeks US Investor	April 30, 1994
• Draft Master Implementation & 1st Year Plans prepared	June 30, 1994
• FI negotiates and signs HG loan	June 30, 1994
• Guaranty Agreements negotiated and signed	June 30, 1994
• Implementation Plans approved	July 31, 1994
• FI draws down authorized disbursement of HG loan	August 31, 1994
• First yearly evaluation completed	July 31, 1995

•	Second year implementation plans approved	August 31, 1995
•	Second yearly evaluation completed	July 31, 1996
•	Third year implementation plans approved	August 31, 1996
•	Third yearly evaluation completed	July 31, 1997
•	Fourth year implementation plans approved	August 31, 1997
•	Fourth and final yearly evaluation completed	July 31, 1998

VI. COST ESTIMATE AND FINANCIAL PLAN

A. Estimated Cost of the Project and Proposed Fund Allocations

The total cost of the Project, is estimated to be US $277.0 million, of which A.I.D. will contribute funding of US $145.0 million and the Host Country the equivalent of US $132.0 million. A.I.D. funding will consist of US $20.0 million in Development Assistance (DA) and US $125.0 million in HG-backed loans. The budget estimate of US $20.0 million in Development Assistance includes a provision for price and physical contingencies.

1. Financial Analysis

The PP accounts for a combined physical and price contingency on 10 percent of the total project costs. Price contingencies have been provided for dollar-financed local currency costs because since the rupee became freely convertible against the dollar, it has not depreciated and has remained fairly stable against the dollar. Given the past trend and current projections of economic indicators, it appears that the rupee is not likely to depreciate as consistently as it had in earlier years. Since no depreciation in the value of the rupee is envisaged, inflation on local currency costs is unlikely to be offset by depreciation; therefore, price contingency has been provided on local costs as well.

Fund outlays under the HG-loan financing component of the Project will also be made incrementally, in terms of US $12.5 to US $25.0 million loans to financial intermediaries (FIs), and will be spread evenly over the five-year term of the Project. The FIs, and downstream borrowers, will bear the risk of inflation for the purposes of this component of the Project. Financial viability will be one of the key criteria applied in the selection of urban infrastructure projects for the HG-loan financing component. Each project to be considered for a loan will have been subjected to stringent financial feasibility analysis by its state or municipal proponent and by the financial intermediary involved. Since a major share of the financing for each infrastructure project is to be obtained through the sale of long-term bonds (or other appropriate instruments) to private investors, the financial soundness of each project will be subjected to close scrutiny by potential investors.

USAID considers that the financial criteria to be applied during the project selection process, together with the feasibility analysis and market testing that will be applied before a HG loan is granted, will virtually assure the financial soundness and sustainability of the urban infrastructure projects that eventually do receive HG loans.

2. Methods of Implementation and Financing

The MSS contracts and other contracts with U.S. firms, such as for short-term technical assistance, training consultancies, and project evaluations, will be implemented through direct payments to the U.S firms engaged in those activities. In those cases where A.I.D. funds are used to pay some portion of the local costs of a project activity, such as for in-country staff training, workshops, or internships or industry training tours in the U.S., or RHUDO regional training courses or tours, these will be effected through funding mechanism appropriate to the legal status of the involved institutions.

3. Recurrent Cost Analysis

The hosts country's contribution of US $7 million will be provided by local institutions and agencies and will be made in cash and/or in kind. This accounts for 25 percent of the project cost. Thus, the stipulation of Section 110 of the FAA, that the host country must provide.... "at least 25 percent of the costs of the entire program, project or activity...," has been complied with.

Recurrent costs are defined as the operating expenditures needed to carry out project activities. The recurrent costs envisaged under this Project include salary payments of staff directly/indirectly associated with the implementation of the Project, the cost of office space to be provided by local institutions and agencies to carry out identified activities, cost of domestic travel of participants attending seminars, workshops and training courses to be conducted within India.

B. Input Financing

Input financing will be directed at both long and short-term technical assistance, as well as both overseas and in-country training.

1. Long-Term Technical Assistance

DA funds allocated for the MSS contracts will, in effect, cover the U.S. portion of the cost of managing implementation of the Project. The funds will pay for the services of long-term U.S. consultants who will oversee implementation of the overall project, and specialists who will monitor the delivery of input elements (short-term technical assistance and training) and assist in the implementation of specific components of project activity.

2. <u>Short-Term Technical Assistance</u>

Short-term consultants funded under the Project will provide services to each of the major institutions involved in project implementation and will cover activities being carried out under each of the Project's components.

3. <u>Training Assistance</u>

Like technical assistance, a large proportion of DA funding for training assistance activities will be directed to the major institutions that are involved in project implementation. In the case of the Debt Market Development Component, DA funds will be provided to NIUA that will help train local government officials in the methodologies to be employed in formulating commercially-viable urban infrastructure projects. DA funds will be provided to ILFS and HUDCO which will serve as financial intermediaries and are charged with arranging adequate financing for those projects judged to be commercially viable. They will also serve as trainers (especially HUDCO) for the staff of other institutions or firms seeking to become financial intermediaries.

4. <u>HG Loans</u>

HG funds will be used to complement and promote the sale of debt instruments in India's securities markets (and abroad, if possible) to finance urban infrastructure development projects. They will be applied to a range of projects to demonstrate alternative approaches that might be taken to mobilize private sector funding for such projects. A key financial objective of the FIRE Project is to identify or create debt instruments that appear attractive to private investors, thereby stimulating greater investor interest in debt instruments and expanding the pool of private funds available for urban infrastructure projects. Increased private sector funding is essential given the steady reduction that is occurring in the availability of government funding for such projects.

C. Audits and Evaluations

1. <u>Audits</u>

In the case of any grantee or subgrantee who receive US $25,000 or more per year under the Project, the grantee will be required (or in the case of subgrantees the grantee will require the subgrantee) to have audits performed in accordance with the Standard Provisions in the Project Grant Agreement. These audits will be performed by local CPA firms who are on the IG's approved list of firms. The IG's "Guidelines for Financial Audits Contracted by Foreign Recipients" and the Statement of Work for such audits, also provided by the IG, will be followed in conducting the audits.

A specified sum has been provided for audits under the Project. However, the specified amount may have to be revised as the Project progresses depending upon the number of grantees/sub-grantees. The foregoing estimates take account of current price inflation in both the U.S and India. U.S. inflation is continuing to hold at a modest 3-4 percent annual rate. In India, the annual rate has shown a steady decline in recent years, from 17 percent in 1991 to 14 percent in 1992, and to an estimated 7 percent in 1993.

2. Evaluations

All Project-funded activities will be subject to annual reviews by the institutions or agencies responsible for their implementation. These reviews will provide the basis for the preparation of proposed annual implementation plans. The financial aspects of project implementation related to the activities under review will be given appropriate attention during the annual review sessions.

The overall financial aspects of project implementation will be assessed in detail as part of the mid-term project evaluation that is scheduled to be conducted toward the end of the third year of project implementation.

A specified sum has been provided for evaluations under the Project. As with audit funding above, this amount may have to be revised as the project progresses depending upon the number of grantees/ sub-grantees. Again as above, the estimates take account of current price inflation in both the U.S and India.

3. Monitoring

The USAID Mission will be primarily responsible for monitoring the allocation and use of DA grant and HG loan funds during the course of project implementation, using standard Agency financial and project monitoring practices. The MSS Contractors and all FIRE participating institutions will be required to submit quarterly financial reports detailing the status, scope and purposes of fund allocations and disbursements during the quarter. These reports will be reviewed by USAID project management staff on a regular basis.

Local institutions receiving direct funding under the Project will be responsible for establishing similar financial monitoring procedures to cover sub-grant activities. The quarterly reports provided by these institutions to the USAID Mission will include summaries of significant and noteworthy developments or events occurring during the implementation of sub-grant activities.

II. MONITORING AND EVALUATION

Project monitoring will be the responsibility of the Management Support Services Contractor. The Management Support Services Contractor, in conjunction with all project counterpart organizations, will prepare a set of basic project indicators to be used to track project progress. These indicators will be included in the overall implementation plan and will be amended, if necessary, during the annual implementation plan negotiations.

Annual program evaluations will be conducted to determine project progress and future direction. Each evaluation will determine if there are any material changes required in the implementation of the Project. Expatriate consultants will conduct the evaluation jointly with USAID. Any consultants or consulting firms involved in the implementation of this Project will be excluded from participating in any of these evaluations.

VIII. SUMMARY OF ANALYSES

A. OVERVIEW

Capital market development and infrastructure finance are both areas of dramatic change in India at present. In the capital market area, the changes being made involve a basic shift in the way the market is being regulated, and the modernization of market operations. In infrastructure finance, the changes relate mainly to expanding the capacity of the debt component of the market to finance municipal urban infrastructure projects.

The FIRE Project is a technical assistance and training project, the purpose of which is to provide the technical skills needed to enable the government to change the way in which India's capital markets are structured and the way in which they operate. The starting point of the Project is to identify the gaps and shortages in the technical skills needed to implement these changes.

The Project is well-timed. India now needs to compete for investment capital and export earnings in a global environment that has become highly competitive. Within India itself, there is heightened competition for capital resources between the country's private sector enterprises, which are being urged to expand production and export earnings to accommodate the material needs of the growing economy, and the country's public sector agencies, which face an urgent need to expand infrastructure to accommodate the country's rapidly expanding population.

The Project will play the central role among India's assistance donors in providing the technical assistance needed to enable the country to modernize and improve the operations of its capital markets, and to engage the private sector more fully in financing urban infrastructure projects.

B. Economic Analysis

The Indian economy is still recovering from the severe disruption suffered in mid-1990 as a consequence of the Gulf War. The prospects for continued good performance are promising. The GOI is working to raise the sustainable level of annual economic growth to over 5 per cent by the mid-1990s, and appears determined to maintain the gains already achieved. As noted in a recent World Bank report, however, certain additional reforms will need to be implemented before the higher level of growth can be achieved.

Since independence and until the early 1990s, India had pursued an economic growth strategy that can best be characterized as inward-oriented, self-reliant, and heavily-regulated. The strategy was focused primarily on achieving economic growth through public investment in publicly-owned enterprises. The country has now changed course, as the Government has begun to pursue economic and financial policies that are dramatically different from those initiated 40 years ago. Almost every area of the economy is undergoing modernization and reform to pave the way for India's entry into global markets.

The Government's liberalization and reform policies have been a boon to India's capital markets. The speed at which change is taking place has been very rapid. The equity markets in particular have been growing at impressive rates. Moreover, the links that have now been established between government policy reform efforts and the future operations of the country's capital markets will be further strengthened as the Government continues to look increasingly to market sources to satisfy its own future financing needs.

The assistance to be provided under the FIRE Project will be provided on a highly cost-effective basis. U.S experts and institutions are being tapped to provide managerial and technological know-how that has been acquired directly through their participation in market activities in the U.S. Their expertise will be transferred directly to the individuals and institutions that are responsible for guiding and directing the further development of India's markets.

The actual demonstration projects (under the HG) have not yet been selected. This will be done during the initial stages of the implementation phase. Standard economic benefit/cost analysis and the computation of internal rate of return (IRR) for the projects being considered, will be a requirement of the project review and selection process.

C. Supplemental Economic Analysis for Housing Guaranty

The economic environment over the life of the Project is one in which the GOI will be undertaking a broad reform agenda. A discussion paper prepared by the Ministry of Finance entitled "Economic Reforms: Two Years After and the Task Ahead," sets forth a fiscal and financial reform agenda which will have a substantial impact on the ability of the Project to be carried though to completion. A series of reforms are aimed at generating a sustainable economic growth rate of 6 to 7 percent per year. Reductions in subsidies combined with decreases in budget support for municipal services will drive the demand for resources in the domestic capital markets. Policy changes in administered prices and user fees will promote commercialization. Reductions in controlled credit, a ban on loan waivers, and improved recycling and recovery of public savings will add to the resources available from domestic capital markets.

The major strength of the HG Component is the opportunity to implement the GOI's basic policy reform agenda (see Annex I); the major weakness is a lack of understanding at the operating level on how to implement these policy changes. The Project will use HG funding combined with technical assistance and training support to operationalize commercially viable infrastructure projects at demonstration municipalities. This process will lead to substantive institutional improvements at the state and local government level, and in the financial intermediaries.

Increasing capital market investment in basic urban services will have a significant impact on the overall economy. The correlation of economic growth with increased infrastructure investment is a fundamental principle. Entrepreneurial access to a consistent supply of power, water and sewage disposal, solid waste collection, and roads is essential to increase business productivity. Improving the health of the workforce through better access to potable water and improved sanitation also increases productivity.

The financial intermediaries will assume overall responsibility for eligible projects for the HG loan, for selecting HG investors, and for repayment of the HG loan. USAID will neither approve nor disapprove individual projects, borrowers or on-lending transactions. USAID's role will be to monitor and evaluate the program to ensure conformity with conditions and covenants established between USAID and the financial intermediary, and the framework of agreements between the financial intermediary and the borrowers/developers of eligible projects.

The GOI or a designee acceptable to USAID will provide a full-faith-and-credit guaranty for the HG loan. Since the financial intermediary has no need for free foreign exchange, the U.S.

dollar proceeds of the HG loan will be placed with a swap-partner acceptable to USAID. The swap-partner will on-lend Rupee funds to the financial intermediary, with an interest-rate margin to create a foreign-exchange risk hedge. The swap-partner and the GOI or its designee will assume full responsibility for repayment of the U.S. dollar denominated HG loan, regardless of fluctuations in foreign exchange.

D. Social Soundness Analysis

India's population profile reflects a pattern of vast diversity. The country's inhabitants range from sophisticated urbanites living in Bombay to uneducated, share cropping peasants who farm rice paddies in West Bengal. Not surprisingly for a developing country, there are many more peasants than there are sophisticated urbanites. About three quarters of the population, or roughly 680 million, live in rural areas; leaving an urban population of around 200 million.

Social researchers have identified two main sets of attitudes or values that characterize the basic political orientation of Indian society. One is based on Western, liberal democratic, and secular ideals, and is strongest at the level of the Central Government and its institutions, e.g., the Parliament, the courts and the civil service. USAID staff deal mainly with individuals imbued with this set of values. The other, which was built around loyalties to caste, family and clan, is the norm in rural panchayats and among local authorities. The battleground between these two contrasting sets of values is located at approximately the level of the State Governments.

Participants and agents involved in changing the way India's markets operate will need to be aware of how the cultural characteristics of the Indian people influence their investment choices. Among these characteristics (which obviously vary by individual) are preferences for keeping cash rather than investing in securities; a dislike of debt as an institution; a preference for debt instruments that are both liquid and that have guarantied principal repayment at any time (as contrasted with instruments that are liquid but in which the principal amount varies prior to maturity); a preference for the perceived capital gain opportunities of the equities market; lack of knowledge of the debt markets (even when the markets are theoretically open to them, such as government debt auctions); and, perhaps, most importantly, a profound distrust of brokers.

The GOI's current plans to establish an integrated nation-wide trading system based on automated facilities and modern telecommunications links will truly test the culture's ability to adapt. The proposed system will extend well beyond the boundaries of Bombay and New Delhi, and penetrate into the far reaches of the country's hinterland bringing together for the purpose of mounting a concerted effort to achieve economic progress, the many diverse elements of the population.

With the likely ratification of Amendment No. 74 of the Indian Constitution, the role of municipal governments in managing the financial resources of their urban communities will be changed dramatically. Under the Amendment, funds for the construction of urban infrastructure facilities, which have traditionally been a responsibility of the State Governments, will now be the responsibility of the municipal governments. The need for urban localities to recover the cost of construction and operation through user fees will also, in principle, be passed down.

For the newly-established relationships between municipal authorities and central government agencies to flourish, there will be a need for real and effective communication. This need is dramatically underscored by the requirements of the FIRE Project. Only if it is able to establish such communication can the Project expect to have a lasting impact upon the way in which urban infrastructure is financed in India. In order to succeed, it will need to evolve an ability to bridge the communications gaps which now separate small groups of bright, mostly youthful, money managers in Bombay from the elected and appointed officials who manage the vast majority of the nation's municipalities.

The need for municipalities to begin covering the cost of constructing and operating infrastructure by imposing user fees and other income generating methods (except for those who cannot afford to pay), is a new idea that has yet to enter the consciousness of most local leaders. The finer points of fiscal engineering, relating to the choice of instruments, the methods of repayment, interest strategies, the use of secondary markets and the like, are also well beyond their knowledge base, at least at the present time.

The impact of their carrying out this new responsibility on the prospects for successful implementation of the infrastructure finance component of the FIRE Project, is serious and profound. To "sell" the idea at the level of the individual municipalities will involve long hours of dialogue, flexibility, imaginative packaging and a sympathetic understanding of local dynamics.

To the extent that urban infrastructure can be improved, urban life will be improved, urban health enhanced, urban employment generated and the urban environment rendered more livable. Women stand to gain substantially from these improvements. While the FIRE Project does not address directly the lowly social position low-income women suffer, it does aim to improve living conditions in India's municipalities and will, accordingly, bring considerable benefit to women who constitute a substantial portion of the country's urban population.

E. Technical Analysis

Many of the technical skills needed to facilitate the Government's proposed changes in the way its markets operate are already available in-country, though not in adequate supply. In some cases, a higher order of skills is needed. A key part of the challenge of the FIRE Project will be to identify the specific areas where outside technical assistance and training resources need to be applied. In some cases, project resources will need to be directed to bringing the local level of performance up to international standards.

Another area of particular importance will be to strengthen the technical training capacities of the country's educational and training institutions. This will help assure that these institutions are better able to fulfill the country's future requirements for technical skills, which it will need to continue making improvements in its market operations at home and to support its growing efforts to compete effectively for capital resources globally.

A sizeable share of the technical assistance and training that needs to be provided under the FIRE Project is related to the technological changes that are to be made in the way the capital markets conduct their business. The Government is depending heavily, for example, on the automation of market operations to effect needed improvement in the transparency of market operations, while adding significantly to the efficiency of those operations.

An area in which more detailed assessments are needed, relates to the country's need to establish a better and broader institutional base for developing its own specialized technical expertise. Several well-qualified technical training institutions are currently operating, and show excellent prospects for continued success. These include the UTI Institute of Capital Markets (UTI/ICM) and the Institute of Certified Financial Analysts of India (ICFAI). The National Institute of Urban Affairs (NIUA) is a third training institute that is well equipped to play a key role in raising the level of India's technical expertise.

Perhaps the most critical need for technical assistance and technical training in the infrastructure finance area, in the broadest sense of the term "technical," will be the need for financial institutions and firms to serve as intermediaries between municipal infrastructure planners and private sources of capital. Fulfilling this role will truly be a growth area for financial firms in India for at least the next decade.

F. Financial Analyses to be Performed During Project Implementation

The Project will provide training and technical assistance to a large number of institutions. The majority of this assistance will be provided through direct AID contracts with the two Management Support Services contractors. In those cases, financial controls will be exercised by AID and the contractor through the various instruments that will be used to supply the assistance. If substantial levels of funding will be passing through the institutions involved, the Mission will perform financial analyses of the involved institutions prior to the award of the assistance instrument that provides the funds.

In those cases in which direct financial assistance is to be provided to institutions (such as NIUA), the Mission will perform a financial analysis of the institution to determine its capability to adequately control the funds to be provided prior to the award of the assistance instrument.

Financial analyses for projects to be funded under the Housing Guaranty (HG) portion of the FIRE Project will be performed during project implementation as potential projects are analyzed for possible HG funding.

IX. Conditions and Covenants

A. The Project will have the following condition precedent to first and subsequent disbursements:

Prior to the first and all subsequent disbursements under the Grant, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee will, except as the Parties may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D. a statement of the name(s) of the person(s) holding or acting in the office(s) of the Grantee specified in Section 8.2, and of any additional representatives, together with a specimen signature of each person specified in such statement.

B. The Project will have the following covenants:

1. The Grantee agrees to create a Project Advisory Board to provide policy guidance and advice to the Project.

2. The Grantee agrees to establish a Project Implementation Unit for the Debt Market Development Component. The Unit, to be located in the National Institute of Urban Affairs, will include officers responsible for overall management and such other personnel considered necessary to implement Project.

3. Reporting of Grantee's Project Contribution: The Grantee agrees to furnish to A.I.D. in writing, annually during the life of the Project, a report of the Grantee's contribution (in cash and in kind).

4. Evaluations. Except as the Parties may otherwise agree in writing, an annual review of the Project will be conducted during the life of the Project, in addition to in-depth, mid-term evaluation and final evaluations. The evaluation program will include:

(a) An evaluation of progress towards attainment of the objectives of the Project;

(b) Identification and evaluation of problem areas or constraints which may inhibit such attainment;

(c) Assessment of how such information may be used to help overcome such problems or constraints; and

(d) Evaluation, to the degree feasible, of the overall development impact of the Project in controlling or abating industrial pollution, and the sustainability of the effort.

5. Training. The Grantee shall make all training under the Project available without discrimination on the basis of gender.

6. Use of Training. The Grantee shall exercise every reasonable effort to require that personnel trained under the Project shall work in activities related to the Project or in activities approved for financing under this Project Grant Agreement, in India, for not less than three times the length of his or her training program.

ANNEX A
PAGE A-1

ACTION: AID-2 INFO: AMB DCM POL ECON FAS (6)

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AIDAC FROM AA/ASIA TO MISSION DIRECTOR, WALTER BOLLINGER

E.O. 12356: N/A
TAGS:
SUBJECT: INDIA NEW PROJECT DESCRIPTIONS (NPDS)

DO,
TM,
KKC

1. ASIA/DR/PD CONVENED A MEETING ON JULY 8 TO REVIEW THE TWO NPDS FOR INDIA: FINANCIAL INSTITUTIONS REFORM AND EXPANSION PROJECT (FIRE) AND RESTRUCTURING OF ENTERPRISE AND TRADE PROJECT (RESET). THE MEETING WAS ATTENDED BY REPRESENTATIVES OF ASIA/SA, ASIA/DR/PD, ASIA/DR/TR, ASIA/FPM, AND PRE/EM. ASIA/TR COMMENTS SUBMITTED FOR WOMEN IN DEVELOPMENT (WID) CONCERNS ARE INCORPORATED IN THIS MESSAGE.

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2. BASED ON THE NPD REVIEWS, THE AA/ASIA APPROVES THE FIRE NPD AT THE REQUESTED LEVEL OF 20 MILLION DOLS. TO COMMENCE IN FY94, AND RESET AT THE REQUESTED LEVEL OF 25 MILLION DOLS. TO COMMENCE IN FY93. THUS, WE HEREBY DELEGATE AUTHORIZATION AUTHORITY TO THE INDIA MISSION DIRECTOR, PURSUANT TO DELEGATION OF AUTHORITY (DOA) NO. 400 (AUG. 16, 1991), AND INTERIM REORGANIZATION DOA NO. 9, PARA. A (OCT. 1, 1991). THIS ALSO AUTHORIZES THE MISSION DIRECTOR TO APPROVE THE PIDS IN THE FIELD, THOUGH WE WILL STILL REVIEW THEM INFORMALLY.

3. WE ARE CONCERNED THAT THERE MAY BE INADEQUATE PRIVATE SECTOR, ENVIRONMENT AND ENERGY (PSEE) FUNDS TO FUND EITHER PROJECT, LET ALONE BOTH. THE COMMITTEE ALSO FELT THAT THE FIRE PROJECT IS MUCH MORE CLEARLY CONCEIVED THAN RESET AT THIS POINT. PERHAPS THE MISSION SHOULD CONSIDER REVERSING THE START DATES, ALLOWING USAID ADDITIONAL TIME TO IDENTIFY IN WHICH DIRECTION RESET SHOULD PROCEED.

4. A NUMBER OF CONCERNS WERE RAISED ABOUT THE LACK OF FOCUS AND POTENTIAL MANAGEMENT INTENSITY OF THE RESET PROJECT. IT WAS SUGGESTED THAT THE MISSION PAY CAREFUL ATTENTION TO THE CRITERIA THAT WOULD BE USED TO BOTH SELECT FIRMS AND TARGET INTERVENTIONS (SECTORALLY, GEOGRAPHICALLY, OR BY SCOPE OF SERVICES PROVIDED) TO HAVE AN IMPACT WITH OUR LIMITED RESOURCES. ATTENTION WAS CALLED TO POLICY DETERMINATION NO.14 CONCERNING A.I.D. ASSISTANCE TO PUBLIC ENTERPRISES. FINALLY, REVIEWERS FELT THAT THE MISSION MAY HAVE UNDERESTIMATED MANAGEMENT REQUIREMENTS FOR THE PROJECT. PAST EXPERIENCE IN OTHER COUNTRIES HAS SHOWN THAT THE POLITICAL SENSITIVITIES OF

DECISIONS CONCERNING ENTERPRISE SELECTION AND RESTRUCTURING HAVE MADE PROJECTS SUCH AS RESET MANAGEMENT INTENSIVE AND HAVE OFTEN REQUIRED CONSIDERABLE TIME AND ATTENTION OF SENIOR MISSION MANAGEMENT.

5. PRE HAS SUGGESTED THAT THE MISSION CONSIDER BUY-INS TO THE FINANCIAL SECTOR DEVELOPMENT PROJECT AND THE FINANCIAL SERVICES VOLUNTEER CORPS, THOUGH THE FORMER MAY ONLY BE AVAILABLE IF PRE CAN RAISE THE BUY-IN CEILING. ANOTHER POSSIBLE SOURCE OF PRE SUPPORT MAY BE THE PRIVATE ENTERPRISE DEVELOPMENT SUPPORT PROJECT (PEDS), FOR WHICH PRE IS NOW DEVELOPING A FOLLOW-ON. ONCE THE PIDS ARE PREPARED AND PROJECT DIRECTION FOR BOTH IS CLEARER, WE WOULD LIKE TO ASK OTHER BUREAUS, INCLUDING PRE, TO OFFER ADDITIONAL COMMENTS. WE COULD ALSO SHARE THE RESET OPTIONS PAPER/SCOPE OF WORK WITH PRE AT THIS TIME, IF YOU THINK THEIR INPUT WOULD BE USEFUL.

6. WE ALSO HOPE SOME OF THE RESEARCH MATERIALS WE SENT ON BANKRUPTCY LAW, DIVESTITURE OF UNDERPERFORMING COMPANIES AND ASSET RESTRUCTURING HAVE BEEN HELPFUL IN FURTHER CONCEPTUALIZATION OF RESET. WE HAVE ESTABLISHED CONTACTS WITH OTHER BUREAUS AND AGENCIES CONCERNING THE PROJECT, AND WOULD BE HAPPY TO FURTHER OUR RESEARCH IN WASHINGTON AT MISSION'S REQUEST.

7. IN FURTHER DESIGN, ASIA/TR SUGGESTS THAT BOTH PROJECTS BE SENSITIVE TO GENDER ISSUES. IN FIRE THIS MIGHT BE ACCOMPLISHED BY ENCOURAGING TRAINING FOR WOMEN STOCK BROKERS AND INVESTORS; IN RESET BY ENCOURAGING INCLUSION OF SENIOR-LEVEL WOMEN MANAGERS AND FACILITATING A CLIMATE FOR WOMEN-OWNED FIRMS.

8. IF THE PLANNED LOP LEVEL OF FUNDING EXCEEDS THAT STATED IN THE NPDS, PLEASE NOTIFY ASIA/FPM AND ASIA/PD BY CABLE. MISSION IS REMINDED THAT IEE'S MUST BE SUBMITTED TO ASIA/DR/TR, MOLLY KUX, FOR APPROVAL PRIOR TO PROJECT AUTHORIZATION. WE SUGGEST YOU SUBMIT IEE'S WITH A COPY OF THE MISSION APPROVED PIDS.

9. PLEASE FEEL FREE TO CALL ON ASIA/DR/PD FOR FURTHER ASSISTANCE. EAGLEBURGER

BT

#3244

NNNN

FINANCIAL INSTITUTIONS REFORM AND EXPANSION PROJECT (FIRE)

365-0531

LOGICAL FRAMEWORK

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
SECTOR GOAL: To broaden and deepen India's competitive debt and equity markets	**MEASURES OF GOAL ACHIEVEMENT:** 1. Increased domestic and foreign investor participation in the debt and equity markets 2. Increased availability and trading of securities instruments 3. Increased private sector investment in urban infrastructure	1. SEBI statistics and records: a. An increased volume of securities traded (a measure of depth) b. An increased number of issues offered (a measure of breadth) 2. Ministry of Urban Dev statistics 3. Project reporting	1. Political and economic stability 2. Continuation of liberalization 3. Major policy changes to be effected by the GOI and other donors working in capital markets
PROJECT PURPOSE To improve the operating environment of the capital market and to assist in the development of the debt component of that market with special emphasis on infrastructure finance as a means for stimulating debt market development	**END OF PROJECT STATUS: (EOPS)** 1. Improved transparency in trading practices 2. Decreased time required for the settlement and clearing of transactions 3. Improved disclosure norms for all market participants 4. Improved investor services 5. A developed debt market mobilizing a significant portion of domestic savings for infrastructure financing 6. Increased households below the median income level benefiting from infrastructure projects financed by the debt and equity markets	1. Stock exchange statistics 2. SEBI statistics 3. Project Reporting 4. Municipal records 5. Census statistics	1. India and the markets will continue current trends toward transparency 2. An organized debt trading structure will be established 3. Viable infrastructure projects that substantially meet the criteria for HG eligibility can be generated
PROJECT OUTPUTS 1. The establishment of a national depository system and a national clearing and settlement system 2. Greater automation of the debt and equity trading system 3. Increased trading volume and the introduction of new financial instruments 4. Development of the retail brokerage and mutual fund industry 5. Increased indigenous technical capacity in securities trading, pricing and regulation through both overseas training and the development of indigenous training capacities in these areas 6. Increased private sector participation in the delivery of municipal services 7. Improved capacity of local governments to plan, finance and recover the costs of basic urban infrastructure projects	**MAGNITUDE OF OUTPUT:** 1. Reduction by (X %) in the average time required for settlement 2. (X number) debt instruments utilized 3. (X $ value) debt instruments traded 4. Increased number of retail brokerage firms and private mutual funds 5. (X number) persons trained in securities trading, pricing and/or regulation; and (x number) of courses in those areas designed and offered in India through project interventions 6. (X $ value) investment in debt and equity funded infrastructure projects 7. (X number) below median income families benefiting from debt and equity funded infrastructure projects	1. Stock exchange statistics 2. SEBI statistics 3. Project Reporting 4. Municipal records 5. Census statistics	1. India and the markets will continue current trends toward transparency 2. An organized debt trading structure will be established 3. Viable infrastructure projects that substantially meet the criteria for HG eligibility can be generated
PROJECT INPUTS — USAID / CP FUNDS LOAN FUNDS: (US $ 000) HG GUARANTEED FUNDS: 125 / 0 NON-HG GUARANTEED: 0 / 125 TOTAL: 125 / 125 DA FUNDS: (US $ 000) TOTAL: 20 / 7.0		* USAID & counterpart financial reports * Regular output monitoring records	* Timely funding and procurement by USAID and counterparts

ANNEX C

R.R. JHA
UNDER SECRETARY
TEL. 3015581

सत्यमेव जयते

D.O. No. 2(38)-AID/92

भारत सरकार Government of India
वित्त मंत्रालय Ministry of Finance
आर्थिक कार्य विभाग Department of Economic Affairs

नई दिल्ली / New Delhi, 17th Sept., 1993

Dear Mr. Tarter,

Please refer to your letter dated September 14, 1993 regarding proposed USAID assistance for the Financial Institutions Reforms and Expansion (FIRE) Project and the subsequent discussions held in the room of Director(AC) two days ago. In order to enable us to sign this Agreement next week you are kindly requested to send us the revised draft incorporating the changes agreed by us in the above meeting.

As regards the proposal pertaining to the Housing Guarantee Loan of US $ 125 million to be obtained by HUDCO and ILFS from US Capital Market, I may like to clarify that while we have no objection in principle to this proposal, it will not be possible for the Government of India either to sign the Agreement or to extend guarantees for the loan. However, the loan agreement could be signed by the concerned Organisations and the lender, subject to the prior clearance of this Department of the terms and conditions of the loan. In case it is felt necessary, one of the commercial banks could be approached by the borrowers to extend the guarantees for this loan.

With regards,

Yours sincerely,

(R.R. JHA)

Mr. Jerry Tarter,
Office Director,
Project Dev. Implementation & Training,
USAID, American Embassy,
New Delhi.

5C(2) - ASSISTANCE CHECKLIST

Listed below are statutory criteria applicable to the assistance resources themselves, rather than to the eligibility of a country to receive assistance. This section is divided into three parts. Part A includes criteria applicable to both Development Assistance and Economic Support Fund resources. Part B includes criteria applicable only to Development Assistance resources. Part C includes criteria applicable only to Economic Support Funds.

CROSS REFERENCE: IS COUNTRY CHECKLIST UP TO DATE?

Yes

A. CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUNDS

1. Host Country Development Efforts (FAA Sec. 601(a)): Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

a. The Project will not directly encourage international trade.

b. Project activities will increa investments. This will encoura more companies to seek funding from the capital market and thereby increase their competitiveness.

c. An efficient capital market wi encourage savings and loan ass tions to invest their resource profitably.

d. The project will foster greate competition among Indian compa and thereby reduce monopolies

e. There will be additional resou available for industry, agricu ture and commerce and this wil improve its technical efficien

f. No assistance is being provide for this purpose.

2. U.S. Private Trade and Investment (FAA Sec. 601(b)): Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

2. Assistance under the project w foster linkages between U.S. and Indian institutions and bu nesses especially in private sector training and technical assistance.

3. Congressional Notification

a. General requirement (FY 1993 Appropriations Act Sec. 522; FAA Sec. 634A): If money is to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified (unless the Appropriations Act notification requirement has been waived because of substantial risk to human health or welfare)?

Yes

b. Notice of new account obligation (FY 1993 Appropriations Act Sec. 514): If funds are being obligated under an appropriation account to which they were not appropriated, has the President consulted with and provided a written justification to the House and Senate Appropriations Committees and has such obligation been subject to regular notification procedures?

N/A

c. Cash transfers and nonproject sector assistance (FY 1993 Appropriations Act Sec. 571(b)(3)): If funds are to be made available in the form of cash transfer or nonproject sector assistance, has the Congressional notice included a detailed description of how the funds will be used, with a discussion of U.S. interests to be served and a description of any economic policy reforms to be promoted?

N/A

4. Engineering and Financial Plans (FAA Sec. 611(a)): Prior to an obligation in excess of $500,000, will there be: (a) engineering, financial or other plans necessary to carry out the assistance; and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

Yes

5. Legislative Action (FAA Sec. 611(a)(2)): If legislative action is required within recipient country with respect to an obligation in excess of $500,000, what is the basis for a reasonable expectation that such action

Legislative action is not required

will be completed in time to permit orderly accomplishment of the purpose of the assistance?

6. **Water Resources** (FAA Sec. 611(b); FY 1993 Appropriations Act Sec. 501): If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, <u>et seq</u>.)? (See A.I.D. Handbook 3 for guidelines.)

N/A

7. **Cash Transfer and Sector Assistance** (FY 1993 Appropriations Act Sec. 571(b)): Will cash transfer or nonproject sector assistance be maintained in a separate account and not commingled with other funds (unless such requirements are waived by Congressional notice for nonproject sector assistance)?

N/A

8. **Capital Assistance** (FAA Sec. 611(e)): If project is capital assistance (<u>e.g.</u>, construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?

N/A

9. **Multiple Country Objectives** (FAA Sec. 601(a)): Information and conclusions on whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

See Para One above

10. U.S. Private Trade (FAA Sec. 601(b)): Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

See Para Two above

11. Local Currencies

a. Recipient Contributions (FAA Secs. 612(b), 636(h)): Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

a. A major portion of the DA funds w be utilized to finance dollar cos of training in the US and the hir US based TA. Even though AID gran funds will finance some of the lo currency components, a major port of local currency expenditures wi incurred by the Host Country for country expenses. In addition HG Loan funds from the US will be su mented by matching contribution b the Host Country.

b. U.S.-Owned Currency (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

b. NO

c. Separate Account (FY 1993 Appropriations Act Sec. 571). If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies:

c. N/A

(1) Has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that government providing the amount of local currencies to be generated and the terms and conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account?

N/A

(2) Will such local currencies, or an equivalent amount of local currencies, be used only to carry out the purposes of the DA or ESF chapters of the FAA (depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government? N/A

(3) Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purposes? N/A

(4) If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government? N/A

12. Trade Restrictions

a. Surplus Commodities (FY 1993 Appropriations Act Sec. 520(a)): If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity? N/A

b. Textiles (Lautenberg Amendment) (FY 1993 Appropriations Act Sec. 520(c)): Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of N/A textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

13. Tropical Forests (FY 1991 Appropriations Act Sec. 533(c)(3)(as referenced in section 532(d) of the FY 1993 Appropriations Act): Will funds be used for any program, project or activity which would (a) result in any significant loss of tropical forests, or (b) involve industrial timber extraction in primary tropical forest areas?

N/A

14. PVO Assistance

a. Auditing and registration (FY 1993 Appropriations Act Sec. 536): If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.?

N/A

b. Funding sources (FY 1993 Appropriations Act, Title II, under heading "Private and Voluntary Organizations"): If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government?

N/A

15. Project Agreement Documentation (State Authorization Sec. 139 (as interpreted by conference report)): Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).

The aggregate amount of DA funds being provided is less than $25 million; therefore, this requirement is inapplicable.

16. Metric System (Omnibus Trade and Competitiveness Act of 1988 Sec. 5164, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance activity use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?

To the extent practicable, metric measurements will be use in procurements, grants and oth activities under the project.

17. Women in Development (FY 1993 Appropriations Act, Title II, under heading "Women in Development"): Will assistance be designed so that the percentage of women participants will be demonstrably increased?

Yes

18. Regional and Multilateral Assistance (FAA Sec. 209): Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

Other multilateral donors are providing assistance for capita market development program, fin cial sector programs and basic infrastructure development. How AID's objective of capital mark and debt market reforms cannot achieved through regional or mu lateral organizations. Experien in this project may encourage o developing countries to follow develop similar reform programs through regional cooperation.

19. Abortions (FY 1993 Appropriations Act, Title II, under heading "Population, DA," and Sec. 524):

N/A

a. Will assistance be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?

N/A

b. Will any funds be used to lobby for abortion?

N/A

20. Cooperatives (FAA Sec. 111): Will assistance help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better\life?

NO

21. U.S.-Owned Foreign Currencies

a. Use of currencies (FAA Secs. 612(b), 636(h); FY 1993 Appropriations Act Secs. 507, 509): Are steps being taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.

See response to para 11a

b. Release of currencies (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No

22. Procurement

a. Small business (FAA Sec. 602(a)): Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?

Procurement opportunities will [illegible] advertised publicly, including in AID publications aimed at small businesses.

b. U.S. procurement (FAA Sec. 604(a) as amended by section 597 of the FY 1993 Appropriations Act): Will all procurement be from the U.S., the recipient country, or developing countries except as otherwise determined in accordance with the criteria of this section?

Yes

c. Marine insurance (FAA Sec. 604(d)): If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company? N/A

d. Non-U.S. agricultural procurement (FAA Sec. 604(e)): If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) N/A

e. Construction or engineering services (FAA Sec. 604(g)): Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.) No

f. Cargo preference shipping (FAA Sec. 603)): Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates? N/A

g. Technical assistance (FAA Sec. 621(a)): If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the Yes facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?

h. U.S. air carriers (International Air Transportation Fair Competitive Practices Act, 1974): If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?

Yes

i. Termination for convenience of U.S. Government (FY 1993 Appropriations Act Sec. 504): If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

Yes

j. Consulting services (FY 1993 Appropriations Act Sec. 523): If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)?

Yes

k. Metric conversion (Omnibus Trade and Competitiveness Act of 1988, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance program use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest

Metric measurements are used to the maximum practicable extent.

No bulk purchases are contempla

Where measurements are included project documentation, metric measurements are used to the extent practicable.

documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?

1. Competitive Selection Procedures (FAA Sec. 601(e)): Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? — Yes

23. Construction

a. Capital project (FAA Sec. 601(d)): If capital (e.g., construction) project, will U.S. engineering and professional services be used? — N/A

b. Construction contract (FAA Sec. 611(c)): If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? — N/A

c. Large projects, Congressional approval (FAA Sec. 620(k)): If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the Congressional Presentation), or does assistance have the express approval of Congress? — N/A

24. U.S. Audit Rights (FAA Sec. 301(d)): If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? — N/A

25. Communist Assistance (FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? — Yes

26. Narcotics

a. Cash reimbursements (FAA Sec. 483): Will arrangements preclude use of financing to make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated? — Yes

b. Assistance to narcotics traffickers (FAA Sec. 487): Will arrangements take "all reasonable steps" to preclude use of financing to or through individuals or entities which we know or have reason to believe have either: (1) been convicted of a violation of any law or regulation of the United States or a foreign country relating to narcotics (or other controlled substances); or (2) been an illicit trafficker in, or otherwise involved in the illicit trafficking of, any such controlled substance? — Yes

27. Expropriation and Land Reform (FAA Sec. 620(g)): Will assistance preclude use of financing to compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President? — Yes

28. Police and Prisons (FAA Sec. 660): Will assistance preclude use of financing to provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? — Yes

29. CIA Activities (FAA Sec. 662): Will assistance preclude use of financing for CIA activities? — Yes

30. Motor Vehicles (FAA Sec. 636(i)): Will assistance preclude use of financing for purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? — Yes

31. Military Personnel (FY 1993 Appropriations Act Sec. 503): Will assistance preclude use of financing to pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? Yes

32. Payment of U.N. Assessments (FY 1993 Appropriations Act Sec. 505): Will assistance preclude use of financing to pay U.N. assessments, arrearages or dues? Yes

33. Multilateral Organization Lending (FY 1993 Appropriations Act Sec. 506): Will assistance preclude use of financing to carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)? Yes

34. Export of Nuclear Resources (FY 1993 Appropriations Act Sec. 510): Will assistance preclude use of financing to finance the export of nuclear equipment, fuel, or technology? Yes

35. Repression of Population (FY 1993 Appropriations Act Sec. 511): Will assistance preclude use of financing for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? Yes

36. Publicity or Propaganda (FY 1993 Appropriations Act Sec. 516): Will assistance be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress? No

37. Marine Insurance (FY 1993 Appropriations Act Sec. 560): Will any A.I.D. contract and solicitation, and subcontract entered into under such contract, include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate?

Yes

38. Exchange for Prohibited Act (FY 1993 Appropriations Act Sec. 565): Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person in exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employee, expressly prohibited by a provision of United States law?

No

39. Commitment of Funds (FAA Sec. 635(h)): Does a contract or agreement entail a commitment for the expenditure of funds during a period in excess of 5 years from the date of the contract or agreement?

No

40. Impact on U.S. Jobs (FY 1993 Appropriations Act, Sec. 599):

(a) Will any financial incentive be provided to a business located in the U.S. for the purpose of inducing that business to relocate outside the U.S. in a manner that would likely reduce the number of U.S. employees of that business?

No

(b) Will assistance be provided for the purpose of establishing or developing an export processing zone or designated area in which the country's tax, tariff, labor, environment, and safety laws do not apply? If so, has the President determined and certified that such assistance is not likely to cause a loss of jobs within the U.S.?

No

(c) Will assistance be provided for a project or activity that contributes to the violation of internationally recognized workers rights, as defined in section 502(a)(4) of the Trade Act of 1974, of workers in the recipient country?

No

B. CRITERIA APPLICABLE TO DEVELOPMENT ASSISTANCE ONLY

1. Agricultural Exports (Bumpers Amendment) (FY 1993 Appropriations Act Sec. 521(b), as interpreted by conference report for original enactment): If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities: (1) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (2) in support of research that is intended primarily to benefit U.S. producers?

N/A

2. Tied Aid Credits (FY 1993 Appropriations Act, Title II, under heading "Economic Support Fund"): Will DA funds be used for tied aid credits?

No

3. Appropriate Technology (FAA Sec. 107): Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

Yes, where feasible

BEST AVAILABLE

4. **Indigenous Needs and Resources** (FAA Sec. 281(b)): Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.

The Project will strengthen and develop key financial institution: and impart training to personnel from these institutions for effec participation in market restructu and reform processes.

5. **Economic Development** (FAA Sec. 101(a)): Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

An efficient capital market will bring competition and develop amo various private sector entities a ensure their sustainable economic growth. This project will also strengthen the demonstration model of viable and self sustaining infrastructure projects through debt market financing.

6. **Special Development Emphases** (FAA Secs. 102(b), 113, 281(a)): Describe extent to which activity will: (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions; (b) encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries.

a. The DA project, which will complement the HG element, will facilitate the selection of commercially viable infrastruc projects to be implemented by local municipalities. The US technical assistance will be u: to promote program sustainabi

b. Yes

c. The above infrastructure proje will be demonstrations for oth municipalities to follow.

d. Efforts will be made to encour women's participation in the training programs.

e. Regional cooperation by develo countries is not appropriate a this time.

7. **Recipient Country Contribution** (FAA Secs. 110, 124(d)): Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

Yes

8. **Benefit to Poor Majority** (FAA Sec. 128(b)): If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?

The project will increase institutional capabilities of capital market related private and public sector institutions. The project has been designed to improve the infrastructure facilities in the urban areas through the debt mark This will ultimately benefit the poor majority in those urban area

9. **Abortions** (FAA Sec. 104(f); FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 535):

N/A

a. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?

b. Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family-planning or to coerce or provide any financial incentive to any person to undergo sterilizations?

c. Are any of the funds to be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?

d. Will funds be made available only to voluntary family planning projects which offer, either directly or through referral to, or information about access to, a broad range of family planning methods and services?

e. In awarding grants for natural family planning, will any applicant be discriminated against because of such applicant's religious or conscientious commitment to offer only natural family planning?

f. Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to

BEST AVAILABLE

methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

g. Are any of the funds to be made available to any organization if the President certifies that the use of these funds by such organization would violate any of the above provisions related to abortions and involuntary sterilization?

10. Contract Awards (FAA Sec. 601(e)): Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes

11. Disadvantaged Enterprises (FY 1993 Appropriations Act Sec. 563): What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 40 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

A specific portion of project fund have not been set aside for disadvantaged enterprises. However the Mission will ensure that any contract in excess of $500,000 whi is financed under the project includes a requirement for 10% of value of the contract to be sub-contracted to disadvantaged enterprises unless AID regulations provide otherwise.

12. Biological Diversity (FAA Sec. 119(g): Will the assistance: (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?

No

No

No

No

13. Tropical Forests (FAA Sec. 118; FY 1991 Appropriations Act Sec. 533(c) as referenced in section 532(d) of the FY 1993 Appropriations Act):

a. A.I.D. Regulation 16: Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16?

Yes

b. Conservation: Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest\extent feasible: (1) stress the importance of conserving and sustainably managing forest resources; (2) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (3) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (4) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (5) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (6) conserve forested watersheds and rehabilitate those which have been deforested; (7) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (8) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (9) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation,

N/A

and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (10) seek to increase the awareness of U.S. Government agencies and other donors of the immediate and long-term value of tropical forests; (11) utilize the resources and abilities of all relevant U.S. government agencies; (12) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land; and (13) take full account of the environmental impacts of the proposed activities on biological diversity?

c. Forest degradation: Will assistance be used for: (1) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; (2) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas; (3) activities which would result in the conversion of forest lands to the rearing of livestock; (4) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undergraded forest lands; (5) the colonization of forest lands; or (6) the construction of dams or other water control structures which flood relatively undergraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development? N/A

d. **Sustainable forestry:** If assistance relates to tropical forests, will project assist countries in developing a systematic analysis of the appropriate use of their total tropical forest resources, with the goal of developing a national program for sustainable forestry?

N/A

e. **Environmental impact statements:** Will funds be made available in accordance with provisions of FAA Section 117(c) and applicable A.I.D. regulations requiring an environmental impact statement for activities significantly affecting the environment?

Yes

14. Energy (FY 1991 Appropriations Act Sec. 533(c) as referenced in section 532(d) of the FY 1993 Appropriations Act): If assistance relates to energy, will such assistance focus on: (a) end-use energy efficiency, least-cost energy planning, and renewable energy resources, and (b) the key countries where assistance would have the greatest impact on reducing emissions from greenhouse gases?

N/A

15. Debt-for-Nature Exchange (FAA Sec. 463): If project will finance a debt-for-nature exchange, describe how the exchange will support protection of: (a) the world's oceans and atmosphere, (b) animal and plant species, and (c) parks and reserves; or describe how the exchange will promote: (d) natural resource management, (e) local conservation programs, (f) conservation training programs, (g) public commitment to conservation, (h) land and ecosystem management, and (i) regenerative approaches in farming, forestry, fishing, and watershed management.

N/A

16. Deobligation/Reobligation (FY 1993 Appropriations Act Sec. 515): If deob/reob authority is sought to be exercised in the provision of DA assistance, are the funds being obligated for the same general purpose, and for countries within the same region as

Yes

originally obligated, and have the House and Senate Appropriations Committees been properly notified?

17. Loans

a. Repayment capacity (FAA Sec. 122(b)): Information and conclusion on capacity of the country to repay the loan at a reasonable rate of interest.

N/A

b. Long-range plans (FAA Sec. 122(b)): Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increase productive capacities?

N/A

c. Interest rate (FAA Sec. 122(b)): If development loan is repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed ten years, and at least 3 percent per annum thereafter?

N/A

d. Exports to United States (FAA Sec. 620(d)): If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20 percent of the enterprise's annual production during the life of the loan, or has the requirement to enter into such an agreement been waived by the President because of a national security interest?

N/A

18. Development Objectives (FAA Secs. 102(a), 111, 113, 281(a)): Extent to which activity will: (1) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (2) help develop cooperatives, especially by technical

See response to para 6 of this Part B

assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (3) support the self-help efforts of developing countries; (4) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (5) utilize and encourage regional cooperation by developing countries?

19. Agriculture, Rural Development and Nutrition, and Agricultural Research (FAA Secs. 103 and 103A): N/A

a. Rural poor and small farmers: If assistance is being made available for agriculture, rural development or nutrition, describe extent to which activity is specifically designed to increase productivity and income of rural poor; or if assistance is being made available for agricultural research, has account been taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made.

b. Nutrition: Describe extent to which assistance is used in coordination with efforts carried out under FAA Section 104 (Population and Health) to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people.

c. Food security: Describe extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

20. **Population and Health (FAA Secs. 104(b) and (c)):** If assistance is being made available for population or health activities, describe extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach. N/A

21. **Education and Human Resources Development (FAA Sec. 105):** If assistance is being made available for education, public administration, or human resource development, describe (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities. N/A

22. **Energy, Private Voluntary Organizations, and Selected Development Activities (FAA Sec. 106):** If assistance is being made available for energy, private voluntary organizations, and selected development problems, describe extent to which activity is:

a. concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and facilitative of N/A research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

b. concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations; No

c. research into, and evaluation of, economic development processes and techniques;

d. reconstruction after natural or manmade disaster and programs of disaster preparedness; N/A

e. for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance; N/A

f. for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development. N/A

23. Capital Projects (Jobs Through Export Act of 1992, Secs. 303 and 306(d)): If assistance is being provided for a capital project, is the project developmentally sound and will the project measurably alleviate the worst manifestations of poverty or directly promote environmental safety and sustainability at the community level? N/A

C. CRITERIA APPLICABLE TO ECONOMIC SUPPORT FUNDS ONLY N/A

1. Economic and Political Stability (FAA Sec. 531(a)): Will this assistance promote economic and political stability?

THE HOUSING GUARANTY PROGRAM

STATUTORY CHECKLIST

NAME OF COUNTRY

PROJECT NO. 386-HG-004

Answer Yes/No put up page references and/or explanations where appropriate.

A. General Criteria Under HG Statutory Authority.

Section 221(a)

Will the proposed project meet the following criteria.

1) Is intended to increase the availability of domestic financing by demonstrating to local entrepreneurs and institutions that providing low-cost housing is financially viable; — Yes

2) Is intended to assist in marshalling resources for low-cost housing; — Yes

3) Supports a pilot project for low-cost shelter, or is intended to have a maximum demonstration impact on local institutions and national policy; and, — Yes

4) Is intended to have a long run goal to develop domestic construction capabilities and stimulate local credit institutions to make available domestic capital and other management and technological resources required for effective low cost shelter programs and policies. — Yes

Section 222(a)

Will the issuance of this guaranty cause the total face amount of guaranties issued and outstanding at this time to be in excess of $2,855,800,000 — No

Will the guaranty be issued prior to September 30, 1993? — No

Section 222(b)

Will the proposed guaranty result in activities which emphasize:

1) projects providing improved home sites to poor families on which to build shelter and related services; or — Yes

2) projects comprised of expandable core shelter units on serviced sites; or — No

3) slum upgrading projects designed to conserve and improve existing shelter; or — Yes

4) shelter projects for low-income people designed for demonstration or institution building; or — Yes

5) community facilities and services in support of projects authorized under this section to improve the shelter occupied by the poor? — Yes

Section 222(c)

If the project requires the use or conservation of energy, was consideration given to the use of solar energy technologies, where economically or technically feasible? — N/A

Section 223(a)

Will the A.I.D. guaranty fee be in an amount authorized by A.I.D. in accordance with its delegated powers? — Yes

Section 223(f)

Is the maximum rate of interest allowable to the eligible U.S. Investor, as prescribed by the Adminstrator, not more than one percent (1%) above the current rate of interest applicable to housing mortgages insured by the Department of Housing and Urban Development? — N/A

Section 223(j)

1) Will the proposed Housing Guaranty be coordinated with and complementary to other development assistance in the Host Country? — Yes

2) Will the proposed Housing Guaranty demonstrate the feasibility of particular kinds of housing and other institutional arrangements? — Yes

3) Is the project designed and planned by A.I.D. so that at least ninety percent (90%) of the face value of the proposed guaranty will be for housing suitable for families below the median urban income for housing in urban areas, in the host country? — Yes

4) Will the issuance of this guaranty cause the face value of guaranties issued with respect to the host country to exceed $25 million in any fiscal year? — No

5) Will the issuance of this guaranty cause the average face value of all housing guaranties issued in this fiscal year to exceed $15 million? No

Section 238(c)

Will the guaranty agreement provide that it will cover only lenders who are "eligible investors" within the meaning of this section of the statute at the time the guaranty is issued? Yes

B. Criteria Under General Foreign Assistance Act Authority.

Section 620/620A

1) Does the host country meet the general criteria for country eligibility under the Foreign Assistance Act as set forth in the country eligibility checklist prepared at the beginning of each year? Yes

2) Is there any reason to believe that circumstances have changed in the host country so that it would not be ineligible under the country statutory checklist? No

SUJATA\STATCHEC

A. The Current State of India's Economy: Recent Trends and Future Prospects

The Indian economy is still recovering from the severe disruption suffered in mid-1990 as a consequence of the Gulf War. Considerable progress has been made. Real GDP growth of four percent is expected in 1993 compared to the 1.2 percent growth registered in 1992. Inflation is running at ten percent on an annual basis, down from 14 percent in 1992. Reduction of the budgetary deficit of the central government is continuing despite a shortfall in revenues caused by recent civil disturbances. Ongoing Government efforts to increase the role of market forces in determining resource allocations and to open the economy to foreign trade and investment, remain on track.

The prospects for continued good performance are promising. The GOI is working to raise the sustainable level of annual economic growth to over five per cent by the mid-1990s, and appears determined to maintain the gains already achieved. As noted in a recent World Bank report, however, certain additional reforms will need to be implemented before the higher level of growth can be achieved. In the financial sector, these reforms include accelerating commercialization of public sector banks, allowing greater private sector participation in banking activities, mandating further reductions in bank reserve requirements, and instituting more flexible interest rate policies.

B. Liberalization and Reform

Since independence and until the early 1990s, India had pursued an economic growth strategy that can best be characterized as inward-oriented, self-reliant, and heavily-regulated. The strategy was focused primarily on achieving economic growth through public investment in publicly-owned enterprises. An elaborate and complex regulatory system was constructed, and private sector investment was restricted to selected subsectors. Investment from abroad was closely controlled.

The country has now changed course, as the Government has begun to pursue economic and financial policies that are dramatically different from those initiated 40 years ago. Almost every area of the economy is undergoing modernization and reform to pave the way for India's entry into global markets. The country's present goals are to build a vigorous and competitive private sector that will increase output and employment, and to build a strong and competitive financial sector that is able to attract capital from international as well as domestic sources.

1. Privatization

Until the early 1990s, public sector enterprises (PSEs) occupied a pre-eminent position in the economy and absorbed a sizeable share of the government's budgetary resources. Under its current reform strategy, the Government is aiming to significantly reduce the role of state-run enterprises in the production of goods and services. Existing publicly-owned enterprises are being privatized. Industries that have previously been reserved for the public sector are now being thrown open to private investors as well, and budgetary support for public sector enterprises has been appreciably trimmed.

Progress to date in the Government's privatization program has been modest; however, reform efforts are being intensified. Direct private sector participation in disinvestment proceedings is being encouraged, and foreign investors are being invited to participate in these proceedings. In addition, the GOI has created a Board for Industrial and Financial Reconstruction (BIFR) to dispose of public enterprises whose commercial prospects are uncertain. Over 150 enterprises have been referred to the board for determination as to whether they might best be restructured or liquidated.

2. The Impact of the Reforms

The constraints that were placed on the operations of the financial sector under India's former statist approach to managing the economy were formidable. The most glaring examples included placing artificial caps on the interest rates for government securities; forcing banks to buy securities to meet government financing needs, whether or not it made good economic sense to do so; permitting only the Reserve Bank of India (RBI) to invest in foreign bonds; limiting the types of debt securities that could be traded on certain markets; and permitting accounting rules that allowed banks to overstate the market value of their bond portfolios. These constraints have now been largely removed, and the market response to this has been encouraging.

The impact of privatization has been particularly evident in the banking sector. While still largely dominated by state-owned banks, there is now greater scope for privately-owned financial institutions to operate. Foreign-owned private banks are competing vigorously for funds. The elimination of certain direct controls over capital market operations, particularly the freeing up of pricing on new issues, has led to the establishment of new financial and banking institutions, and to increased trading activity in the markets.

Market activity has been further stimulated by the Government's liberalization of interest rate policies. While not yet totally free of controls, current rates are being determined more by market influences than by government fiat. The continuation of this policy is critical to the further development of the country's financial and capital markets.

Largely as a result of government efforts to stabilize the economy over the past several years, domestic demand for investment has been dampened and has remained sluggish. Foreign investors have been very active, however.' A number of foreign companies have increased their equity stakes in existing firms, and a sizeable number of new foreign joint venture proposals have been approved. The foreign equity participation proposed for new projects this past year was several times the amount approved in recent years. Although the large number of approvals has not as yet been translated into a significantly greater volume of investment inflows, the prospect exists for a steady increase in such inflows in the years to come.

3. The Impact on the Capital Markets

The Government's liberalization and reform policies have been a boon to India's capital markets. The speed at which change is taking place has been very rapid. The equity markets in particular have been growing at impressive rates. New equity issues to finance industrial investment have set records as liberalization has taken hold in the private sector. The total number of new issues placed in the primary market during 1992 was over four times the number placed in 1991. Liberalization and, in particular, the relaxation of government controls on capital markets has also led to a marked increase in the volume of capital resources mobilized through the issuance of corporate debentures.

There have been other significant developments in the capital markets that can be attributed to changes in the Government's overall economic policies. Two new credit rating agencies have been established, seven public sector institutions are now operating mutual funds in addition to the Unit Trust of India (UTI), and a stock holding company has been established to facilitate share transfers. OTCEI (the Over-the-Counter Exchange of India) commenced operations in September 1992, as an electronically-equipped national exchange that aims to facilitate access to capital markets for India's small and medium-sized companies.

The establishment of a new capital markets regulatory authority, the Securities and Exchange Board of India (SEBI), represents an important additional change in direction resulting from the Government's new approach to economic growth, and one that will greatly ease the further development of India's capital markets. How effectively SEBI manages its regulatory functions will have a direct bearing on India's prospects for integrating its financial markets into the global financial system.

The links that have now been established between government policy reform efforts and the future operations of the country's capital markets will be further strengthened as the Government continues to look increasingly to market sources to satisfy its own future financing needs. In India, the sale of government bonds at market rates will signal the depth of the Government's commitment to reform, and along with continued reductions in bank reserve requirements, will remove a huge element of distortion from India's capital markets. In all competitive financial systems, the government segment of the market represents the reference against which all borrowers are measured. Truly market-based government bond issues are essential for the development of an active long-term debt market.

Government actions during the current year to reduce bank reserve requirements have been widely applauded. Parallel action by the central bank to raise the returns on new issues of government bonds has brought them to what some market observers are currently defining as "near market" conditions. These instruments are nearing the point of being attractive to the private sector as investment vehicles. As further upward adjustments are made, further dramatic progress toward establishing a more competitive market environment will inevitably follow.

C. The Economic Implications of the FIRE Project

The FIRE Project is well-timed. As is clear, India now needs to compete for investment capital and export earnings in a global environment that has become highly competitive. Within India itself, there is heightened competition for capital resources between the country's private sector enterprises, which are being urged to expand production and export earnings to accommodate the material needs of the growing economy, and the country's public sector agencies, which face an urgent need to expand infrastructure to accommodate the country's rapidly expanding population.

The technical assistance and training to be provided under the FIRE Project will be directed towards improving the regulatory environment of the capital markets, modernizing market operations, and evolving longer-term approaches for further improvement. These developments are expected to lead, in turn, to greater investor involvement, greatly increased trading activity, and the mobilization of increased capital resources. These prospective improvements will have a significant if not a critical impact on India's growth prospects. Improving the operational efficiency and scope of its own capital markets provides India with the only chance it really has to meet its burgeoning need for investment resources. There is no practical alternative source.

The assistance to be provided under the Project will be provided on a highly cost-effective basis. U.S experts and institutions are being tapped to provide managerial and technological know-how that has been acquired directly through their participation in market activities in the U.S. Their expertise will be transferred directly to the individuals and institutions that are responsible for guiding and directing the further development of India's markets. Considerable attention was devoted during the design phase of the Project to ensure that India's needs for assistance were clearly defined. Additional steps will be taken during the implementation phases to ensure that assistance is effectively delivered.

D. The Growing Budgetary Constraint on Funding for Infrastructure Projects

As noted in the analysis above, because of sizeable recurrent budgetary deficits, the ability of the central government to finance urban infrastructure projects has been seriously diminished at a time when the country's need for urban infrastructural facilities has been rapidly expanding. State and municipal governments are being forced to turn to private sources to obtain the capital they need to construct needed facilities. The long-term nature of infrastructure development and maintenance requires that governments resort to the issuance of project-based bonds and other long-term debt instruments to fulfill their capital needs.

The FIRE Project will employ several approaches to help state and municipal governments acquire the capital resources that they desperately need. As in the case of the capital markets development component of the Project, technical assistance and training will be the main forms of assistance. Considerable effort was taken during design of the Project to ensure that such assistance would be well-targeted. Additional efforts will be made through the use of demonstration projects to ensure that the benefits of the expertise and experience gained under the Project are replicated efficiently to other localities. The Project has been designed to facilitate the institutionalization of market access skills in the various GOI government agencies, private financial intermediaries, and training institutions that are to be involved in the demonstration process.

The actual participants in HG-funded demonstration projects have not yet been selected. This will be done during the initial stages of the implementation phase. Standard economic benefit/cost analysis and the computation of internal rate of return (IRR) for the projects being considered will be a requirement of the project review and selection process.

E. Supplemental Economic Analysis for Housing Guaranty

1. Country Risk Assessment

In the past, a country risk assessment was undertaken as a part of the economic analysis for each project. Since the passage of the Credit Reform Act, the procedures for establishing country risk have changed; the analysis is no longer carried out in the field. As a part of the authorization process, A.I.D. Washington has established an AID "subsidy" set-aside for each Housing Guaranty authorization, which will be used, as required, to repay the U.S. investor in the event of non-payment by the borrower. This process has already been completed for the HG authorization proposed in this project paper.

The amount of the subsidy is based upon an analysis, by AID Washington, of the country's ability to exercise its full-faith-and-credit guaranty in the case of default. It should be noted that this subsidy is in addition to the full-faith-and-credit guaranty of the Government of India, or its designee acceptable to USAID, and the guaranty against foreign exchange risk.

2. Is the Economy Sufficiently Strong to Ensure that the Project Will Be Carried Through to Completion

The economic environment over the life of the project is one in which the GOI will be undertaking a broad reform agenda. A Discussion Paper prepared by the Ministry of Finance entitled "Economic reforms: Two Years After and the Task Ahead," examines the fiscal and financial over the past two years, and sets forth a reform agenda which will have a substantial impact on the ability of the Project to be carried though to completion.

The aim of the central government is to set the economy on a sustainable path of a 6 to 7 percent annual growth through a series of reforms which will lead to a substantial rise in employment and incomes, especially in urban areas. At the same time, the combined fiscal deficit of the central and state governments will be reduced from about 7 percent of GDP in 1993-94, and to about 5 percent in 1996-97. These reforms will provide a solid foundation for the sustained growth of the economy.

One of the results of these reforms will be a reduction in subsidies for all sectors of the economy, combined with significant decreases in financial support from the central and state government for the provision of municipal services. At present, local governments rely almost entirely on the center and states for funds for the financing of systems to provide potable water, sewage disposal, solid waste collection and roads. Lack of budgetary support has already hand an impact in that municipalities are already experimenting with alternative funding sources. Most important to the success of this Project is that the growing resource constraint will drive the demand for new resources into the only other source of significant funding: the domestic capital markets.

A number of significant and supporting policy changes have already been undertaken. The issue of centrally administered prices has been undergoing changes for the past two years. More recently, at a conference of state ministers for urban development, a consensus was reached that user fees for municipal services based on full cost recovery was essential to increase supply and control consumption. These policy changes will contribute substantially to the commercialization of infrastructure projects under this program.

Reductions in controlled credit will free-up significant additional financial resources; a ban on the waiver of loan repayments by elected officials will improve repayment trends among individual borrowers; and improved mechanisms for capturing household savings will add to the resources available from domestic capital markets.

3. What are the Major Strengths and Weaknesses of the Project, and What Institutional Changes Need to be Implemented to Eliminate the Major Problems.

The major strength of the Project is the opportunity to implement the GOI's basic policy reform agenda (see Annex T). These include: assistance to a national level finance institution to provide infrastructure guidelines and establish a commercially viable infrastructure fiance system; promotion of innovative infrastructure finance mechanisms; improvement of the capacity of local governments to enter into agreements with private providers of urban services; and improvement of the capacity of local governments to plan, operate, maintain and recover the costs of basic urban services.

The major weakness is the lack of understanding at the state and local government level, where implementation and operation take place, on how to implement these policy changes. The Project will use HG funding combined with technical assistance and training support to overcome these weaknesses. Two to four municipalities in one to two states will be selected to participate in a demonstration program. Key to the selection process is the willingness to implement these policy reforms, and to participate in the technical assistance and training programs. The development of projects eligible for HG funding will emphasize commercial viability, and private public partnerships. This process will lead to substantive institutional improvements at the state and local government level.

4. What Impact Will This Project Have on the Overall Economy

Increasing capital market investment in basic urban services will have a significant impact on the overall economy. The correlation of economic growth with increased infrastructure investment is a fundamental principle. In addition, there is increasing evidence that sustainable long term growth requires that initial investment priorities focus on urban environmental issues: potable water supply, sewage disposal, solid waste collection, roads and power. HG eligible projects will focus on water, sewerage and waste management.

The lack of infrastructure and basic municipal services is a fundamental constraint against expanded economic productivity. Approximately 60 percent of India's GDP is produced in urban areas with poor access to infrastructure and municipal services. Even with national policies which promote economic growth and improved access to global markets, assess to a consistent supply of power, potable water and sewage disposal, solid waste collection, and roads are essential to increased business productivity.

The lack of potable water, proper sanitation facilities and solid waste management is the root cause of urban environmental health problems: chorea, typhoid, malaria, tuberculosis. According to a public health official in Delhi, on any given day more than half of India's work force is affected by illness. Improving the health of the work force through better access to improved municipal services will significantly increase productivity.

5. Who is Undertaking the Risks of Project Finance, and Is It Highly Probable That the Loan Will Be Repaid on Schedule

The financial intermediaries will assume overall responsibility for eligible projects for the HG loan, for selecting HG investors, and for repayment of the HG loan. USAID will neither approve nor disapprove individual projects, borrowers or on-lending transactions. USAID's role will be to monitor and evaluate the program to ensure conformity with conditions and covenants established between USAID and the financial intermediary, and the framework of agreements between the financial intermediary and the borrowers/developers of eligible projects.

The GOI or a designee acceptable to USAID will provide a full-faith-and-credit guaranty for the HG loan. Since the financial intermediary has no need for free foreign exchange, the U.S. dollar proceeds of the HG loan will be placed with a swap-partner acceptable to USAID. The swap-partner will on-lend rupee funds to the financial intermediary, with an interest-rate margin to create a foreign-exchange risk hedge. The swap-partner and GOI or its designee will assume full responsibility for repayment of the U.S. dollar denominated HG loan, regardless of fluctuations in foreign exchange.

The proceeds of the HG loan will be on-loaned at commercial interest-rates and repayment periods to finance viable infrastructure projects designed and developed by either public sector (municipal corporation, authorities and boards), and/or partnerships between municipalities and private sector entities. Therefore, the cash flow from project income will be sufficient to service the underlying HG loan.

Based on the foregoing, it is highly probably that the HG loan will be repaid on schedule.

A. India's Social Environment

1. Cultural Diversity

India's population profile reflects a pattern of vast diversity. The country's inhabitants range from sophisticated urbanites living in Bombay to uneducated, share cropping peasants who farm rice paddies in West Bengal. Not surprisingly for a developing country, there are many more peasants than there are sophisticated urbanites. About three quarters of the population, or roughly 680 million, live in rural areas; leaving an urban population of around 200 million. But rural/urban differences are not the only differences one finds in India, nor even the most important. An elaborate mixture of cultures, languages and religious practices further complicates the pattern and is itself complicated by communalism, caste conflicts, and local chauvinism.

2. Contrasting Sets of Deeply-Held Values

Social researchers have identified two main sets of attitudes or values that characterize the basic political orientation of Indian society. One is based on Western, liberal democratic, and secular ideals, and is strongest at the level of the Central Government and its institutions, e.g., the Parliament, the courts and the civil service. USAID staff deal mainly with individuals imbued with this set of values. The other, which was built around loyalties to caste, family and clan, is the norm in rural panchayats and among local authorities. The battleground between these two contrasting sets of values is located at approximately the level of the State Governments.

The depth of the divide between these two sets of beliefs cannot be overemphasized. To the proponent of one set, the logic of the other is nothing less than illicit. Finding common ground is neither simple nor easy. The depth of these feelings need to be kept clearly in mind as efforts are made to mesh modern concepts of organization and reform with traditional ways of doing business.

B. The Social Aspects of Regulating Market Activity

India is in the process of converting its approach to regulating market activity from one that has attempted to provide investor protection through direct government controls to one that is more orderly and open, and based in large part on standardization and self-regulation, wherein investors receive a reasonable degree of protection but make their own investment decisions and personally bear the risk of their decisions.

This change in approach is a profound one, and will require that virtually everyone involved in market operations and market-related activities understands what is happening and how it will affect his involvement in future market operations. Policy makers will need to be keenly aware of the legal and regulatory implications of the new approach. Market makers and brokers will need to know the new rules of the game, and specifically what is allowed and what is not. Individual investors will want to assess the impact of the new approach on their interests in order to gauge the extent to which they will want to participate in markets in the future. From the social perspective, however, the bottom-line question is how readily those being affected by the transition will adapt to it and move to learn essentially a new way of doing business.

1. Facilitating the Adjustment Process

India has made great strides in establishing an educational infrastructure that has the potential to provide the educational and training support needed to modernize and improve the country's capital market operations. A number of institutions are prepared to assist in this process and the FIRE Project will devote considerable resources to strengthening their ability to assist. In addition, there are numerous professional organizations in India that are capable of performing research and of organizing workshops and conferences that can be used help to educate the public on the purposes and likely effects of capital market reforms.

2. Broadening the Scope of Training

There is, however, still a need to broaden further the scope of educational and training activities. Professional and staff training related to the managerial and technical aspects of market operations, and courses that inform policy makers and investors of the implications of a major shift in the regulatory environment are important and need to be supported. As noted below, however, India's social fabric will be seriously tested as the Government moves to develop an integrated trading system that covers the country and as the need for infrastructure projects to access capital markets for finance filters down to the municipal and community levels.

C. Cultural Characteristics and Investment Choices

Participants and agents involved in changing the way India's markets operate will also need to be aware of how the cultural characteristics of the Indian people influence their investment choices. Among these characteristics (which obviously vary by individual) are preferences for keeping cash rather than investing in securities; a dislike of debt as an institution; a preference for debt instruments that are both liquid and that have guaranteed principal repayment at any time (as contrasted with instruments that are liquid but in which the principal amount varies prior to maturity); a preference for the perceived capital gain opportunities of the equities market; lack of knowledge of the debt markets (even when the markets are theoretically open to them, such as government debt auctions); and, perhaps, most importantly, a profound distrust of brokers.

D. Modernizing Capital Market Operations

1. The Impact of Automation

The success of OTCEI over the past year and a half has demonstrated that an automated facility which abides by rules of full disclosure can operate successfully in India and even quickly expand the scale of its operations.

2. Setting Up an Integrated Nation-Wide Trading System

The GOI's current plans to establish an integrated nation-wide trading system based on automated facilities and modern telecommunications links will truly test the culture's ability to adapt. The proposed system will extend well beyond the boundaries of Bombay and New Delhi, and penetrate well into the far reaches of the country's hinterland, bringing together for the purpose of mounting a concerted effort to achieve economic progress, the many diverse elements of the population.

The FIRE Project can play a critical role in ensuring that the social and cultural requirements for implementing the proposed system are addressed and receive the support needed to ensure that they do not become obstacles to the potential success of this ambitious venture.

E. The Implications of Decentralization on Infrastructure Finance

1. The New Financial Role of the Municipal Governments

With the likely ratification of Amendment No. 74 of the Indian Constitution, the role of municipal governments in managing the financial resources of their urban communities will be changed dramatically. The extent of the change, of course, can only be determined once the Amendment is actually implemented, which is scheduled to occur by the end of the year.

Under the Amendment, the existence of municipal governments will be constitutionally recognized for the first time in the country's history, and municipal governments will be permitted to deal directly with central government agencies, without the intermediation of state governments. Funds for the construction of urban infrastructure facilities, which have traditionally been a responsibility of the state governments, will now be the responsibility of the municipal governments. The need for urban localities to recover the cost of construction and operation through user fees will also, in principle, be passed down.

2. Communications Gaps

For the newly-established relationships between municipal authorities and central government agencies to flourish, there will be a need for real and effective communication. This need is dramatically underscored by the requirements of the FIRE Project. Only if it is able to establish such communication can the Project expect to have a lasting impact upon the way in which urban infrastructure is financed in India. In order to succeed, it will need to evolve an ability to bridge the communications gaps which now separate small groups of bright, mostly youthful, money managers in Bombay from the elected and appointed officials who manage the vast majority of the nation's municipalities.

The difficulty of even discussing issues such as these was emphasized by an official of Infrastructure Leasing and Financial Services, Ltd. (ILFS), a financial services firm located in Bombay, which is being considered as a possible participant in the implementation of the FIRE Project. As he noted, he and his colleagues simply did not speak the same language as municipal officials. While they could make themselves understood by a few local authorities, such as those from the Bombay municipality, the City and Industrial Development Corporation of Maharasthra (CIDCO), and Indian Administrative Service (IAS) officers, most municipal officials, initially at least, appeared suspicious of the company, its methods, and its motives.

He concluded that municipal officials would certainly be more comfortable dealing with counterparts from government agencies, with whom they have been doing business for years. Yet, they were also aware of the need to begin to find ways to communicate with representatives of whichever agencies or firms could provide the financial resources needed to enable them to build the infrastructure facilities which their home communities sorely needed.

3. The Intermediary Role of the Indian Administrative Service (IAS)

The IAS is the successor to the pre-independence British Indian Civil Service (ICS). It is made up of an elite group of administrators, recruited initially on the basis of a rigorous examination administered on an all-India basis. These recruits undergo a comprehensive training program at the IAS Staff Training

Center in Mussoorie. They graduate in annual "batches," with which they are thereafter associated, and are then assigned initially to State cadres. Ethnically, each State cadre includes a substantial number of members from other States. Typically, the novice IAS officer begins his, or her, career in charge of a sub-division of one of the districts into which each State is divided. By the time he is ready to be posted as a municipal commissioner he will have held a variety of important administrative posts.

The underlying concept of the Service is that each officer is a generalist administrator, capable of running any organization. He is transferred every two to four years so that he does not become identified with any particular institution or specialty. Nevertheless, the depth of his experience is taken into consideration when postings are assigned, and any IAS officer who has held a number of positions dealing with urban affairs is likely to be allowed to continue to do so.

The IAS may offer a linguistic bridge, of sorts, between the municipalities and their outside correspondents. Officers from the Service are now commonly assigned by state governments to serve as commissioners in municipal corporations, a position analogous to that of a city manager, in American cities. In Indian cities where a locally elected government has been suspended by State decree, the IAS commissioner also has a role in determining policy as well as in carrying it out.

The intermediary role of the IAS officer in the municipality is particularly important at this time of constitutional change. As local bodies establish new relationships, not only with parent state governments, but also with central government agencies, there will be a premium on an officer's ability to circumvent formal channels of communication by contacting appropriate "batch mates" or other members of the IAS. An important part of his task will be that of getting across to local officials, both elected and appointed, the new realities of municipal finance.

The FIRE Project, over time and with sensitivity on the part of those participating in its training and technical assistance components, can also play a key role in creating effective channels of communication. To the extent that the immediate aims of the project are achieved, and debt finance is channeled into urban infrastructure, the people of India's municipalities will benefit. To the extent that it also helps to contribute to the larger urban initiatives now underway, it will have made an immeasurable contribution towards breaking down the longstanding tradition of mutual suspicion and antagonism that has long afflicted Indian political life and hampered economic progress at all levels.

4. Cost Recovery Requirements

The need for municipalities to begin covering the cost of constructing and operating infrastructure by imposing user fees and other income generating methods (except for those who cannot afford to pay), is a new idea that has yet to enter the consciousness of most local leaders. The finer points of fiscal engineering, relating to the choice of instruments, the methods of repayment, interest strategies, the use of secondary markets and the like, are also well beyond their knowledge base, at least at the present time.

The impact of their carrying out this new responsibility on the prospects for successful implementation of the infrastructure finance component of the FIRE Project is serious and profound. To "sell" the idea at the level of the individual municipalities will involve long hours of dialogue, flexibility, imaginative packaging and a sympathetic understanding of local dynamics. But it can be done successfully, if only because the Project is offering the municipalities something they badly need: funding to build urban infrastructure facilities.

F. The Project and Its Impact on Women

Women, especially women in the lower income and lower caste communities, face many forms of discrimination in India. They are commonly treated as property. As children, they are liabilities for whom dowries must be found. When they reach marriageable age, they are disposed of to a family which will accept the dowry offered. As wives, they are valued for the sons they rear. If promised dowries are not forthcoming, or if wives prove infertile, they face the danger of, at best, abandonment, and at worst, injury or death.

To the extent that urban infrastructure can be improved, urban life will be improved, urban health enhanced, urban employment generated and the urban environment rendered more livable. Women stand to gain substantially from these improvements. Because of their subservient position on the social ladder, and because they have to undertake the least desirable of activities, the benefits that accrue to them from improved municipal conditions, will be marginally greater than those received by their male counterparts.

While the FIRE Project does not address directly the low social position low-income women suffer, it does aim to improve living conditions in India's municipalities and will, accordingly, bring considerable benefit to women who constitute a substantial portion of the country's urban population.

A. The Technical Aspects of the FIRE Project Design and Implementation

Capital market development and infrastructure finance are both areas of dramatic change in India at present. In the capital market area, the changes being made involve a basic shift in the way the market is being regulated, the modernization of market operations, and expansion of the capacity of the long-term debt component of the market to finance infrastructure projects.

Many of the technical skills needed to facilitate these changes are already available in-country, though not in adequate supply. In some cases, a higher order of skills is needed. A key objective of the FIRE Project will be to provide technical assistance and training to increase the level and availability of requisite skills.

The technical skills requirements in the infrastructure finance area will in some respects be less burdensome. The technical skills needed for most of the demonstration projects to be funded under this component of the Project are already available locally, and well qualified. The transition that is taking place in the infrastructure finance area is related more to how infrastructure projects are to be financed and at which level of government. Up until now, state and municipal governments have been operating under a central government-controlled mode of infrastructure finance. They must now develop the skills to develop and finance commercially viable projects on their own.

A key part of the challenge of the FIRE Project will be to identify the specific areas where outside technical assistance and training resources need to be applied. In some cases, project resources will need to be directed to bringing the local level of performance up to international standards. Another area of particular importance will be to strengthen the technical training capacities of the country's educational and training institutions. This will help assure that these institutions are better able to fulfill the country's future requirements for technical skills, which it will need to continue making improvements in its market operations at home and to support its growing efforts to compete effectively for capital resources globally.

While an objective of the FIRE Project is to provide the technical assistance and training needed by India to help it achieve certain project-related objectives, it should be kept in mind that implementation of the FIRE Project will itself require a substantially high level and broad range of technical skills.

B. The Technical Requirements of Transforming India's Capital Market Operations and of Changing Its Approach to Infrastructure Finance

One cannot fail to be impressed by the speed at which changes have been taking place in India; in particular, changes that are of critical importance to improving the operation of its capital markets. Almost simultaneously, the country has mandated partial convertibility of the rupee and delicensed all but eighteen of its major industries; developed plans for the privatization of public enterprises, banks, insurance companies, railways and airways; engineered the establishment of private sector mutual funds; and laid the groundwork for the emergence of a National Stock Exchange. In addition, schemes have been evolved to attract increased foreign equity; interest rates on debentures have been freed; flexible interest rates (subject to a floor) have been introduced for bank finance and term loans; and a policy of free pricing of new securities issues inaugurated.

In the midst of these changes, the country has been embarked on a major effort to shift the method by which it regulates its capital markets, from a "merit review" to a "full disclosure" basis of operation. A major realignment of organizational and financial relationships between the country's central, state and municipal governments is also currently underway. As noted earlier, municipal governments which have been attuned to operating under a centrally controlled mode of financial administration must now develop the skills to come up with commercially viable projects on their own and must, in addition, find the means to finance the projects.

The technical requirements of carrying out these two major initiatives form much of the basis for the design and implementation of the FIRE Project.

C. Specifying the Kinds of Technical Assistance and Training That Need to be Provided

A sizeable share of the technical assistance and training that needs to be provided under the FIRE Project is related to the technological changes that are to be made in the way the capital markets conduct their business. The Government is depending heavily, for example, on the automation of market operations to effect needed improvement in the transparency of market operations, while adding significantly to the efficiency of those operations.

The mechanical and structural characteristics of current market operations point up clearly why improvements are needed. Correcting such deficiencies will be a main focus of the project. Among the characteristics noted that need to be rectified, are a generally disorderly telephone market; lack of disclosure about prices and the sequence of trades; a lack of disclosure of an operating market's existence (e.g., not circulating information concerning the eligibility of the public to bid at RBI auctions, and the alleged willingness of the RBI to maintain individuals' accounts); lack of a modern book-entry delivery system and depository and of a modern settlement payment system; lack of regulation assuring honest brokering/dealing; and the difficulty of access by retail customers to the marketplace.

1. A Higher Order of Technical Skills Will Be Needed

With automation, higher levels of technical skills will be needed to ensure that the intended benefits of the process are in fact, realized. The development of a consolidated market tape, which would contain pricing and sequence of trading data, is essential to the improvement of market operations and to bringing the level of operations up to international standards. In India, automation will be critical to maintaining a current tape. The GOI's intention to integrate the country's regional stock exchanges into a nation-wide network will require the installation and maintenance of highly sophisticated telecommunications facilities. Again, a higher order of technical skills will be needed to ensure the success of this networking effort, which if implemented successfully, would greatly improve the efficiency of market operations and virtually solve the markets' transparency problem.

2. Identifying the Kinds of Assistance Needed

It can be assumed at this point that the FIRE Project will play the central role among India's assistance donors, in providing the technical assistance needed to enable the country to modernize and improve the operations of its capital markets and to engage the private sector more fully in financing urban infrastructure projects. Comprehensive assessments of certain areas of need were carried out by technical consultants who contributed to the design of the FIRE Project. Their findings have been presented in some detail in published reports, and are being used by the USAID to decide on initial allocations of project resources. Mid-term evaluations to be conducted during the implementation phases of the project, will also be directed in part to reassessing the country's needs for such assistance.

3. Training up to International Standards

An area in which more detailed assessments are needed, however, relates to the country's need to establish a better and broader institutional base for developing its own specialized technical expertise. In brief, there is a great need to develop or strengthen institutions which can supply India's capital markets with the technical and managerial skills that they will need to operate and guide India's capital markets effectively in the future.

Several such institutions are currently operating, and show excellent prospects for success. These include the UTI Institute of Capital Markets (UTI/ICM) and the Institute of Certified Financial Analysts of India (ICFAI).

UTI/ICM, for example, is planning to offer a program of courses which focuses on the most modern practices being used in international markets. As noted earlier, exposure to the best international practices is vital to those practitioners who will be involved in market operations that must measure up to international standards.

ICFAI, which is an institute of specialized learning, is equipped to fill a very necessary role in upgrading the technical skills required for modern market operation. It has established a Correspondence School that enables practicing professionals to obtain a CFA (Certificate of Financial Accounting) while still holding a full time position in the markets. This kind of technical training will be of particular use in conjunction with the implementation of both the CMD and IF components of the FIRE Project.

The National Institute of Urban Affairs (NIUA) is a third training institute that is well equipped to play a key role in raising the level of India's technical expertise. NIUA understands the importance of the FIRE Project, particularly as it relates to the difficulties inherent in overcoming the inertia that will characterize the initial responses of most municipal officials to their new financial management responsibilities.

There are, at present, 15 full-time professional staff at the Institute, encompassing the disciplines of urban and regional planning, economics, municipal finance, social planning, and environmental planning. Professional staff members are supported by research assistants and clerical staff.

4. Financial Intermediaries as a Growth Area

Perhaps the most critical need for technical assistance and technical training in the infrastructure finance area, in the broadest sense of the term "technical", will be the need for financial institutions and firms to serve as intermediaries between municipal infrastructure planners and private sources of capital. These intermediaries are also needed to assemble infrastructure financing "packages", and to create debt market instruments that will induce private sector investors to contribute funding resources to these packages. Fulfilling these roles will truly be a growth area for financial firms in India for at least the next decade.

Two such financial intermediaries have been identified as qualified to serve in this capacity during the early stages of FIRE Project implementation. These are ILFS (Infrastructure Leasing & Financial Services Limited) and HUDCO (the Housing and Urban Development Corporation of the Ministry of Housing and Urban Development.

ILFS is a non-bank financial institution, whose business purpose is to provide a comprehensive range of financial services in a broad range of areas. Since its beginning, ILFS has also attempted to develop a string of international relationships, to gain access to additional financial resources and to gain experience in developing new lines of business.

ILFS appears to be the only institution in India that is presently in a position to develop commercially viable urban infrastructure projects. The firm employs a number of highly trained professionals. Among its 154 employees, are five lawyers, 27 MBAs, 22 Chartered Accountants, nine economists and four engineers.

A modest amount of FIRE Project technical resources will need to be allocated to ILFS during the initial stages of Project implementation, to assist it in developing a broader array of infrastructure financing instruments, and to bolster its capacities to reach and communicate with municipal planners.

The Infrastructure Directorate of HUDCO is the largest single department in the public corporation, employing ten engineers, one architect, four finance specialists, two lawyers, one documentation expert and two administrators.

HUDCO has had an impressive track record of financing development projects since its inception in 1970. It has made loans for rural housing projects, and for a number of different urban housing programs including shelter upgrading, rental housing programs, basic service schemes, new town development, resettlements and others.

The Directorate has a well-established appraisal process through which it reviews projects proposed by municipal bodies. In addition to a description of the benefits expected, the appraisals explicitly address such matters as the legal capacity and administrative capability of relevant institutions to carry out their assigned tasks, and to prepare financial and economic analysis.

HUDCO has had limited exposure to capital markets, and would need considerable technical assistance to enable it to participate in the FIRE Project as a financial intermediary. Assistance would be needed in particular to develop its capacity to provide assistance to municipalities for the design of commercially viable projects and to strengthen their capacity to access the debt market.

ANNEX H

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

USAID

NEW DELHI, INDIA

July 22, 1993

ACTION MEMORANDUM FOR THE ASIA BUREAU ENVIRONMENTAL OFFICER

THROUGH: Steven Mintz - Acting Director, USAID/India

FROM: Andrea J. Yates AJY Mission Environmental Officer
J. David Foster - Regional Environmental Advisor

ACTION:

To approve a Categorical Exclusion from Environmental Procedures for USAID/India's Financial Institutions Reform and Expansion Project (386-0531).

BACKGROUND:

The Financial Institutions Reform and Expansion Project (FIRE, 386-0531) will consist of Housing Guaranty funded loan support to intermediate credit institutions for infrastructure development projects, and training and technical assistance in support of capital market reform activities. The infrastructure development projects will be implemented through the Infrastructure Leasing and Financial Services (ILFS) and through the Housing and Urban Development Corporation (HUDCO). ILFS and HUDCO are both intermediate credit institutions and will have complete review and approval authority for FIRE/HG-funded loans. USAID will not directly approve projects to be financed by the intermediaries. FIRE is therefore eligible for a Categorical Exclusion from Environmental Procedures under 22 CFR Parts 216.2(c)(2)(i) and 216.2(c)(2)(x).

However, both ILFS and HUDCO have agreed that there will be thorough consideration of potential adverse environmental impacts of any infrastructure financed under this project. In addition, the FIRE Project will specifically provide training and technical assistance designed to improve existing environmental review procedures both at the local level and at the intermediate credit institution. Development of funding criteria (to be satisfactory to USAID), which includes environmental considerations, will be included in the Conditions Precedent of the Project Agreement. Furthermore, both ILFS and HUDCO already include environmental considerations in their standard review processes, and these requirements will also apply to Project-funded activities.

RECOMMENDATION:

That you sign below indicating your approval of the attached Initial Environmental Examination, which states that the Project is Categorically Excluded from further Environmental Procedures.

8-13-93

Approved/~~Disapproved~~

U. Lck, ASIA/DR
Asia Bureau Environmental Officer

ENVIRONMENTAL ANALYSIS

Environmental procedures for AID are established in 22 CFR part 216. These procedures are designed to assure that environmental factors and values are integrated into the A.I.D. decision making process and are intended to implement the requirements of the National Environmental Policy Act as they affect the A.I.D. program.

The FIRE Project is fully consistent with the goals and purposes of part 216. The project is specifically designed to improve environmental quality by improving finance for urban infrastructure, particularly water supply, waste water treatment and solid waste disposal. In addition, training and technical assistance is specifically provided to improve and upgrade the capacity of Indian institutions to evaluate potential environmental impacts indirectly arising from these infrastructure projects.

While the FIRE project will provide training and technical assistance in general environmental review and assessment methodologies, the actual assessments will be performed by the implementing agencies and local municipalities. A.I.D. will not have advance knowledge or control over individual projects and will thus not be in a position to conduct assessments on its own.

Although the FIRE project will be fully consistent with the purposes of section 216 and it will help to assure that all potential environmental impacts are subject to effective review, the FIRE project is entitled to a categorical exclusion from the procedural requirements under this section. The conditions for categorical exclusion are spelled out under 216.2(c)(2).

The FIRE project provides for two basic categories of assistance in support of capital market reform for infrastructure development:

1) Training and technical assistance (not including construction of facilities); and

2) Financial support for an intermediate credit institution.

The training and technical assistance will be provided through various capital market regulatory and training agencies and insitutions such as the Securities and Exchange Board of India (SEBI); the Unit Trust of India (UTI); and the National Institute for Urban Affairs (NIUA). These activities are specifically identified as qualifying for a categorical exclusion under 216.2(c)(2)(i):

> "Education, technical assistance, or training programs except to the extent such programs include activities directly affecting the environment (such as construction of facilities, etc.)"

Financial assistance is provided through TA and Housing Guaranty loan support of intermediate credit institutions. These institutions become the primary implementing agencies for this project. Implementation under the FIRE Project will be provided by the Infrastructure Leasing and Financial Services (ILFS) and by the Housing and Urban Development Corporation (HUDCO). ILFS and HUDCO will have the authority to review and select investment projects and proposals subject to the criteria of this program. While AID has established basic criteria and program direction, it will not have knowledge of individual projects prior to funding nor will it have control over individual projects selected. This support for an intermediate credit institution is also specifically identified as qualifying for a categorical exclusion under 216.2(c)(2)(x):

> "Support for intermediate credit institutions when the objective to assist in the capitalization of the institution or part thereof and when such support does not involve reservation of the right to review and approve individual loans made by the institution."

Despite these categorical exclusions from procedural requirements, USAID, ILFS and HUDCO are committed to inclusion of environmental criteria for infrastructure activities under FIRE. ILFS and HUDCO already include environmental review in their appraisal processes (Attachments A and B). In addition to the environmental review performed by the implementing agency, project proponents will also have to assure that their projects have been reviewed by the State Pollution Control Board or another competent independent environmental review body. Furthermore, in those circumstances where the implementing authority lacks the specialized expertise to fully review potentially critical environmental projects, the implementing authority will contract with an outside consultant to perform this review on its behalf.

HUDCO is a development finance institution with a mandate that includes social and environmental considerations. HUDCO can and does refuse to support projects based on an evaluation of environmental concerns and measures taken to address them.

Furthermore, development of funding criteria (to be satisfactory to USAID), which includes environmental considerations, will be included in the Conditions Precedent of the Project Agreement. Periodic evaluations will be conducted by USAID, with review of a representative sample of projects, to determine if the intermediate credit institution and the local authorities have complied with the agreed upon environmental criteria.

Although USAID will not have the right of individual project review or approval, the Mission is assured that environmental considerations will be integrated into this process.

HOUSING GUARANTY POLICY MATRIX

Policy Reform I: Promote the development of a commercially-viable infrastructure finance system:

Policy Objective	HG Conditions Precedent	Technical Assistance & Training Support
1. Provide assistance to a national level infrastructure finance institution to set infrastructure development policy and establish an infrastructure finance system.	1.1 Identify/establish financial institution and provide operational responsibility & authority. 1.2 Identify local government borrowers. 1.3 Appraise local government loan applications for water, sewer, and/or solid waste collection projects. 1.4 Package project revenue bond financing. 1.5 Identify investors for revenue bonds. 1.6 Establish local gov't revenue generation authority.	1.1 Develop capacity of finance institution to originate and service project revenue bonds. 1.2 Improve capacity of local government to formulate viable projects, to provide land information, and to plan and implement a land title registration system. 1.3 Provide legal & regulatory assistance. 1.4 Improve capacity of underwriters, credit rating agencies, regulators, etc. 1.5 Improve capacity of local gov't to generate revenues.

Policy Objective:

2. Promote innovative infrastructure finance methods such as build, own, operate, transfer (BOOT); or build and transfer for payment through transfer of physical assets such as land.

HG Condition Precedent:

2.1 Form joint sector Development Corporation (DC) with private & public equity participation.

2.2 Authority from state & local government to undertake development.

2.3 Dynamic spacial plan: capital improvement plan.

2.4 Joint venture agreements with land developers.

2.5 Identify water, sewer and/or solid waste collection projects.

2.6. Package revenue bond financing.

2.7 Identify investors.

Technical Assistance & Training Support:

2.1 Develop DC capacity to plan, finance, construct and manage BOOTs, etc.

2.2 Improve capacity of local government to implement land title registration system, and provide land information.

2.3 Improve capacity of underwriters, credit rating agencies, regulators, etc.

2.4 Assist with identifying US joint venture partners.

2.5 Provide legal & regulatory assistance.

Policy Reform II: Increase private sector participation in the delivery of municipal services and land development.

Policy Objective:	HG Conditions Precedent:	Technical Assistance & Training Support:
3. Improve the ability of private land developers and local governments to form partnerships.	3.1 Local government & land developers must form partnerships to be eligible to participate in infrastructure finance programs.	3.1 Improve local government's ability to facilitate privatization (negotiate, prepare contracts, contract administration).
	3.2 Substantial progress towards creating local gov'nt urban management information system.	3.2 Improve local government's capacity to evaluate physical, economic and environmental impacts of land development.
		3.3 Improve the capacity of private developers to carry-out physical, economic and environmental analysis.
		3.4 Promote self-regulation and licensing of real estate agents and land developers.
		3.5 Assist with identifying US joint venture opportunities.

Policy Objective:

4. Improve the capacity of local governments to enter into agreements with private providers of basic urban services.

HG Conditions Precedent:

4.1 Willingness to implement trial programs for privatizing municipal services, and participate in technical assistance & training programs.

4.2 Substantial progress towards development of state level performance standards for privatization.

Technical Assistance & Training Support:

4.1 Improve capacity to solicit, negotiate, contract and manage private sector providers.

4.2 Improve capacity of private providers to deliver municipal services.

4.3 Assist with identifying US joint venture opportunities.

Policy Reform III: Improve the capacity of local government's to plan, operate, maintain and recover the costs for basic urban services.

Policy Objective	HG Conditions Precedent	Technical Assistance & Training Support
5. Improve the capacity of local governments to plan for basic urban services.	5.1 Willingness to implement trial programs and participate in technical assistance & training. 5.2 Substantial progress towards delegation of authority from state to local gov'nt for management of urban development.	5.1 Improve capacity to carry-out dynamic spacial planning in lieu of master planning. 5.2 Improve capacity for capital improvement planning, and coordination with dynamic spacial planning. 5.3 Improve ability to coordinate planning between municipal corporations and authorities. 5.4 Assist with identifying US joint venture opportunities. 5.5 Provide legal & regulatory assistance.

Policy Objective:

6. Improve capacity of local governments to operate, maintain and recover costs for basic urban services.

HG Conditions Precedent

6.1 Willingness to implement trial programs and participate in technical assistance & training.

6.2 Substantial progress towards delegation of authority from state to local gov't to recover costs for basic urban services.

Technical Assistance & Training Support:

6.1 Improve capacity of municipal corporations and authorities to coordinate operations, maintenance and cost recovery.

6.2 Improve institutional capacity through organizational development and training.

6.3 Provide legal & regulatory assistance.

6.4 Improve operating, maintenance and cost recovery technologies such as computerization, leak detection, etc.

ACTION: AID-2 INFO: CHG ADM (3)

BEST AVAILABLE

VZCZCND0283NE0863
PP RUEHNE
DE RUEHC #7124/01 2250848 13-AUG-93 TOR: 08:46
ZNR UUUUU ZZH CHRG: AID
P 130846Z AUG 93 DIST: AIDA
FM SECSTATE WASHDC
TO AMEMBASSY NEW DELHI PRIORITY 1606
BT PROJECT # 386-0531
UNCLAS SECTION 01 OF 05 STATE 247124

AID ADM

E.O. 12356: N/A
TAGS:
SUBJECT: INDIA FINANCIAL INSTITUTIONS REFORM AND EXPANSION (FIRE) (386-HG-015) HOUSING GUARANTY AUTHORIZATION

8/16/93
12:00
ACTION:
RHUDO-2
INFO:
D/DD
PRO
PDIT
TDE
CO
CHRON

1. THE ASSISTANT ADMINISTRATOR, BUREAU FOR ASIA, HEREBY DELEGATES TO USAID/INDIA THE AUTHORITY TO AUTHORIZE THE SUBJECT PROJECT BY SIGNING THE GUARANTY AUTHORIZATION. A CONGRESSIONAL NOTIFICATION (CN) FOR SUBJECT AUTHORIZATION WAS SUBMITTED TO CONGRESS ON JULY 26, 1993. THE SENATE FOREIGN RELATIONS COMMITTEE (SFRC) PUT AN INFORMATIONAL HOLD ON THE CN ON JULY 27. THE ASIA BUREAU AND PRE/H WILL MEET WITH SFRC STAFF MEMBERS ON 12 AUGUST 1993 TO DISCUSS THE PROJECT. ONCE WE NOTIFY YOU THAT THE INFORMATIONAL HOLD ON THE CN HAS BEEN REMOVED, THE ASIA BUREAU AND PRE/H REQUEST THAT USAID/INDIA AUTHORIZE THE SUBJECT PROJECT, AND THEN OBLIGATE THE SUBJECT PROJECT, AFTER SIGNING THE GUARANTY AUTHORIZATION, BY ISSUING A LETTER OF ADVICE TO THE REPUBLIC OF INDIA.

2. 386-HG-015 IS A FOURTEEN MILLION DOLLAR HOUSING GUARANTY (HG) WITH A SUBSIDY COST OF TWO MILLION EIGHT HUNDRED FIFTY-SEVEN THOUSAND DOLLARS. THE CREDIT SUBSIDY HAS BEEN APPROVED.

3. THE MISSION DIRECTOR OR DEPUTY DIRECTOR OF USAID/INDIA IS REQUESTED TO SIGN AND APPROVE THE GUARANTY AUTHORIZATION AND TO SIGN AND DELIVER THE LETTER OF ADVICE FOR INDIA IN THE NAME OF AND ON BEHALF OF THE UNITED STATES OF AMERICA, ACTING THROUGH THE AGENCY FOR INTERNATIONAL DEVELOPMENT. THE TEXT OF THE GUARANTY AUTHORIZATION IS AS FOLLOWS IN PARA 5 BELOW. THE TEXT OF THE LETTER OF ADVICE IS AS FOLLOWS IN PARA 6. ITS ATTACHMENT, ANNEX A: TERM SHEET, IS AS FOLLOWS IN PARA 7.

4. FOLLOWING EXECUTION OF THE AUTHORIZATION AND RECEIPT FROM THE BORROWER OF THE COUNTERSIGNED LETTER OF ADVICE, PLEASE NOTIFY PRE/H BY CABLE CONFIRMING THAT THE LETTER OF ADVICE WAS RECEIVED AND COUNTERSIGNED BY THE BORROWER NO LATER THAN AUGUST 31, 1993, AND SEND ONE ORIGINAL SIGNED COPY OF BOTH THE AUTHORIZATION AND THE LETTER OF ADVICE TO AID/FA/FM/LM:DNEWMAN WITH COPIES TO PRE/H.

BEST AVAILABLE

: GUARANTY AUTHORITY
ROGRAM NO. 386-HG-IV
AUTHORIZATION NO. 386-HG-015)

ROVIDED FROM: HOUSING GUARANTY AUTHORITY

OR: THE GOVERNMENT OF INDIA

URSUANT TO THE AUTHORITY VESTED IN THE MISSION DIRECTOR Y THE FOREIGN ASSISTANCE ACT OF 1961, AS AMENDED (FAA) ND THE DELEGATIONS OF AUTHORITY ISSUED THEREUNDER, I EREBY AUTHORIZE THE ISSUANCE TO ELIGIBLE U.S. INVESTORS INVESTORS) ACCEPTABLE TO A.I.D. OF GUARANTIES PURSUANT TO ECTION 222 OF THE FAA OF NOT TO EXCEED UNITED STATES OLLARS FOURTEEN MILLION ONLY (U.S. DOLS 14,000,000) IN ACE AMOUNT. THE GUARANTIES SHALL ASSURE AGAINST LOSSES S PROVIDED IN THE HOUSING GUARANTY STANDARD TERMS AND ONDITIONS (22 C.F.R. PART 204) WITH RESPECT TO LOANS NCLUDING ANY REFINANCING THEREOF. THESE GUARANTIED LOANS HALL BE MADE TO THE GOVERNMENT OF INDIA (BORROWER) TO UPPORT THE IMPROVEMENT OF THE OPERATING ENVIRONMENT OF HE CAPITAL MARKET AND TO ASSIST IN THE DEVELOPMENT OF THE EBT COMPONENT OF THAT MARKET WITH SPECIAL EMPHASIS ON NFRASTRUCTURE FINANCE AS A MEANS FOR STIMULATING DEBT ARKET DEVELOPMENT AND THAT BENEFITS SHELTER-RELATED NFRASTRUCTURE FOR THE URBAN POOR.

HESE GUARANTIES SHALL BE SUBJECT TO THE FOLLOWING TERMS ND CONDITIONS:

- 1. TERMS OF GUARANTY

HE LOANS AND ANY REFINANCING THEREOF SHALL EXTEND FOR A ERIOD OF UP TO THIRTY (30) YEARS FROM THE DATE OF EACH ISBURSEMENT OF THE LOANS AND MAY INCLUDE A GRACE PERIOD F UP TO TEN (10) YEARS ON REPAYMENT OF PRINCIPAL, DURING HICH THE INTEREST SHALL ACCRUE AND BE PAYABLE, AND CONTAIN SUCH OTHER TERMS AND CONDITIONS AS ARE AGREED TO Y THE BORROWER AND THE INVESTOR, SUBJECT TO THE APPROVAL F A.I.D. THE GUARANTIES OF THE LOANS SHALL EXTEND FOR A ERIOD BEGINNING WITH THE FIRST DISBURSEMENT OF THE LOANS ND SHALL CONTINUE UNTIL SUCH TIME AS THE INVESTOR HAS EEN PAID IN FULL PURSUANT TO THE TERMS OF THE LOANS.

- 2. INTEREST RATE

INTEREST RATE OR RATES OF INTEREST PAYABLE TO THE INVESTOR PURSUANT TO THE LOANS SHALL NOT EXCEED THE ALLOWABLE RATE OF INTEREST PRESCRIBED PURSUANT TO SECTION 223(F) OF THE FOREIGN ASSISTANCE ACT OF 1961, AS AMENDED (FAA), AND SHALL BE CONSISTENT WITH THE RATES OF INTEREST GENERALLY AVAILABLE FOR SIMILAR TYPES OF LOANS MADE IN THE LONG-TERM U.S. CAPITAL MARKETS.

- 3. GOVERNMENT OF INDIA GUARANTY

PRIOR TO DISBURSEMENT OF ANY LOAN AMOUNTS PURSUANT TO THIS GUARANTY AUTHORIZATION, A WRITTEN GUARANTY TO INDEMNIFY A.I.D. AGAINST ALL LOSSES ARISING BY VIRTUE OF A.I.D.'S GUARANTIES TO THE INVESTOR OR FROM NON-PAYMENT OF THE A.I.D. FEE SHALL BE PROVIDED IN A FORM SATISFACTORY TO A.I.D. BY THE GOVERNMENT OF INDIA (OR A FINANCIAL INSTITUTION AUTHORIZED BY THE GOVERNMENT OF INDIA TO PROVIDE SUCH A GUARANTY AND APPROVED BY A.I.D.).

- 4. FEE

THE FEE OF THE UNITED STATES SHALL BE PAYABLE IN U.S. DOLLARS AND SHALL BE EQUAL TO ONE-HALF OF ONE PERCENT (1/2 PERCENT) PER ANNUM OF THE OUTSTANDING GUARANTIED AMOUNT OF THE LOANS PLUS A FIXED AMOUNT EQUAL TO ONE PERCENT (1 PERCENT) OF THE AMOUNT OF THE LOANS AUTHORIZED OR ANY PART THEREOF, TO BE PAID AS A.I.D. MAY DETERMINE UPON DISBURSEMENT OF THE LOANS.

- 5. OTHER TERMS AND CONDITIONS

THE GUARANTY SHALL BE SUBJECT TO SUCH OTHER TERMS AND CONDITIONS AS A.I.D. MAY DEEM NECESSARY.

IN ACCORDANCE WITH THE PROVISIONS OF THE FEDERAL CREDIT REFORM ACT OF 1990, I HEREBY AUTHORIZE THE OBLIGATION OF

UNITED STATES DOLLARS TWO MILLION EIGHT HUNDRED FIFTY-SEVEN THOUSAND (DOLS 2,857,000) TO COVER THE SUBSIDY COST OF AUTHORIZATION NO. 386-HG-015 AND FOR USE OF UNITED STATES DOLLARS FOURTEEN MILLION (DOLS 14,000,000) IN GUARANTY AUTHORITY. ACTION MUST BE TAKEN TO OBLIGATE THESE FUNDS BY NO LATER THAN AUGUST 31, 1993 BY RECEIVING FROM THE GOVERNMENT OF INDIA THE COUNTERSIGNED LETTER OF ADVICE. THE GUARANTIED LOANS MUST BE DISBURSED BY NO LATER THAN SEPTEMBER 30, 1998 AFTER WHICH TIME THE OBLIGATED FUNDS EXPIRE.

WALTER G. BOLLINGER
DIRECTOR
USAID/INDIA

E:

LETTER OF ADVICE

BEST
AVAILABLE

E

. VARADACHARY
NT SECRETARY
PARTMENT OF ECONOMIC AFFAIRS
IISTRY OF FINANCE
ERNMENT OF INDIA
RTH BLOCK, NEW DELHI 110001

AR MR. VARADACHARY:

BJECT TO THE TERMS OF THIS LETTER OF ADVICE AND SUCH RMS AND CONDITIONS TO BE FURTHER AGREED UPON IN AN PLEMENTATION AGREEMENT AND IN CONSIDERATION FOR SUCH LICY CHANGES AND OTHER COMMITMENTS TO BE MADE BY THE VERNMENT OF INDIA ("BORROWER") AS SET FORTH BELOW, THE ENCY FOR INTERNATIONAL DEVELOPMENT ("A.I.D.") HAS AGREED GUARANTY LOANS TO THE BORROWER OF UP TO FOURTEEN LLION UNITED STATES DOLLARS (US DOLS 14,000,000) TO NANCE COSTS ASSOCIATED WITH THE DEVELOPMENT OF THE DEBT RKET WITH SPECIAL EMPHASIS ON URBAN ENVIRONMENTAL FRASTRUCTURE FINANCE IN INDIA.

SET FORTH IN DETAIL IN THE APPROVED PROJECT PAPER RMING THE BASIS FOR THE AUTHORIZATION OF THE GUARANTY,

1

PURPOSE OF THIS PROJECT IS TO SUPPORT THE IMPROVEMENT
THE OPERATING ENVIRONMENT OF THE CAPITAL MARKET AND TO
IST IN THE DEVELOPMENT OF THE DEBT COMPONENT OF THAT
KET WITH SPECIAL EMPHASIS ON URBAN ENVIRONMENTAL
RASTRUCTURE FINANCE THAT BENEFITS THE URBAN POOR AS A
NS FOR STIMULATING DEBT MARKET DEVELOPMENT. THE

BEST AVAILABLE

JECT WILL PROMOTE DEVELOPMENT OF AN INFRASTRUCTURE
ANCE SYSTEM; FINANCIAL INSTITUTIONS TO ORIGINATE AND
VICE PROJECT BASED REVENUE BONDS AND SIMILAR LONG TERM
T INSTRUMENTS; LOCAL GOVERNMENTS TO FORMULATE VIABLE,
IRONMENTALLY SOUND URBAN INFRASTRUCTURE IMPROVEMENTS;
) TRAINING CAPACITY FOR LOCAL GOVERNMENTS/AUTHORITIES
) PRIVATE DEVELOPERS TO DEVELOP, OPERATE, MAINTAIN, AND
COVER COSTS OF URBAN INFRASTRUCTURE AND INNOVATIVE
FRASTRUCTURE FINANCE METHODS. THE RUPEE EQUIVALENT OF
E LOANS WILL BE USED TO IMPROVE URBAN ENVIRONMENTAL
FRASTRUCTURE FOR HOUSEHOLDS BELOW THE URBAN MEDIAN
COME LEVEL OF INDIA. A.I.D.'S COMMITMENT TO GUARANTY
E LOANS IS VALID FOR A PERIOD OF 24 MONTHS FROM THE DATE
IS LETTER OF ADVICE IS COUNTERSIGNED. SHOULD THE
RROWER FAIL TO EXECUTE A LOAN AGREEMENT WITHIN THAT
RIOD, A.I.D. RESERVES THE RIGHT TO CANCEL ITS COMMITMENT
GUARANTY.

IIOR TO THE ISSUANCE OF A.I.D.$S GUARANTY, THE BORROWER
ILL COMPLETE EXPENDITURES SATISFACTORY TO A.I.D. WHICH
ILL DIRECTLY BENEFIT BELOW-MEDIAN-INCOME FAMILIES.
.I.D.'S ISSUANCE OF A GUARANTY IS FURTHER DEPENDENT ON
HE GOVERNMENT OF INDIA'S DEMONSTRATED SUPPORT FOR THE
MPLEMENTATION OF THE FOLLOWING OBJECTIVES CONTAINED IN
HE PROJECT PAPER:

1. PROMOTE DEVELOPMENT OF A COMMERCIALLY VIABLE INFRASTRUCTURE FINANCE SYSTEM:

1.1 DEVELOP THE CAPACITY OF FINANCE INSTITUTIONS TO ORIGINATE AND SERVICE PROJECT BASED REVENUE BONDS AND SIMILAR LONG TERM DEBT INSTRUMENTS.

1.2 CREATE THE LEGAL AND REGULATORY FRAMEWORK FOR URBAN ENVIRONMENTAL INFRASTRUCTURE FINANCE AND DEVELOPMENT.

1.3 IMPROVE THE CAPACITY OF UNDERWRITERS, CREDIT RATING AGENCIES, AND REGULATIONS TO PROMOTE PROJECT BASED REVENUE BONDS.

1.4 PROMOTE INNOVATIVE INFRASTRUCTURE FINANCE AND PROJECT DESIGN METHODS THAT BUILD IN PRIVATE SECTOR PARTICIPATION AND ASSESS DISASTER HAZARDS THAT WOULD AFFECT PROJECT DEVELOPMENT RISK.

2. STRENGTHEN LOCAL GOVERNMENT MANAGEMENT OF URBAN

ENVIRONMENTAL INFRASTRUCTURE:

2.1 IMPROVE THE CAPACITY OF LOCAL GOVERNMENT TO FORMULATE VIABLE, ENVIRONMENTALLY SOUND PROJECTS.

2.2 IMPROVE THE CAPACITY OF LOCAL GOVERNMENT TO GENERATE REVENUES.

2.3 APPLY AND IMPROVE THE ENVIRONMENTAL ASSESSMENT CAPACITY OF NATIONAL, BUT ESPECIALLY STATE AND LOCAL, AUTHORITIES AND PRIVATE ENTITIES.

2.4 IMPROVE OPERATIONS AND MAINTENANCE AND COST RECOVERY TECHNOLOGIES SUCH AS COMPUTERIZATION AND LEAK DETECTION.

2.5 ASSIST THE CENTRAL AND STATE GOVERNMENTS IN TARGETING THEIR BUDGETARY SUPPORT TO LOCAL GOVERNMENTS, AND STRENGTHEN THE CAPACITY OF THE NATIONAL INSTITUTE OF URBAN AFFAIRS TO MONITOR AND SUPPORT RESEARCH AND PROVIDE TRAINING IN SUPPORT OF THE NEW DECENTRALIZATION INITIATIVES AND PRIVATIZATION OF MUNICIPAL/INFRASTRUCTURE SERVICES.

- 3. FACILITATE PUBLIC/PRIVATE PARTNERSHIPS FOR URBAN ENVIRONMENTAL INFRASTRUCTURE:

3.1 IMPROVE THE ABILITY OF PRIVATE LAND DEVELOPERS AND STATE/LOCAL AGENCIES TO FORM PUBLIC/PRIVATE PARTNERSHIPS.

3.2 DEVELOP STATE LEVEL PERFORMANCE STANDARDS FOR PRIVATIZATION.

E APPRECIATE YOUR COMMITMENT TO SUCCESSFUL PROJECT MPLEMENTATION AND LOOK FORWARD TO CLOSE COLLABORATION ITH YOU IN THIS IMPORTANT EFFORT.

BEST AVAILABLE

OR SIGNATURE:

Y: WALTER G. BOLLINGER
IRECTOR
SAID/INDIA

CCEPTED AND AGREED AS OF THE DATE FIRST ABOVE WRITTEN:

HE GOVERNMENT OF INDIA, ACTING BY AND THROUGH ITS INISTRY OF FINANCE

Y:
AME
TITLE

TTACHMENT:
NNEX A: TERM SHEET.

7. TERM SHEET
FINANCIAL INSTITUTION REFORM AND EXPANSION
INDIA HOUSING GUARANTY
PROGRAM NO. 386-HG-IV
AUTHORIZATION NO. 386-HG-015

BORROWER: GOVERNMENT OF INDIA

- A. TERMS AND CONDITIONS:

- 1. TERM OF GUARANTY: THE LOANS (INCLUDING ANY REFINANCING THEREOF) SHALL EXTEND FOR A PERIOD OF UP TO THIRTY (30) YEARS FROM THE DATE OF EACH DISBURSEMENT AND MAY INCLUDE A GRACE PERIOD OF UP TO TEN (10) YEARS ON REPAYMENT OF PRINCIPAL AND SUCH OTHER TERMS AND CONDITIONS AS MAY BE AGREED BY THE BORROWER AND THE INVESTOR, SUBJECT TO THE APPROVAL OF A.I.D. THE GUARANTIES OF THE LOANS SHALL EXTEND FOR A PERIOD BEGINNING WITH THE DISBURSEMENT OF THE LOANS AND SHALL CONTINUE UNTIL SUCH TIME AS THE INVESTORS HAVE BEEN PAID IN FULL PURSUANT TO THE TERMS OF THE LOANS.

- 2. INTEREST RATE: THE RATE OR RATES OF INTEREST

YABLE TO THE INVESTORS PURSUANT TO THE LOANS SHALL NOT
CEED THE ALLOWABLE RATE OR RATES OF INTEREST PRESCRIBED
JRSUANT TO SECTION 223(F) OF THE FOREIGN ASSISTANCE ACT
' 1961, AS AMENDED ("FAA"), AND SHALL BE CONSISTENT WITH
E RATES OF INTEREST GENERALLY AVAILABLE FOR SIMILAR
PES OF LOANS MADE IN THE LONG-TERM U.S. CAPITAL MARKETS.

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3. GOVERNMENT OF INDIA INDEMNITY: THE FULL FAITH AND
EDIT OF THE GOVERNMENT OF INDIA SHALL BE PLEDGED TO
DEMNIFY A.I.D. IN U.S. DOLLARS AGAINST ALL LOSSES
ISING BY VIRTUE OF A.I.D.'S GUARANTIES TO THE INVESTORS
FROM NON-PAYMENT OF THE A.I.D. FEE. THE INDEMNITY
LIGATIONS OF THE GOVERNMENT OF INDIA SHALL BE SET FORTH
THE IMPLEMENTATION AGREEMENT.

4. FEE: THE A.I.D. FEE SHALL BE PAYABLE BY THE
RROWER IN U.S. DOLLARS AND SHALL BE EQUAL TO ONE-HALF OF
E PERCENT (1/2 PERCENT) PER ANNUM OF THE OUTSTANDING
JARANTIED AMOUNT OF THE LOANS PLUS A FIXED AMOUNT EQUAL
ONE PERCENT (1 PERCENT) OF THE AMOUNT OF THE LOANS
THORIZED OR ANY PART THEREOF, TO BE PAID AS A.I.D. MAY
TERMINE UPON DISBURSEMENT OF THE LOANS.

5. SELECTION OF INVESTORS: AT A TIME AGREED TO BY
I.D. AND THE BORROWER, A.I.D. WILL PUBLISH AN
NNOUNCEMENT INFORMING INTERESTED AND ELIGIBLE U.S.
NVESTORS, AS DEFINED IN SECTION 238(C) OF THE FAA, OF THE
I.D. AUTHORIZATION AND INVITING SUCH INVESTORS TO
MMUNICATE WITH THE BORROWER DIRECTLY. THE TEXT OF THE
NNOUNCEMENT WILL BE AGREED UPON BY A.I.D. AND THE
ORROWER PRIOR TO ITS PUBLICATION.

- 6. APPROVAL OF INVESTORS: A.I.D.'S CONCURRENCE IN THE SELECTION OF INVESTORS IS NECESSARY PRIOR TO THE BORROWERIS SIGNING A LOAN COMMITMENT. THIS CONCURRENCE WILL BE BASED UPON RECEIPT OF COPIES OF LOAN PROPOSALS, INCLUDING NAME, INTEREST RATE· RELATED FEES, SPECIAL CONDITIONS, AND THE REASONS FOR THE BORROWERIS PROPOSED SELECTION AS WELL AS A COPY OF THE COMMITMENT THE BORROWER PROPOSES TO SIGN.

BEST AVAILABLE

- 7. TERMINATION OF COMMITMENT: A.I.D.'S COMMITMENT TO GUARANTY LOANS TO THE BORROWER IS VALID FOR A PERIOD OF 24 MONTHS FROM THE DATE OF THIS LETTER. SHOULD THE BORROWER FAIL TO EXECUTE A LOAN AGREEMENT WITHIN THAT PERIOD, A.I.D. RESERVES THE RIGHT TO TERMINATE ITS COMMITMENT TO GUARANTY.

- 8. OTHER TERMS AND CONDITIONS: THE GUARANTY SHALL BE SUBJECT TO SUCH OTHER TERMS AND CONDITIONS AS A.I.D. MAY DEEM NECESSARY.

- B. IMPLEMENTATION DOCUMENTS

- 1. IMPLEMENTATION AGREEMENT COVERING THE PROJECT BETWEEN BORROWER AND A.I.D.

- 2. LOAN AGREEMENT (OR EQUIVALENT AGREEMENT) COVERING THE LOAN BETWEEN INVESTORS AND BORROWER.

- 3. A LOAN-ASSOCIATED PAYING AND TRANSFER AGENCY AGREEMENT, BETWEEN THE BORROWER AND THE A.I.D.-APPROVED PAYING AGENT (THE RIGGS NATIONAL BANK OF WASHINGTON, D.C.) TO FACILITATE LOAN SERVICING.

- 4. STANDARD TERMS AND CONDITIONS (CODIFIED AT 22 C.F.R., PART 204) COVERING THE GUARANTY OF THE LOANS BETWEEN THE INVESTORS AND A.I.D.

CHRISTOPHER
BT
#7124

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