Volume I

USAID/INDIA
REFORM PROJECT
COMPENDIUM WITH PRACTITIONERS' GUIDE
To State Fiscal Management Reform

REFORM Project: Overview

Compendium Disclaimer:

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Preface

As a result of the states' own initiatives, central government support as well as implementation of the recommendations of constitutional bodies such as the finance commissions, the fiscal health of Indian states has significantly improved since the mid-2000. In a majority of Indian states, state fiscal deficit is now less than 3 percent of the Gross State Domestic Product, achieving the Twelfth Finance Commission recommendations well before the target date of 2009-10; in many states, revenue deficits have already become revenue surpluses.

With respect to expenditure planning and management, one of the key central government initiatives introduced by the Honorable Finance Minister, Shri P. Chidambaram in 2005, was the Outcome Budget. The objective was to help improve the accountability in the use of public funds by linking budget outlays to program outcomes at the state level also. This was to ensure value for public expenditure and improve citizen satisfaction.

To attain and sustain fiscal stability and a high-growth scenario at the state level, the capacity of state governments to manage their public finances is increasingly being recognized as essential. Indeed, the sustainability and development of any sector of the economy is, to a large extent, determined by how effectively and efficiently funds are mobilized, allocated and utilized. Governments and donors in many countries, despite spending large sums of money, have been limited in their ability to develop successful, sustainable programs due to the inadequacy of fiscal management expertise and infrastructure.

Following the 2000-01 fiscal crisis that challenged the states' ability to insulate their economies against exogenous shocks, the United States Agency for International Development India Mission (USAID/India) designed the India State Fiscal Management Reform project (REFORM). REFORM was developed to strengthen the analytical capacity of state governments to make *"informed"* choices supported by appropriate quality information, databases and best practice tools and techniques.

Initial reports on the impact of the REFORM interventions are welcoming harbingers of the positive gains that can be achieved if there is a serious and sustained effort to re-engineer fiscal management practices based on international practices and standards. For example:

- In Jharkhand, to help improve the quality of expenditures and bring accountability between budget allocations and actual program results on the ground, the state government introduced program and performance budgeting (PPB) in 2005. Since then, 39 of its 42 ministerial departments have developed PPB documents, covering more than 95 percent of the state budget. Realizing the benefits of this methodology, the state is extending PPB to all 24 district health resource centers. Already, visible improvements are being seen in expenditure planning and management. The Directorate of Irrigation Revenue in Department of Water Resources had been spending almost 10 times more on staff salary than was being collected in terms of water charges for irrigation. This finding, discovered with the aid of PPB methodology, led the Government of Jharkhand to begin the process of dissolving the Directorate of Irrigation Revenue and transferring collection responsibility to the Water Users Association. The application of the PPB methodology, therefore, helped not only to expose hidden inefficiencies and redistribute resources more efficiently, but also helped to promote Public-Private Partnerships.

- One key institutional structure promoted under REFORM was a Fiscal Policy and Analysis Cell (FPAC) at the state level. An analytical unit supported by a team of dedicated trained staff, with access to relevant quality data, tools and techniques, would institutionalize a culture/practice of continuous analysis of the implications of policy, procedural and regulatory decisions on the fiscal health of the state. In Karnataka, the establishment of the FPAC has catalyzed the state government to establish a Fiscal Policy Institute (FPI) that will serve as the nodal agency for all fiscal-related research, training, and policy advice. The FPI, when finally established, will have 52 posts. The Director for the FPI has already been identified and appointed by the state government. The staff recruited for the FPAC will constitute the initial core analysts for the FPI. To date, the FPAC has already been commissioned to undertake 11 studies.
- In Uttarakhand, a systemic correction has been instituted with respect to appraisal and selection of large capital projects. A State Government Circular issued in June 2007 mandates the application of the Harberger project appraisal methodology introduced by REFORM. This rigorous, comprehensive, and structured project appraisal methodology will be applied for all projects valued at more than INR 5 crores before the projects can be considered by a high-level Expenditure Finance Committee (EFC) chaired by the Principal Finance Secretary. In 2007-08, this enabled the Government of Uttarakhand to filter out 11 unviable projects valued at INR 25 crores from a total of 35 project proposals received
- Across all three REFORM partner states, Jharkhand, Karnataka, and Uttarakhand, REFORM helped introduce the *Commonwealth Secretariat Debt Recording and Management System (CS-DRMS)* software to strengthen state government capacity in debt and contingent liability management. This has given all three states the distinction of being among the first sub-national governments anywhere in the world to implement the software for debt and guarantees reporting. The states already are beginning to use the software to schedule and report on their public debt.
- To help promote and sustain the new practices, states like Jharkhand, have incorporated the fiscal management training programs developed under REFORM into their state civil servant training institute, the Shri Krishna Institute for Public Administration (SKIPA) to train entry-level and mid-career officers.

USAID/India has been extremely fortunate to have been able to work with three very forward-looking state governments. The leadership in these states has been true advocates and champions of fiscal management reform. They assumed complete ownership and provided critical direction to help begin the foundations of a solid fiscal management infrastructure in their respective states. Without their strong and sustained support, the REFORM project would not have been able to attain the results achieved.

To help the REFORM partner states to further promote the new practices, REFORM has compiled a compendium, containing relatively detailed guidelines for improving expenditure planning and management, revenue management, debt and investment management, and project appraisal. The compendium also includes the experiences of the REFORM partner states in implementing the program, which has been comprehensive in its approach and in most part, not previously undertaken at the Indian state level.

Another key product of REFORM has been the design and launch of a virtual resource center, "Fiscal Watch". This is a dedicated site to promote greater thinking, collaboration, discussions, best practices and, information exchange and current data on fiscal policy and management. The key feature of "Fiscal Watch" is the dedicated discussion forums to facilitate interaction between fiscal practitioners, both Indian and international (*e.g.*, to provide a platform for finance secretaries, budget officers, revenue officials, and researchers). In addition, there are numerous hyperlinks to related online resources such as government Web sites, professional societies, consultancy opportunities, and training and education providers.

We hope both the compendium and the "Fiscal Watch" virtual resource center, would enthuse the professional practitioners to adopt best practices and find solutions in their daily work. In addition, it is also hoped that these two tools will enable and encourage them to establish virtual professional communities across borders both within India as well as globally.

Although the REFORM project is coming to closure, considering the continued enthusiasm of each state government, the GoI support, and the interest of other stakeholders in addition to the capacity already enhanced in the three partner states, we are confident that each state is well-positioned to sustain and further improve their fiscal management reforms.

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Foreword

Since finances that deteriorated in late 90s, have seen a remarkable turnaround after a decade. The Fiscal Reform Facility of the 11th Finance Commission under which States signed Memoranda of Understanding (MoU) with the Government of India for undertaking fiscal reforms aimed at elimination of revenue deficit by 25 percent during the award period was only a partial success. However, carrying forward the process of fiscal reforms, barring two States, all other States have enacted fiscal responsibility legislation for eliminate revenue deficit and containing fiscal deficit to 3 percent of GSDP by end of FY 09.

2. The 12th Finance Commission's recommendations for a Debt Consolidation Relief Facility (DCRF) along with a Fiscal Restructuring Plan aimed at reducing the combined fiscal deficit to 6 percent GDP by FY 09, to a large extent facilitated significant improvement in the fiscal health of the States. Barring three States, all others have emerged revenue surplus and at the aggregate level, States' fiscal deficit is now less than 2.5 percent of the GDP.

3. The secular growth of the economy in the last four years have contributed to higher tax buoyancy and higher devolution from the Centre to the States as well as higher realization of States' own tax revenues. While the revenue deficit correction had been largely revenue driven, expenditure rationalization and contraction has not made significant headway. Though the States appear to be on a fiscal consolidation path, the fiscal stabilization could still require sustained efforts over a medium-term.

4. At the State level, there is still inadequate capacity for managing public finances which constrains the implementation of sustainable programs as well as the conversion of fiscal intent into fiscal output, outlays into outcomes.

5. In the aftermath of the fiscal crisis in 2000-01, USAID was associated with Department of Expenditure in designing the India State Management Programme Project (REFORM) aimed at strengthening the analytical capacity of selected States to make fiscally prudent choices supported by appropriate information systems, data base templates and public finance management tools.

6. The REFORM project was taken up a Jharkhand, Uttarakhand and Karnataka. The preliminary report of the impact of REFORM intervention indicate that there can be significant fiscal gains through sustained policy design and efforts in restructuring fiscal management practices.

7. The REFORM project focused on the four pillars on fiscal management viz., Revenue enhancement, Expenditure management, Project appraisal and Debt and Investment Management. The project also enabled setting up of training institutes at the State level on Fiscal Management and in establishment of a Fiscal Policy and Analysis Cell in the State Finance Departments. As the REFORM project was in progress in the three States, D/o Expenditure in association with Commonwealth Secretariat facilitated the introduction of Commonwealth Secretariat Debt Recording Management system (Capital CS-DRMS).

8. As the REFORM project comes to a close, the best practices based on the experience in the three State have been compiled as a compendium giving detailed guidelines for improving expenditure planning and management, revenue management, debt and investment management and project appraisal. This Compendium provides four critical Toolkits for fiscal management at the State level—Expenditure Planning and Management Toolkit, the Revenue Forecasting and Management Toolkit, the Project Appraisal Toolkit, and the Debt/Contingent Liability/Investment & State Creditworthiness Toolkit. The compendium also includes the experiences of the three states in implementing the program of a size not undertaking before at the Sub-national level.

9 I am certain that this compendium would be of immense use to the three States which were part of the project and for all the other States in carrying forward the process of capacity building to sustain and further improve their fiscal management.

13/10/08.

Rita Menon
Special Secretary (Expenditure)
13.10.2008

Acknowledgments

It is with great pleasure that we acknowledge below a very impressive team of technical experts and advisers who helped bring the USAID REFORM project to a reality and subsequently to a successful conclusion.

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The true owners and architects of REFORM, however, must remain the state governments, namely the Principal Finance Secretaries and their officers in the Department of Finance in the three REFORM Partner States of Jharkhand, Karnataka and Uttarakhand. Our gratitude and thanks especially go to: Mrs. Rajbala Verma, Finance Secretary, Government of Jharkhand and her predecessors Mr. Mukhtiar Singh and Mr. Rahul Sarin and their officers; Mr. Sreenivasa Murthy, Principal Finance Secretary, and Mr. Ajay Seth, Secretary Budget and Resources, Government of Karnataka and his predecessors Mr. Yogendra Tripathi, Dr. S. Subramanya, Mr. Gurucharan, and Mr. Kuntiya and their officers; and Mr. Alok Jain, Principal Finance Secretary, Government of Uttarakhand and his predecessor Mr. Indu Kumar Pande and their officers. Without the state governments' cooperation, guidance and subsequent ownership of the REFORM implementation process and its institutionalization, it would not be possible to introduce, mainstream and sustain this endeavor. Further, we would be remiss if we did not include in our acknowledgment officials from the Planning Departments, other state administrative departments, and the state Administrative Training Institutes and the Institutes for Rural Development. It has truly been a pleasure to work with the three REFORM partner states.

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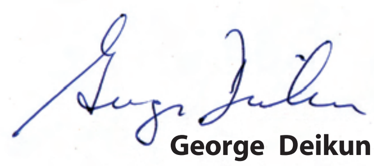

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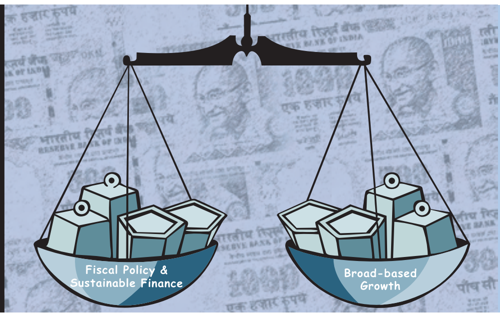
List of Abbreviations

BE	Budget Estimate
CAG	Comptroller and Auditor General
CFS	Centre for Fiscal Studies
CS	Commonwealth Secretariat
CS-DRMS	Debt Recording and Management System (CS-DRMS)
CSO	Central Statistical Organisation
DCID	Duke Center for International Development
DCRF	Debt Consolidation Relief Facility
DE	Development Expenditure
DG	Director General
DIMC	Debt and Investment Management Cell
DoF	Department of Finance
DRMS	Debt Recording and Management System
EFC	Eleventh Finance Commission
FCP	Fiscal Correction Path
FD	Fiscal Deficit
FMIS	Financial Management Information System
FPAC	Fiscal Planning and Analysis Cell
FPC	Fiscal Policy Correction
FRBM	Fiscal Responsibility and Management Act
FRL	Fiscal Responsibility Legislation
FY	Fiscal Year
GDP	Gross Domestic Product
GFD	Gross Fiscal Deficit
GSDP	Gross State Domestic Product
GO	Government Order
GoB	Government of Bihar
GoI	Government of India
GoJ	Government of Jharkhand
GRF	Guarantee Redemption Fund
GST	Goods and Services Tax
IAS	Indian Administrative Service
ICAI	Institute of Chartered Accountants of India
INR	Indian Rupees
IO	Input-Output
IPHS	Indian Public Health Standards
JH	Jharkhand
JPSC	Jharkhand Public Services Commission
KAP	Knowledge, Attitudes, and Practices
MTFRP	Medium Term Fiscal Reform Program
MIS	Management Information System
MoF	Ministry of Finance
MoH	Ministry of Health
MoU	Memorandum of Understanding
MS	Microsoft
MTFF	Medium Term Fiscal Framework
NABARD	National Bank for Agriculture and Rural Development
NCAER	National Council of Applied Economic Research
NGOs	Nongovernmental Organizations
NIC	National Information Center
NIFM	National Institute of Financial Management
NRHM	National Rural Health Mission
PA	Project Appraisal
PD	Primary Deficit
PFAD	Project Formulation and Appraisal Division
PHC	Primary Health Centre
PIP	Program Implementation Plan
PPB	Program and Performance Budgeting
PPPs	Public-Private Partnerships
PRI	Panchayati Raj Institutions
PU	Project Unit
RBI	Reserve Bank of India
RD	Revenue Deficit
RE	Revised Estimate
REFORM	India State Fiscal Management Reform Project
RFP	Request for Proposal
SAG	State Accountant General
SC	Subcentre
SCS	Special Category State
SIRD	State Institute of Rural Development
SKIPA	Sri Krishna Institute of Public Administration
SOE	State Owned Enterprise
SoW	Statement of Work
TA	Technical Assistance
TARF	Tax and Revenue Forecasting
TD	Tender Documents
TFC	Twelfth (XII) Finance Commission
ToR	Terms of Reference
USAID	United States Agency for International Development
VAT	Value Added Tax
WB	World Bank



Section I

REFORM Project: Approach, Impact and Lessons Learned

REFORM Project: Approach, Impact and Lessons Learned

Madhumita Gupta, USAID/India

Part 1: Introduction

The REFORM Vision ......

"State governments have the necessary organizational structures, analytical tools, decision-making processes, information sources and trained staff to enable them to make better informed choices on a transparent and accountable basis with respect to state public finances. Subsequently, this capacity is institutionalized into the mainstream of state government practices to ensure the sustainability of the effort."

Lately, discussions have turned toward "broad-based (inclusive) growth" to bring India's 700 million into the mainstream of socioeconomic activities, the millions who currently survive on less than two dollars a day. The critical role of India's public finance to fuel this inclusive growth process is well recognized and accepted. While the necessary policies and regulations are in place to guide the mobilization, allocation and utilization of public funds, their effectiveness, especially in the delivery of services to its citizens, is somewhat hindered by dated administrative and fiscal practices.

Effective administration of public funds and delivery of services are largely guided by institutionalized best practices, especially fiscal management tools, techniques, systems, and expertise. These management practices must be dynamic, they must stay abreast of the changing need, and protected from arbitrary and populist decision-making. They must also be sufficiently transparent to promote the accountability required to deliver meaningful results.

In 2003-04, the United States Agency for International Development (USAID)/India Fiscal Management Reform Project (REFORM), presented an agenda for equipping Indian state governments with the necessary fiscal management tools, techniques, systems and expertise to help states make forward-looking fiscal decisions, grounded in careful analysis and leading to good governance. This was and remains important, especially in light of the emerging challenges that Indian states will face with the gradual opening up of the Indian economy and with the state finances being increasingly linked to market forces, making the REFORM project interventions complimentary and relevant to all fiscal reform endeavors. Indeed, this was the first time such a comprehensive effort was undertaken at the state level to strengthen fiscal management practices, efforts that would also help to improve the quality of service delivery to India's citizens.

Part 2: A Fiscal Overview

Significance of Public Finance in India: In India, public finance has played and continues to play a critical role in the economic and social development of the country. Its effective allocation and utilization affect all, but more so the poor, the marginalized and the disenfranchised who are dependent on public services, public investments, and public programs. Deprivation of basic amenities and social services to this segment of the population (which makes up for almost 60-70 percent of India's 1.1 billion) tends to widen the gap between the haves and have-nots. The lack of opportunities that result from the absence of such socioeconomic interventions has affected the social fabric of the country and calls for a wider inclusive growth strategy.

Importance of State Governments in India's Development: Under the Indian Constitution, Indian states have predetermined, exclusive jurisdiction in certain sectors, including public health, education, water supply and sanitation, roads and bridges (except national highways), minor ports, agriculture, power, irrigation, and urban services. The Concurrent List under the Indian Constitution lists those sectors where the responsibilities are shared by the Union and State governments. Successful implementation of any socioeconomic project calls for active cooperation from the concerned state governments. Even the recently launched central government Mission Mode projects are dependent upon the supply of physical and human resources provided by the states. Similarly, to attract private sector investments, the state governments have to extend developed physical resources and a healthy educated workforce. States' management of public resources also affects private sector's ability to invest in development programs; poor fiscal management, manifested in heavy state borrowing, has the potential to crowd out the private sector's ability to raise funds from the market.

In the context of the continued significance of public finance in India and the important developmental role state governments play, the ability of state fiscal managers to strike the *right balance between fiscal policy, broad-based growth, and financial sustainability* will be critical for promoting and sustaining balanced and inclusive growth.

What's Wrong with Fiscal Deficits? In 2000-01, the combined fiscal deficit of the centre and the states stood at 9.2 percent of its GDP (showing very little improvement over the 1991-92 level); Indian states continued to contribute slightly less than 50 percent to this deficit. Likewise, the combined revenue deficit climbed to 6.5 percent, an increase of 2.3 percentage points over the 1991-92 levels. Indian states accounted for 40 percent of this deficit. While there is a strong case to be made in favor of fiscal deficit if the expenditures are incurred to create productive assets that lead to a future stream of economic returns, there is an equally strong case to be made against fiscal deficit if the expenditures are incurred to meet current expenditure. In the past 15 years, India's fiscal deficit has primarily been the result of high expenditures on wages and salaries, pensions, subsidies, and interest payments on debt (*i.e.*, "revenue" expenditures). This was indicative of poor fiscal management.

Poor Fiscal Management—A Threat to India's Development Agenda: Despite continuing high fiscal deficits endangering development, the state governments failed to modernize fiscal management systems and structures to enable them to make informed fiscal choices on a consistent, transparent and accountable manner. Populist and discretionary expenditure decisions continued to be made hindering developmental investment. Investments in social services and physical infrastructure have become the major victims of the fiscal indiscipline. The budget deficits have been met either by capping developmental expenditure or resorting to increased market borrowings. Increased market borrowings by state governments, especially in situations of tight liquidity, can crowd out private sector investment programs. To camouflage such unsustainable direct (on-budget) borrowings, the state governments increasingly began to float Special Purpose Vehicles (SPVs) to raise funds, which resulted in increased state government guarantees. Of late, this has been considerably controlled by bringing them into the ambit of Article 293 (3) of the

Indian Constitution, limiting the permissible level of guarantees based on a number of criteria. (Please see *Volume IV, The Debt & Investment Management Practitioners' Guide* for further details on state borrowing.)

Fiscal Situation at the turn of the Millennium—The deterioration in the fiscal situation of the states in the latter half of the nineties, (ending in a fiscal crisis in 2000-01) was, in fact, more acute than what would appear from the aggregate deficit figures. The number of states with a revenue deficit-to-GSDP ratio of over 3 percent went from one state in 1990-91 to 14 in 1998-99, with at least two states registering a revenue deficit of over 7 percent. (Please see *Volume VI Invited Papers* for paper by A. Maitra.) By 2000-01, all Indian states, without exception, were in fiscal distress, with fiscal deficits-to-GSDP ratio ranging from 21.2 percent (Mizoram) to 3.6 percent (Tamil Nadu). On average, the percentage of revenue expenditure to revenue receipts ratio for Indian states registered 123 percent, implying that for every rupee of revenue earned, 123 paise was going toward payment of recurring expenditures, leaving no room for investments in new social and physical infrastructure development. In fact, the gap of 23 paise needed to be filled. The gap-filling, or fiscal dentistry as it is sometimes termed, was done through borrowing, resulting in high debt-to-GDP ratio of 22 percent in 1991-92 that rose to 27 percent in 2000-01 for Indian states. Indian states debt servicing (interest payment-to-GDP) rose from 1.7 percent to 2.5 percent over the same period. This situation was neither tenable nor conducive to sustain broad-based growth.

Recovery in the First Decade—but is it Sustainable? Sustained high growth of the Indian economy in the recent past (averaging around 7 percent and one of the highest in the world) has helped to raise revenue buoyancy and considerably reduce the fiscal distress through higher central transfers and higher local tax collections (including VAT) at the state level. Measures like debt swaps and debt consolidations and relief facility have led the state finances to a fiscal correction path. *However, there has been limited progress with respect to improving the quality of expenditure and its management at the state level.* Fiscal experts believe that the improved situation of state finances is more because of revenue buoyancy as opposed to expenditure compression at the state level. In addition to inadequate expenditure compression, the states have also not attempted to improve the quality of expenditures (*i.e.*, the productivity of each rupee spent). In most state departments, large percentages of funds lie unutilized for the first nine months of the fiscal year, only to be spent with less than adequate scrutiny in the last three months.

The current global financial crisis sends a strong signal that economic growth can be negatively affected, reducing the overall revenue buoyancy. Rising interest rates, a fallout of current inflationary pressure, will push debt service costs up. Quality expenditure management is yet to be achieved by the majority of Indian states. In other words, the current improving fiscal scenario at the state level can significantly change. Even if India manages to ride out the current global financial crisis, the gradual move while moving toward greater globalization and an open economy, will introduce emerging exogenous factors that will have to be increasingly tackled at the state level. Equipping Indian states with international best practice fiscal management tools and techniques will help states to better manage their public funds for broad-based "inclusive" growth under this emerging scenario.

Part 3: The Challenge

Thus, the starting point of the USAID/India Fiscal Management Reform Project (REFORM) is that the fiscal distress seen at the state level in early 2000 was, to a large extent, a result of the systemic weaknesses in state fiscal management (Box 1), including in the key departments of finance and planning. This prevented forward-looking fiscal decision-making grounded in careful analysis and leading to good governance. In short, the majority of Indian states needed better analytical capacity backed by appropriate institutional infrastructure to formulate and implement good fiscal policy.

Box 1: Systemic Weaknesses in Fiscal Management

The systemic weaknesses found in fiscal management at the state level may be described as "inadequate":

- Technical know-how in modern fiscal management practices.
- Comprehensive, current information databases.
- Robust analytical tools/techniques that correspond to internationally accepted standards.
- Integrated management information systems and systematic approaches to the fiscal decision-making processes.
- Transparent, consistent and institutionalized fiscal practices, reporting systems, and structures that promote the desired accountability for the effective and efficient mobilization, allocation and utilization of public funds.

Adoption of the central planning model and fuzzy borders with respect to fiscal authority (*e.g.,* lack of balance between revenue raising and expenditure authority and the Concurrent List of responsibilities) did not allow enough room for most of the states to come into full play. As a consequence, many Indian states do not have the *appropriate capacity*[1] and the *necessary practices,*[2] including recognized local institutions to perform relevant, economic and statistical analyses (Box 2).

Part 4: The Objective

As a response, USAID/India's REFORM Project (October 2003 to October 2008) was designed and developed to provide practical hands-on "how to" skills transferal, based on international best practices, to strengthen fiscal analytical expertise, structures and systems of selected Indian states. The objective was to help these states to better plan and manage their public finances, especially in the light of the challenges they faced following the 2000-01 fiscal crisis. Jharkhand, Karnataka, and Uttarakhand were identified as the three REFORM partner states.

[1] This is defined as fiscal management skill-sets, tools and techniques and organizational structures.
[2] This is defined as consistent, transparent and accountable processes.

Box 2: Consequence of Systemic Weaknesses in Fiscal Management

As a consequence of the systemic weaknesses, most Indian states, for example, have inadequate fiscal management expertise and institutional infrastructure to perform revenue and expenditure projections and distributional analysis, assess multiplier and elasticity effects, and run policy simulation and develop alternative policy scenarios. This includes their inability to establish strong links between budgetary outlays and program outcomes for efficient and effective delivery of results, establish debt and investment frameworks to improve their quality and profile, and conduct rigorous project appraisals to ensure selection of socioeconomically viable projects.

The specific objectives of REFORM were:

- To improve "informed" decision-making within state (sub-national) governments.
- To ensure that decision-making processes followed consistent and transparent principles, leading to greater accountability.
- To sustain the efforts by institutionalizing and mainstreaming the capacity built.

> *REFORM, therefore, was not designed to advise or guide Indian state governments on specific policy decisions but rather to enhance their ability to evaluate and to address crucial policy choices and implementation options, based on an understanding of the environment—i.e., its potentials, its limits and its perceived needs.*[3]

The following gaps were jointly identified by the three REFORM partner state governments, Jharkhand, Karnataka, and Uttarakhand, as the key binding constraints to improving the "informed" decision-making and implementation processes:

- *Revenue Management*—Limited analysis of fiscal policy choices leading to poor fiscal policy decision-making; absence of a dedicated unit to serve as the nodal fiscal reform agency and think tank; inability to forecast tax revenues accurately, preventing good budget planning; lack of attempt to match actual revenues with planning expenditures; and, no analysis of tax policy options in relation to tax implementation issues.
- *Expenditure Planning and Management*—Focus on line-item budgets; a single year horizon; no linkage between outlays and outcomes; inadequate analytical capacity; and, segregated Plan and Nonplan budgets.
- *Debt and Investment Management*—Disparate responsibilities between Finance, State Accountant Generals, Reserve Bank of India; absence of a dedicated unit responsible for reporting and management;

[3] Capacity-building as defined by the United Nations Center for Education and Development (Agenda 21's definition, Chapter 37, UNCED, 1992).

no consolidated datasets or databases; antiquated or absence of reporting templates; and, lack of protocol processes for portfolio management.

- *Project Appraisal*—Continued reliance on ad hoc decision-making on capital expenditures; projects failing to meet their objectives; projects causing serious political tumult; new project proposals submitted without any financial, economic or stakeholder analysis; and, planning and line departments without adequate capacity and the skills to conduct robust project analyses.

Part 5: Terms of Reference

Based on the gaps identified above, the following terms of reference were jointly developed with the three REFORM partner states:

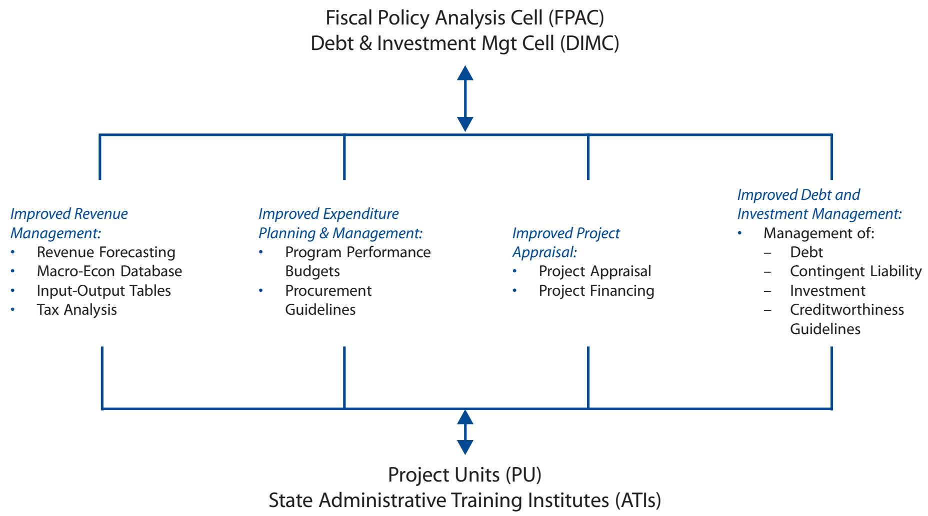
- *Revenue Management Capacity*—To help states undertake detailed analysis of revenue projections and the implications of alternative tax policies and revenue choices. Interventions included: Introduction of improved revenue forecasting methodologies, an Input-Output (I-O) framework and macroeconomic database. A practitioners' guide was also developed along with hands-on training to build state capacity in the above areas. (Please see *Volume III The Revenue Management Practitioners' Guide* for further details on this REFORM Project intervention.)
- *Expenditure Planning and Management Capacity*—To help states improve quality and accountability of expenditures. Interventions included: Introduction of an outlay to outcomes budgeting methodology (*i.e.*, program performance budgeting (PPB)) to help states' prioritize the allocation of public funds, improve program planning, monitoring and evaluation, increase transparency, accountability, and consequently, the quality of public services delivery. A practitioners' guide with related software was developed and delivered. Structured/hands-on training was provided across all levels and in almost all departments. Detailed public procurement guidelines were also developed for two out of the three states. (Please see *Volume II The Expenditure Planning & Management Practitioners' Guide* for further details on this REFORM Project intervention.)
- *Debt and Investment Management Capacity*—To help states to better document, track, analyze, and manage debt, contingent liabilities and investments, in the medium to long term. Interventions included structured and hands-on training as well as introduction of practical guides (with reporting templates). Comprehensive debt datasets were developed and migrated into a database using the *Commonwealth Secretariat-Debt Recording and Management System (CS-DRMS)* software. (Please see *Volume IV The Debt & Investment Management Practitioners' Guide* for further details on this REFORM Project intervention.)
- *Project Appraisal Capacity*—To help states improve appraisal and selection of socioeconomically viable capital projects. Interventions included: Training in the Harberger project appraisal technique which involves financial, economic, social and stakeholders' risks analysis. A Project Appraisal practitioners' guide with sector-specific guidelines was also developed and introduced to serve as a desk reference. (Please see *Volume V The Project Appraisal Practitioners' Guide* for further details on this REFORM Project intervention.)

To sustain and mainstream the above fiscal management reform efforts, four (4) institutional structures were designed and supported:

- *The Fiscal Policy Analysis Cell (FPAC)*—To help states institutionalize continuous analysis of the implications of policies, procedures and regulatory decisions on the fiscal health of the states. An analytic unit supported by a team of dedicated and trained staff, with access to relevant and quality data, tools and techniques was established. (Please see *Annexure 5 The Fiscal Policy Analysis Cell Implementation Guidebook* for further details.)
- *The Debt and Investment Management Cell (DIMC)*—To help states identify, generate, and analyze data and support more effective and prudent debt/investment decision-making. Similar to the FPAC, an analytic unit supported by a team of dedicated and trained staff, with access to relevant and quality data, tools and techniques was established.
- *Project Unit (PU)*—To help states offer a comprehensive range of services from project appraisal and monitoring, to final end-of-project evaluation, a project unit was designed that would also help promote public-private partnerships (PPPs).
- *Administrative Training Institutes (ATIs) and State Institutes for Rural Development (SIRDs)*—To help state civil service training institutes (ATIs and SIRDs) train entry level and mid-career state civil servants in fiscal planning and management, training courses; training materials and reference guides were developed and provided.

The REFORM project may therefore be considered as *four-by-four* (4x4), consisting of four intervention areas (expenditure, revenue, project appraisal, and debt and investment management) supported by four institutional structures (FPAC, DIMC, PUs, and ATIs/SIRDs).

REFORM: Four-by-four



Rationale for Selection of the REFORM Partner States

There was early recognition that given their distinct initial conditions (*i.e.,* socioeconomic profiles, needs and the level of absorptive capacity), no single approach will work for all states in India. States with difficult or weak initial conditions will require a different approach (*e.g.,* more mentoring, more on-the-job training, including occasional tutoring on basic economic and statistical principals). With this in mind, the three REFORM partner states of Jharkhand, Karnataka and Uttarakhand were jointly selected with the Government of India (GoI) to pilot test their absorptive capacity for adopting improved fiscal management practices. Geographically, Jharkhand, Karnataka and Uttarakhand represented the East, South and North of India with a combined population of almost 10 percent of India's total and almost equal in size to that of Mexico. (Please see *Section II Parts 1, 2 and 3* for the REFORM State Case Studies.)

Jharkhand represented a newly formed state.[4] Although many of the social indicators were quite poor, the state did enjoy many economic advantages. There were and continues to be very valuable mineral deposits, particularly coal and iron, and a very active steel industry. Despite these advantages, there are high rates of illiteracy and low per capita income. At the inception of the project, Jharkhand had a revenue surplus as a percentage of GSDP of 1.5 percent in 2003-04 and a fiscal surplus of 6.45 percent over the same period, principally due to royalty payments from mining of mineral deposits and with a strong potential to attract large investments into the state. The challenge to Jharkhand was to manage its investments well and address the infrastructure backlog and improve social indicators.

Uttarakhand was another newly formed state.[5] Uttarakhand came in as a revenue deficit state with a revenue deficit as a percentage of GSDP of 2.45 percent and a fiscal deficit of 4.76 percent in 2002-03. Uttarakhand's revenue generating potential lay in production of hydroelectricity, horticulture/floriculture and tourism (high-end as against pilgrims, who take relatively more out of an economy than they put in). However, all three of the revenue-generating areas would first require heavy investments in infrastructure before they could begin to give returns. Therefore, Uttarakhand's fiscal management needs differed considerably from Jharkhand's as reflected in their respective prioritization of REFORM interventions. While Uttarakhand focused on expenditure management, Jharkhand focused on revenue management. Given the weak initial conditions in Uttarakhand, it was anticipated to be the most challenging of the three states to demonstrate initial results.

In keeping with the general trend in state finances, fiscal developments in Karnataka clearly pointed toward a steady deterioration. During the last decade, while the revenue receipts of the state government, on an average, increased at a rate of 14.1 percent per year, the revenue expenditures showed a higher rate of growth of 15.7 percent. Karnataka, however, had the advantage of being one of the World Bank partner states in 2003-04 and, therefore, already well acquainted in addressing fiscal restructuring issues. Consequently, Karnataka was expected to have a high absorptive capacity with respect to fiscal reforms. Its socioeconomic indicators also started at a much higher base at the inception of the project than other states. Karnataka's population below the poverty line was only 25 percent and almost 100 percent of its villages were electrified and with a ratio of around 31,000:1 population per healthcare centers. In contrast,

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[4] Jharkhand became the 28th state of India on November 14, 2000.

[5] Uttarakhand became the 27th state of India on November 9, 2000.

around 44 percent of Jharkhand's population lived below the poverty line (almost double the national average of 26 percent) and only 45 percent of its villages were electrified and with a ratio of around 53,000:1 population per healthcare center.

REFORM Project Implementation Approach

In order to ensure quality and timely implementation of REFORM activities:

First, a series of performance tracking matrices were developed in consultation with all three partner state governments. These matrices contained key sequential steps toward achieving the final, desired result in each of the above intervention areas. (See Box 3 for a description of the project performance tracking matrices used.)

Second, REFORM project offices were established in each of the three respective partner states to coordinate and facilitate the technical assistance and training provided under the project.

Third, a team of international experts were fielded to transfer international best practices to the three respective REFORM partner state governments.

Box 3: Results Framework Methodology

At the inception of REFORM, to help track project progress, a detailed Results Framework was developed, shared with the three REFORM-assisted state governments and finally discussed with the Ministry of Finance, Government of India. This framework was subsequently used in all major project reviews with central and state governments. The objective was to construct a results tracking mechanism that could be easily understood and would require the minimum time to input data on a regular basis. Based on these requirements, a two-page Results Framework (illustrated below) were prepared for each of the five intervention areas.

Item	**Description**
End of Project Result to be achieved	Program Performance Budget (PPB) Introduced & Capacity Built in its Construction, Application and Reporting
Gaps to be addressed in current expenditure management	Current budget preparations focuses on expenditure controls, physical targets, short-term (one-year) time horizon and fails to adequately insulate against discretionary decision-making
The tools, techniques and systems introduced will enhance state government capacity to:	• Implement budgets based on longer-term achievements of objectives/goals • Prioritize fund allocation based on greater quantitative and qualitative performance and not just on disbursement rates • Better budget monitoring through greater interactions and ties between the budget making (finance) and budget requesting (e.g , health) departments • Improve transparency and accountability
Achievements of project results to date and current operational issues	State Govt now has 309 trained officers in PPB; manuals to help develop PPB; 25% of its depts covered by PPBs, etc.; Due to delayed FPAC formation, regular reporting not possible

Box 3: Results Framework Methodology (Contd.)

No.	Indicator: Steps Required to Achieve Desired Results	Quarters (Three monthly)					Verification Document
		Q1	Q2	Q3	….	Q20	
1	REFORM PPB implementation proposal accepted by state govt	1					REFORM Inception report
2	Staff to be trained identified by state govt		0	1			Govt Order with list of participants
3	Training of pilot departmental (dept) staff initiated			1			Training program design/ training material
4	Initial outcome and output indicators identified by pilot depts						Outcome/output indicators for pilot depts
5	PPB Training manual developed & submitted to state govts						PPB training manual
6	Draft PPB prepared by pilot depts						Draft PPB pages for pilot depts
7	Institutionalization of PPB through issuance of annual state budget circulars instructing depts to prepare PPBs, starting in FY 2006-07						Budget circular
8	At least two pilot departments in each state prepare PPB budget for 2006-07 and submit to Legislative Assembly (LA)				0		Minutes of the meeting of state government
9	PPB extended to additional state depts to ensure that at least 33% of the 2007-08 state expenditure is covered by PPB						Final departmental PPBs covering 33% + of budgeted expenditure for 2007-08
10	PPB in use				0		FPAC conducted analysis using PPB doc
11	PPB extended to district level?					1	District-level PPB documents
	Out of a total score of 11, REFORM achieved "X" to date	**1**		**2**		**1**	

Since the objective of REFORM was *capacity strengthening*, the "process" to achieving the desired capacity became very important. To accomplish this, sequential steps toward achieving the desired results were established. They were tracked over 20 quarters (three-monthly time periods) over the life of REFORM (five years). The maximum score that could be achieved was reflected by the total number of steps. A simple binary method was used which gave equal weight to all the steps. If and when a step was achieved, a "one" would be assigned—marked against the Quarter in which it was achieved. For steps not achieved, a "zero" was assigned against the Quarter should have been achieved. (Please see *Annexure 1* for a report on REFORM Project performance in relation to the four (4) key performance indicators.)

Part 6: Impact Analysis

The success of the REFORM project in meeting its objectives is evaluated in terms of the KAP (***Knowledge, Attitudes,* and *Practices***) concept. REFORM was not designed to advise or guide Indian state governments on specific policy decisions but rather to enhance their ability to evaluate and to address crucial policy choices and implementation options, based on an understanding of the environment—*i.e.*, its potentials, its limits and its perceived needs. While the KAP concept was considered relevant and appropriate for this evaluation, it was not considered necessary, in this context, to adopt its usual survey methodology. Since it was particularly important to capture the efficiencies, effectiveness and the accountabilities beginning to emerge from the REFORM initiative, ***Impact*** was added to KAP, transforming the construct to *KAP-I*:

- ***K**nowledge Transferred*: This is defined as skill-sets enhanced through international best practices. It includes training provided, manuals developed, databases established, and reporting templates designed and introduced.
- ***A**ttitudes Changed*: This is defined as the acceptance of the need for reform, understanding the changed methodology and a willingness to practice it. It includes cabinet decisions/approvals, government orders and circulars issued, notifications released, curricula introduced, commissioning of studies/analysis, and allocation of resources (funds, staff, and physical facilities) by the state governments.
- ***P**ractices Introduced*: This is defined as actual application of the new practices. For example, this includes the selection of projects based on new project appraisal techniques, training programs conducted based on international best practice curricula, development of departmental budgets based on PPB methodology, debt scheduling facilitated by use of internationally accepted software, etc.
- ***I**mpact*: This is defined as the translation of the new practices into efficiency gains, improved effectiveness and increased accountability in the mobilization, allocation and use of public funds—such as savings accrued, unviable projects filtered out, quality of expenditures improved.

All four of the REFORM interventions areas have been evaluated in terms of the above construct. Early results of the REFORM initiative from Jharkhand, Karnataka and Uttarakhand are encouraging harbingers of what can be achieved from such capacity strengthening efforts. (Please see *Annexure 2* for a report on REFORM Project performance in relation to KAPI.)

Expenditure Planning and Management

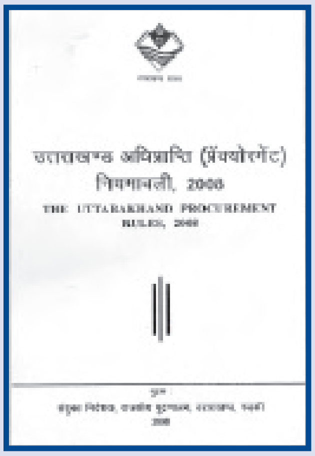
The most successful REFORM intervention across all three states has been the introduction and implementation of the PPB methodology. It clearly signals the desire as well as the priority each of the three REFORM partner states place on establishing a strong link between public funds budgeted and results expected—to help improve accountability of each rupee invested; it was listed as number one by GoK and GoU and as number two by GoJ. Procurement modernization in Karnataka and Uttarakhand further strengthened efforts to improve the quality of expenditures.

The following are some of the key REFORM achievements under Expenditure Planning and Management:

- *Knowledge transferred*: The three states combined, now have 670 officers, trained in the PPB methodology (300 in Jharkhand, 220 in Karnataka and 150 in Uttarakhand) through a series of orientation/sensitization workshops aimed at senior bureaucrats and, structured training and on-the-job mentoring for officials responsible for developing PPBs; in total, over 183 such programs were held over five years. The states also have a PPB implementation/training guide, a pool of trainers and mentors (selected from training participants) as well as PPB task forces/resource persons to help sustain the effort. Finally, both Karnataka and Uttarakhand now have modernized procurement (sector-specific) guidelines with bidding templates.
- *Attitudes changed*: The states' recognition and acceptance of the need for introducing the PPB methodology is visible in all three states. Over the last three years, GoJ and GoU have issued annual budget circulars to request departments to prepare PPB budgets. *The State Government of Karnataka, on January 10, 2007, placed the PPB documents before the State Legislature Estimates Committee.* The decision of the Committee was to extend the PPB methodology throughout the state. The final legislation is awaited. In Uttarakhand, four departments have already presented their PPBs before the State Legislature with another 17 planned for next year. Finally, while the new *Uttarakhand Procurement Rules* were approved and published by the GoU in the *May 2008 Gazette,* in Karnataka, additional sector-specific guidelines were added to the existing *Karnataka Transparency and Public Procurement Act of 1999*.
- *Practices introduced*: In all three states, there's clear evidence of translating intent into practice. In Jharkhand, 95 percent of the state's budget (39 out of 42 departments) is now covered by PPB. In Uttarakhand and Karnataka, this percentage is 60 percent (17 out of 27 departments) and 50 percent (8 out of 28 departments) respectively. Interestingly, while GoJ decided to extend the PPB across all departments, GoK decided to pilot test it first in two of its highest budgeted departments (Education and Health) before extending it to the remaining. Finally, both GoJ and GoK have taken the PPB down to the district level—this time with the approaches somewhat reversed. While GoJ is limiting its immediate PPB application to the 24 District Health Resource Centers, GoK has decided to extend it beyond the Health and Family Welfare Department to include the Departments of Education and Women and Child Development in the four districts of Bijapur, Gulbarga, Mysore, and Udipi. The United Nations Development Programme (UNDP) is also currently collecting information for its Human Development Index Report in these four districts. The application of the PPB in these districts will, therefore, help to strengthen tracking and monitoring of social sector indicators. Future plans signal the extension to all 29 districts.
- *Initial Impact:* In Jharkhand and Uttarakhand, some initial impacts are already being observed. (See Box 4).

Box 4: Initial Impact—Expenditure Planning and Management

Jharkhand: Jharkhand, where there has been the most expansive application of the PPB methodology to date, is now beginning to experience some of its benefits. The Directorate of Irrigation Revenue, Department of Water Resources had been spending almost 10 times more on staff salary than was being collected in terms of water charges for irrigation. This finding, discovered with the aid of PPB methodology, led the Government of Jharkhand to begin the process of dissolving the Directorate of Irrigation Revenue and transferring the collection responsibility to the Water Users Association. The application of the PPB methodology is, therefore, helping the state to not only uncover hidden inefficiencies and redistribute resources more efficiently, but also to promote a Public-Private Partnership. With the aid of this budgeting technique, a large number of projects, some with over two decades of cost and time overruns, were brought to a financial closure.



Uttarakhand: The GoU is the first jurisdiction in India (including the GoI) to have a modern set of procurement rules that address new procurement modalities such as Public-Private Partnerships (PPPs) and eProcurement. The Uttarakhand Procurement Rules were approved by the state cabinet and published in the May 2008 GoU Gazette. The rules enable Internet-based procurement, which has increased the speed and transparency of the process and has promoted a consistent approach. This will result in savings in public funds; current estimates exceed INR 45,000 crores if eProcurement options are available.

Revenue Management

The second most successful REFORM intervention has been the strengthening of the revenue analytic capacity, especially in Jharkhand and Karnataka. Interestingly, it was the establishment of the Fiscal Policy Analysis Cells (FPACs) that served as the catalytic agent for this success—and not so much the introduction of any one specific tool or technique (such as forecasting methodologies, input-output tables or comprehensive macroeconomic databases). The FPAC, aided by a dedicated pool of staff (the majority trained under REFORM in various fiscal disciplines), allowed the states to undertake detailed analyses of revenue projections and the implications of alternative tax policies and revenue choices. These interventions were ranked high by the state governments: number one by GoJ, number two and three by GoU and GoK, respectively. The timely assistance provided to GoJ and GoU in informing and preparing the state revenue department staff and concerned citizens, groups such as labor unions and merchants, on the key issues related to value added tax (VAT) implementation helped to bring down resistance to its introduction.

The following are some of the key REFORM achievements under Revenue Management:

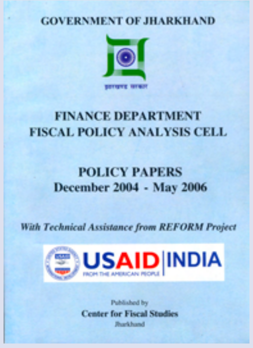
- *Knowledge transferred:* The three states combined now have more than 650 officers (250 in Karnataka, 200 in Jharkhand, and 200 in Uttarakhand) trained in VAT administration, revenue forecasting, macroeconomic policy issues, use of the input-output tables and macroeconomic databases, and tax policy formulation. In a number of instances, initial training involved lessons in basic statistics and *Microsoft (MS) Excel* to promote better understanding of the revenue forecasting methodologies and trend analyses; in total, over 46 such programs were held over five years. All three states now have a revenue forecasting guide with Annexure providing the principles of basic statistics to bring officers with nonstatistical backgrounds up to speed.
- *Attitudes changed*: In Jharkhand and Karnataka, over 70 percent (eight out of 11 and 11 out of 15, respectively) of the studies commissioned to the FPAC, to date, by GoJ and GoK are related to various aspects of tax and nontax policies.
- *Practices Introduced:* In Karnataka, the findings of the FPAC studies are beginning to be used by GoK in revenue policy formulation, as announced in the 2005-06 and 2006-07 state budget speeches. Interestingly, in Uttarakhand, the FPAC has, on its own, taken up numerous tax policy issues, eight, out of 15 of these studies have already been completed. Further, they are in the process of completing two studies, "Introduction of Entertainment Tax in Uttarakhand" and "Introduction of Luxury Tax in Uttarakhand," both requested by the Principal Finance Secretary.
- *Initial Impact:* In Jharkhand and Uttarakhand, some initial impacts are already being observed. (See Box 5).

Project Appraisal

The third most successful REFORM intervention has been the introduction and implementation of modern project appraisal methodology. This intervention has already begun to accrue benefits at the state level. Surprisingly, it was ranked relatively low by the state governments: number four by GoU and as number six by both GoJ and GoK. Finding long-term ownership (*i.e.,* Finance versus Planning) for the establishment of an institutional structure to take it forward has been difficult across all three states due to various factors, including lack of staff. However, given the obvious links between appraisal/selection of socioeconomically viable projects and overall quality expenditure planning and management, REFORM is convinced that this tool will gain increased priority in the future.

Box 5: Initial Impact—Revenue Management

Uttarakhand and Jharkhand: The VAT, finally introduced on 1 October 2005 in Uttarakhand and on 1 April 2006 in Jharkhand, has allowed both the states to increase their own tax revenues. For example, GoU has increased its revenue collection from INR 1444 crores in FY 2004-05 (the year before the VAT introduction) to INR 3120 crores in FY 2008-09 (RE). Similarly, GoJ has raised its tax revenues from 4.99 percent of the GSDP (INR 1986.22 crores) in 2003-04 to 8.03 percent of the GSDP (INR 5535.65 crores) in 2008-09 (BE). The REFORM seminars on the "benefits and implications of VAT implementation" held for the state's business community, trade unions, general public, and tax collection departments, considerably helped to bring down resistance to its introduction.



Jharkhand: A Jharkhand FPAC study on the impact of the new state excise policy, uncovered a system of tax evasion by liquor merchants that led to an estimated loss of more than INR 80 crores in the first two years of the new policy. The study, published in the February 2007 Gazette, found that the tax policy was not being implemented appropriately due to the issuance of a separate government notification that effectively exempted liquor merchants from the tax. The findings, causing considerable concerns within state legislature, resulted in an audit of the Excise and Prohibition Department by order of the Chief Minister. The state is now collecting excise and sales taxes from the liquor merchants, including back taxes owed.

Karnataka: The forecasting capability is assessed in terms of a comparison made for the gap observed between the actual and estimated budgeted figures of the respective years. Though gaps between the actual and forecast figures remain, the difference has come down substantially. For example, actual revenue deficits have been less than the level provided in the Budget Estimate.

The following are some of the key REFORM achievements under Project Appraisal:

- *Knowledge transferred:* The three states combined, now have around 255 officers trained in international best practice project appraisal methodology (100 in Karnataka, 85 in Uttarakhand and 70 in Jharkhand). Of these, 230 are trained in the use of the risk management software, *Crystal Ball*. Again, a series of orientation/sensitization workshops were conducted for senior bureaucrats as well as structured training and on-the-job mentoring for officers responsible for appraising proposals and reporting on ongoing projects. In total, over 42 formal training programs were held over five years. To make this intervention effective, staff of relevant public sector enterprises and state development corporations was included in the training programs. GoU has also taken the training down to the district level. All three states now have an internationally recognized sector-specific project appraisal implementation/ training guide along with a term of reference for establishing a *project formulation and appraisal division (PFAD)* as well as a core group (35 across three states) of trainers/mentors to take the effort forward.
- *Attitudinal changes:* The most visible acceptance of the need for such structured analysis of capital projects has been in Uttarakhand. *In June 2007, a GoU Budget Order mandated the application of the new appraisal methodology for all projects costing more than INR 50 million.* Karnataka is expected to follow suit: for infrastructure projects costing more than INR 100 million and social sector projects costing more than INR 20 million, GoK is expected to mandate the application of this new appraisal technique starting Fiscal Year 2009-10. In Jharkhand, the newly established Empowered Committee, Chaired by the Chief Secretary/Development Commissioner, is in the process of establishing its operational arm, the Project Formulation and Appraisal Division (PFAD). The PFAD is expected to be housed in the State Planning Department. This initiative is the result of a REFORM recommendation to improve GoJ project preparation and appraisal. The GoJ is also expected to issue a Government Order mandating a structured appraisal process for all projects costing more than INR 5 crores.
- *Practices introduced:* Under the mandate of the 2007 GoU Order, 35 capital projects have already been appraised. In addition, as a result of the training provided to the staff of public sector enterprises, the Uttarakhand Transportation Corporation is now using risk analysis software to purchase a new fleet of buses. In Jharkhand, the GoJ is already using the Project Appraisal (sector-specific) Practitioners' Guide as a training tool in its civil service training institutions—the Shri Krishna Institute for Public Administration and the State Institute for Rural Development.
- *Initial impact:* In Uttarakhand and Karnataka, some initial impacts are already being observed. (See Box 6)

Debt and Investment Management

Although all the basic necessary prerequisites (knowledge, attitudes, and practices) are now in place, the initial impacts from strengthening debt management capacity may not be immediately apparent; some benefits from improved investment management are beginning to be experienced in Jharkhand and Karnataka, the two states with considerable investment portfolios. Interestingly, at the inception of this project, the need to enhance debt management capacity was ranked relatively low by the REFORM partner states, however, during the course of REFORM implementation, this changed for the following reasons: The rising state debt burden;

Box 6: Initial Impact—Project Appraisal

Uttarakhand: The 2007-08 GoU Order enabled the state government to filter out 11 unviable projects from a total of 35 project proposals received before they were forwarded to the high-level Expenditure Finance Committee (EFC), Chaired by the Principal Finance Secretary, for final selection. The rejected projects were valued at INR 25 crores. The new project appraisal technique, based on consistent and comprehensive economic, financial, and stakeholders risk analysis, enabled GoU to: insulate the project selection process from discretionary decision-making; prevented expenditure on costly unviable projects; increased the likelihood of successful timely completion of projects within planned budgets. Thus, overall, it helped to promote more quality expenditure.

Uttarakhand: Inclusion of both public sector corporation staff and government department officials in the REFORM project appraisal training programs has paid dividend. Staff from the Department of Transportation and the Uttarakhand Transport Corporation used their newly acquired skills to purchase 300 new buses to modernize and expand its fleet to meet public demand for better inter-city connections. The Crystal Ball risk analysis software, introduced under REFORM, enabled them to evaluate various financing options. They finally chose an economically viable procurement plan using a five-year INR 17 crores debt financing from financial institutions. The exercise has been rewarding. Today, the state is better able to service its public transportation needs in a cost-effective manner.

Uttarakhand: Trained GoU officials have started talking about the cost effectiveness of basic needs projects. For example, when appraising a drinking water project where pumping technology was used for a small population, one participant remarked "…if half of the per capita cost is paid to the families, they will relocate to places where drinking water is available." As a result, this project alternative was actively pursued by the GoU officers concerned to the benefit of the local community.

Box 6: Initial Impact—Project Appraisal (Contd.)

Karnataka: The project appraisal *case study method* of training has helped public sector officials to realize increased savings from their loan portfolio management. For example, the Company Secretary and General Manager (F&A) of the Rajiv Gandhi Rural Housing Corporation Ltd. has managed to save the company around INR 18 lakhs for the quarter ending March 2005. As he explains, "the Company's outstanding loans from major financial institutions (FIs) were INR 4.2 billion in January 1, 2005, with a quarterly repayment of INR 232 million. This consisted of INR 126 million as principal and INR 105 million as interests. With the help of improved analysis, a short-term loan at a lower rate of interest was renegotiated and the principal partially prepaid to the FIs." A vital lesson learned by the trainee was to seek early repayment of the principal (and not interests).

emerging roles and responsibilities of state governments to manage their debt management process; and increasing recognition of the linkage between debt and expenditure management.

The following are some of the key REFORM achievements under Debt and Investment Management:

- *Knowledge transferred:* All three states combined have more than 73 officers (six in Jharkhand, 57 in Karnataka and 10 in Uttarakhand) trained in the principles of debt, contingent liabilities/guarantees, and investment management. In total, over 42 formal training programs were held over five years. Given the macroeconomic nature of debt management issues and the involvement of national level institutions such as the Reserve Bank of India and the central Ministry of Finance, several of these programs were held in Delhi jointly with all three states. Further, all three state governments now have the following: A comprehensive debt and contingent liability database (*i.e.,* using the *Commonwealth Secretariat-Debt Recording and Management System (CS-DRMS)* software) to improve information availability, tracking and reporting (*this is the first time this software has been used at the sub-national level for debt management anywhere in the world. It is also the first time that it has been modified to take cognizance of contingent liabilities);* a comprehensive dataset on state government investments; an international best practice implementation/training guide (with debt reporting templates); and guidelines on state creditworthiness.
- *Attitudes changed:* There is clear acceptance by all three state governments of the need for structured analysis, comprehensive database, and reporting structures for improving debt, contingent liabilities and investment management. For example, both GoJ and GoK have allocated resources (staff, funds and physical location) for the establishment of a *Debt and Investment Management Cell (DIMC)* in their

respective states. In 2005, GoK also created the *Department of Investment Tracking and Monitoring* for investment management.

- *Practices Introduced:* The newly established *Department of Investment Tracking and Monitoring* in Karnataka has already begun to collect back due of dividends assisted by the establishment of comprehensive, updated investment databases. In all three states, DIMC staff are using the *CS-DRMS* software for generating reports on debt and guarantees and sharing these reports with the Department of Finance and RBI.
- *Initial Impact:* In Karnataka and Uttarakhand, some initial impacts are already being observed. (See Box 7)

Although it is recognized that REFORM has been very successful in terms of knowledge transfers, attitudes changed, and practices initiated, it will take patience and persistence to realize tangible results (impact) from capacity enhancements. However, early results of the REFORM initiative from Jharkhand, Karnataka and Uttarakhand are encouraging harbingers of what can be achieved from such capacity strengthening efforts.

Box 7: Initial Impact—Debt and Investment Management

Uttarakhand: Under REFORM assistance, GoU officials collected and assembled state government debt information in a single consolidated Microsoft (MS) Excel spreadsheet and subsequently, with the aid of the CS-DRMS, migrated the data into an Oracle-based database. Today, the GoU has a consolidated debt management process that includes better coordination and data sharing between the state Department of Finance, State Accountant General, Reserve Bank of India, and central Ministry of Finance. As a result of improved staff expertise, comprehensive and updated databases, reporting structures, etc., GoU is better positioned to begin market borrowings, as recommended by the Twelfth Finance Commission, when this becomes a requirement in 2010 for all state governments.

Karnataka: Despite having a relatively large investment portfolio, due to the lack of a comprehensive and updated dataset and appropriate reporting structure to track these investments, GoK did not have the required complete information on its investments in the various public sector undertakings (PSUs). Partly in response to REFORM recommendations, in 2005, GoK converted its Small Savings and Lotteries Department into the Department of Investment Tracking. Since its establishment in 2006, this department has been tracking GoK investments in various PSUs and recording the dividend returns. This new arrangement has enabled the GoK to recover more than INR 124.27 crores worth of unpaid dividends that can now be used to fund its development programs while reducing its public debt burden.

(For a detailed discussion on the experiences of each REFORM partner state, please see *Section II State Case Studies* of this Volume.)

Part 7: Institutionalization

A critical component of capacity enhancement efforts must be the institutionalization and mainstreaming of the new practices to ensure that the tools, techniques, systems and analytical methods introduced are actually utilized. Without institutionalization, sustained application of the new practices become doubtful.

> *In the broadest terms, institutions can be defined as the set of formal rules and informal conventions that provide the framework for human interaction and shape the incentives of members of society.[6] Different initial conditions strongly influence the approach to ownership transformation.*

By the above definition, among others, the following may be considered as means to institutionalization:

- Encouraging state governments to issue orders, circulars and notifications, mandating use of new practices.
- Ensuring officials at all levels (secretaries to section officers across the maximum number of relevant departments), and down to the district and local government levels, are exposed to the new practices and their relevance. This will build a critical mass of users and, thereby, help mainstream the practices.
- Ensuring that the new practices promote consistent and transparent principles that lead to greater accountability. As the government system and civil society become accustomed to a higher level of accountability as a result of the new practices, they will begin to demand the continuation of the new practices.
- Establishing timely, dedicated nodal agencies that will be entrusted to apply and promote the use of the new practices in day to day fiscal operations. Sustainability of the new practices will be better positioned by the vested interest created within these nodal agencies.
- Introducing the new practices in the training programs of state civil service training institutes (*e.g.,* ATIs/SIRDs). This will expose new and mid-career officers to these practices and again help build the critical mass.

This section limits the focus of the discussions to the last two, namely, establishment of appropriate organizational structures and introduction of modern fiscal practices in training curriculum. The first three have already been discussed in the previous section under *REFORM Impact* as "attitudes changed" under the KAP-I construct.

[6] International Monetary Fund, 2005, "Building Institutions," World Economic Outlook, September 2005, p.126.

It is important to remember that any institutionalization effort must be a dynamic process; it needs to be constantly upgraded and modified in response to the changing environmental needs. Below are four institutional structures that were designed and developed jointly with the three REFORM partner states to mainstream and sustain the efforts introduced.

Fiscal Policy Analysis Cell (FPAC)

Objective: The FPAC is considered to be one of the key institutional structures for promoting "informed" decision-making within the state government and is expected to directly support the Department of Finance in their fiscal analysis. The FPAC is expected to provide access to a dedicated cadre of experts trained in the techniques of modern fiscal analysis and equipped with the necessary tools for putting those techniques into practical use. Its primary mandate is to evaluate, on a continuous basis, immediate and long-term impact of fiscal policy, procedural and regulatory decisions on the mobilization, allocation and utilization of public resources. Depending on the perceived needs, among others, it could also take on the following tasks:

- *Promote Greater Analysis:* Support *a priori* and *ex post facto* analysis of longer-term regional development perspectives and distributional issues (e.g., the trade-offs between efficiency and equity issues) and the role of fiscal policy to promote broad-based economic growth.
- *Data Management:* Identify, develop, maintain, and update necessary databases and information systems. Provide guidance in developing appropriate management information system(s) to help integrate fiscal operations across departments.
- *Forecasts and Projections:* Make forecasts and monitor fiscal trends to facilitate early warning. Develop and revise baseline information.
- *Facilitate and Promote Dialog:* Create forums such as networks, round tables, workshops, seminars, and conferences to generate debates, ideas, share analytical tools and techniques, and document both intra and interstate fiscal issues.
- *Outsource Expertise:* Act as consultants and resource experts to other departments in fiscal matters. Help build fiscal analytical capacity in other departments. Support State Finance Commissions with information and analysis. Assist in drafting/updating manuals and guidelines.

It is important for such organizations to start drawing resources (staff and technical expertise) from other organizations (domestic and international, consulting and academia) to keep themselves up to date on fiscal management practices. To promote confidence in its operations, the tasks should be conducted in a transparent, consistent and accountable basis, and where possible, the results and analysis made publicly available. Ideally, FPAC-like institutions should start generating their own finances to allow them some degree of independence to help insulate their analysis and findings from bias and political pressures. However, there is no unique model that is proposed here, as clearly evidenced from the experience of Jharkhand, Karnataka and Uttarakhand.

Box 8: Institutionalization—Fiscal Policy Analysis Cells (FPACs)

Three distinct models emerge from Jharkhand, Karnataka and Uttarakhand, respectively. Though different in their approach, strong state government ownership clearly signal increasing demand for decision-making based on good analysis in all three states. According to a GoK official, "if the FPAC-like institutions had not been there, most of the analytical studies would not have taken place."

Jharkhand: Jharkhand chose to follow a fairly classic FPAC model: i) early state government ownership (through funding, staffing, provision of premises, commissioning of papers and their oversight); ii) formal recognition of the FPAC (through launch of the *Center for Fiscal Studies (CFS)* by the state Finance Minister); and iii) FPAC studies and their findings placed in the public domain (through launch of FPAC dedicated Web site containing abstracts of completed studies and publication of completed studies). One of the biggest constraints encountered by Jharkhand following bifurcation from its mother state of Bihar was the number of officers it inherited. Therefore, although the FPAC was ranked as the number one priority to help improve state revenue analysis and forecasting, GoJ did not have sufficient staff to assign to it. As a solution, GoJ chose to second FPAC resource persons from relevant local institutions based in Ranchi (such as the Department of Economics Ranchi University, Birla Agricultural University, Xavier Institute of Social Service, and St. Xavier's College). Since the resource persons are not as exposed to "frequent transfers" as compared to government officials, a relative amount of consistency is ensured in FPAC practices. The current composition of GoJ staff to outside resource persons is 2:12.

Karnataka: The GoK, on the other hand, has always envisioned the further institutionalization of the REFORM initiatives through the establishment of a Fiscal Policy Institute (FPI), a much broader concept than the classic FPAC. Therefore, although an FPAC has been established, the plan has always been to transplant its expertise into the FPI (*i.e.,* FPAC staff to form the core of the FPI). The FPI, established through a Government Order, is expected to be functional by April 2009. The Director has already been identified and appointed and when fully functional, the FPI will have staff strength of around 52. Although the current FPAC in Karnataka displays most of the properties of the classic model (*i.e.,* GoK ownership through provision of staff, funding, premises and commissioning of studies with oversight), it has not placed its studies and analysis in the public domain. Given the adequate staff strength within the GoK, all 11 of the current FPAC staff are GoK officers. Right from its inception, concerted efforts were made to incentivize FPAC staff through added remuneration and timely promotions. However, a number of officers have left following appointment.

Uttarakhand: In the case of the Uttarakhand FPAC, the GoU is actively thinking of establishing *a fiscal research network* to enhance its fiscal management processes. This network will augment the government's *Fiscal Plan and Resources Directorate* that was established back in 2001 to conduct *ex post facto* analysis of fiscal year expenditures. The Directorate now is considered to be too limited in scope to address the emerging fiscal issues. In 2005, under REFORM recommendations, FPAC

Box 8: Institutionalization—Fiscal Policy Analysis Cells (FPACs) (Contd.)

was formed. However, like Jharkhand, GoU is plagued by severe staff shortage within GoU and unlike Jharkhand, is disadvantaged in not having relevant Dehradun-based institutions from which FPAC can draw staff. Therefore, due to the lack of available premises and staff strength, the FPAC has, at best, been a virtual team of researchers drawn from a few state-level institutions. Most of the studies have been self-generated and are yet to be considered by the GoU. Again, based on REFORM recommendations, GoU is planning to expand its search for researcher to a wider set of state-level institutions (Confederation of Indian Industries, Forest Research Institute, Institute of Certified Financial Analysts of India (ICFAI), Petroleum University, Indian Institute of Management in Roorkee, and the Reserve Bank of India, Uttarakhand office).

(For more information on the establishment of a fiscal policy institute, please see *Annexure No. 4* for the Russian experience and *Annexure No. 5* for the *Fiscal Policy and Analysis Cell Implementation Guide*.)

Project Units (PUs)

Objective: The objective of having a Project Unit within the state governments was two fold. The immediate objective was to help *institutionalize the project appraisal techniques* introduced under REFORM. The long-term objective was to go beyond just project appraisal. The aim was to promote and institutionalize good practices in the following two broad areas: i) p*roject management,* including project identification, planning support, resource mobilization, quality control, risk management, and monitoring and evaluation; and ii) *contract management*, including contract documentation development, contractor evaluation and selection, contract finalization and administration, and contract close-out. It was expected to critically look at capital programing and rationing and potential (preliminary) financing structure of the projects and determine indeed whether, among others, public-private-partnership (PPP) vehicle was appropriate. Finally, over time, it was expected to become a repository/depository of a database on all major projects for easy reference and lessons learned. Both the immediate and the long-term objectives called for a dedicated cadre of experts trained in techniques of project selection and management and armed with the necessary tools for putting those techniques to practical use.

The strong state government ownership that facilitated the establishment of FPAC-like institutions, has been slow in coming with respect to the PUs, even though the introduction of the new project appraisal techniques have been demand-driven (through government orders in some states) and its benefits recognized (through initial impact, see *Impact Analysis* section). There has, however, been some progress with respect to institutionalization of the PU in Jharkhand.

Debt and Investment Management Cell (DIMC)

Objective: To help states improve management and analysis of state debt, investments, liabilities, and creditworthiness. The immediate objective was to create an intelligence cell in each of the three REFORM

Box 9: Institutionalization—Project Units (PUs)

Jharkhand: The Empowered Committee (EC), recently established by GoJ in Jharkhand to improve project appraisal capacity, is in the process of establishing its operational arm, the Project Formulation and Appraisal Division (PFAD). The PFAD is expected to be housed in the State Planning Department. This initiative, a result of REFORM recommendations, once operationalized (scheduled for late 2008), will enable the GoJ to ensure optimal utilization of state resources by examining the different project (investment) alternatives and their funding options. GoJ also expects the substantial cost and time overruns, which have become a common feature of public sector projects, to abate as projects approved for implementation will have the necessary funding arrangements in place to ensure their timely completion as a result of improved project appraisal management.

states, staffed with a dedicated cadre of experts trained in techniques of modern debt and investment management and armed with the necessary tools, databases, and protocols. Ideally, in the long term, the organizational structure should have: i) a Front Office responsible for all funding transactions and negotiations, enforcement of compliance and development of medium- to long-term portfolio strategies; ii) a Middle Office responsible for analysis and reporting; and iii) a Back Office responsible for information recording functions, validation of data and monitoring and disbursements. Interestingly, while REFORM has been quite successful in equipping all three state governments with the necessary, basic prerequisites (knowledge, attitudes, and practices) for improved debt and investment management, it has not been successful in establishing a robust debt and investment management cell. In both Jharkhand and Karnataka, only one-to-two staff members dedicated to debt management were incorporated in the respective FPACs. Karnataka separated out the investment management function from debt to establish an unit only to focus on state investments.

Capacity Strengthening of State Civil Service Training Institutes

Objective: To institutionalize in state civil service training institutions such as the Administrative Training Institute (ATI) and the State Institute for Rural Development (SIRD), the training curricula developed and used under REFORM to train officers in revenue management, expenditure management, debt and investment management, and project appraisal. This was more challenging than initially contemplated since location of these institutes play a critical role in being able to attract quality faculty. Therefore, although REFORM was successful in handing over training curricula and training manuals to all three state ATIs/SIRDs, the Shri Krishna Institute for Public Administration (SKIPA) in Jharkhand is considered to be the only

Shri Krishna Institute for Public Administration (SKIPA) in Ranchi, Jharkhand

Box 10: Institutionalization—Debt and Investment Management Cell (DIMC)

Partly in response to a REFORM recommendation, in 2006, the GoK converted its Small Savings and Lotteries Department into the Department of Investment Tracking. Since its establishment, this department has been tracking GoK investments in various PSUs and recording dividend returns from these PSUs. Today, the Department has succeeded in maintaining detailed financial information on all PSUs in which the GoK holds equity, especially those related to dividend payments. This GoK investment initiative has been very beneficial, as the department now has a detailed and current dataset on investments (updated with REFORM assistance), dividends due the government, and loans released by the government. As a result, GoK's overall returns from investments has considerably improved.

successful intervention under REFORM; Bangalore and Dehradun, the respective capitals of Karnataka and Uttarakhand are seriously disadvantaged because of their distance from their respective state administrative training centers in Nainital and Mysore. Further, most of these institutes are in serious need of modernization with respect to resource materials, teaching methodologies, computerization, and absence of relationships with other similar training/resource institutes internationally to keep them relevant. Establishment of a dedicated Public Finance Chair may also help to promote the importance and relevance of fiscal policy and related issues.

Capacity building should not be equated to training alone. It needs to be supported by relevant databases, integrated management information systems, appropriate protocols, organizational systems and structures, and sometimes even legal amendments, to make the effort effective. However, training is a major, if not the key component of any capacity building exercise. In most capacity building programs, around 70 percent of the effort and resources go toward training. Ideally, baselines should be established prior to the beginning of a training program to be able to gauge efficiency and effectiveness gains per trained officers. However, in order for such evaluations to be meaningful, government departments must ensure the most appropriate candidate is selected and committed to the entire duration of the program. (For more information on the REFORM competency development experience, please see Annexure No. 3.)

***"Fiscal Watch,"* A Virtual Resource Center**

Objective: To promote greater thinking, collaboration, discussions, best practices and, exchange information and post current data on the fiscal health (and related issues) of Indian states and India. Designed and developed under REFORM, the key feature of "Fiscal Watch" is the dedicated discussion forums to facilitate interaction between fiscal practitioners, both Indian and international (*e.g.*, to provide a platform for finance secretaries, budget officers, revenue officials, and researchers). In addition, there are numerous hyperlinks to related online resources such as government Web sites, professional societies, consultancy opportunities, and training and education providers.

REFORM was exceptionally fortuitous in the interest shown and ownership assumed by the National Institute of Financial Management (Department of Expenditure, Ministry of Finance) to take "Fiscal Watch" forward, ensuring its continuation.

Capacity building is behavior change—that will take a number of years for it to be fully imbibed and the results to become visible. Therefore, it is difficult to argue for such interventions where tangible, palpable results are rarely achieved in the short to medium term. To defend the institutionalization of such interventions becomes even more difficult. However, without their institutionalization, the very fundamentals of sustainability of any development effort will be at jeopardy. Institutionalization ensures that the fiscal management practices will be implemented "on a consistent, continuous, transparent and accountable basis" to promote effective change as against on a temporary, *ad hoc*, "fits and starts" basis.

Home Page of *Fiscal Watch* located at www.fiscalwatch.org

Part 8: Lessons Learned

During the course of REFORM implementation, a number of lessons were learned that can benefit other state governments embarking on similar fiscal management reform programs. These lessons learned, which either facilitated or delayed implementation, adoption and the sustained use of the tools and techniques introduced, may be categorized into three:

- Prerequisite factors
- Ongoing implementation factors
- Future sustainability factors

Prerequisite Factors

The three key prerequisite factors that were found to facilitate or hinder timely, relevant, quality, and effective implementation of project interventions at the state level are listed below. Both state governments and project teams need to be cognizant of these factors:

A full-time Program Management Unit (PMU) with a state government appointed coordinator and an upfront detailed operational plan is important.
In hindsight, a full-time *coordinator,* appointed by the state government, is considered vital for facilitating dialog between various state departments and the project team to ensure that all counterparts (including the state government) meet their commitments.

These commitments should be laid out in a *detailed operational plan* that is jointly developed and cleared with state government and disseminated to all parties concerned for information. Under REFORM, the absence of such a coordinator and an adequately detailed operational plan caused some delays and confusion under several of the interventions. The detailed operational plan, among others, should contain the following:

- Implementation timelines and activities to be undertaken, cost-sharing of resources (staff, funding, physical premises, logistical support, etc.), and any government orders and legal amendments would be required for the implementation of the new practices.
- Name/designation of government officer (department) responsible for each project intervention area. Under REFORM, absence of this clarity has, for example, prevented the establishment of the Project Unit across all three states.
- Identification of approaches/methodologies to be used. For example, whether training programs should be of shorter duration with full-time training or of longer duration with part-time training. Advance knowledge helps to design/schedule programs that can avoid, for example, frequent absenteeism.
- Articulation of the time required before results are visible. It is unlikely that tangible results will be produced immediately after introducing a new practice. Therefore, patience and persistence will be required from all parties concerned. It takes time to garner the necessary critical mass with respect to practitioners, new processes, new technology, and political awareness and acceptance. To internalize the new practices introduced, a significant behavior change will be required. This means performing work differently from the way it had been done before (sometimes over the course of decades). There will always be initial skepticism, inertia, and vested interests in the prevailing status quo.

Being aware of local needs, ongoing complimentary/competitive practices, government protocols, and initial conditions is important.
The interventions must be localized to meet local needs because no single approach will work for all states given their distinct initial conditions (*i.e.,* socioeconomic profiles, needs and the level of absorptive capacity). States with difficult or weak initial conditions will require a different approach (*e.g.,* more mentoring, more on-the-job training, including occasional tutoring on basic economic and statistical principles).

Early identification of systems and structures that can help to leverage introduction of new practices, avoid duplications and misfits will be useful. For example, early knowledge of a pre-existing FPAC-like structure in Uttarakhand would have greatly facilitated the design of the present FPAC under REFORM.

Knowledge of other donor programs in the same state will help to leverage resources and avoid duplication and confusion through introduction of contradictory techniques. Establishment of state-level inter-donor committees may help in this process.

When composing a project team, it is important to include experts with knowledge of local government protocols, institutional arrangements and historical background. For example, REFORM was fortunate to have identified and appointed well recognized retired Indian Administrative Service (IAS) officers as lead advisers in each REFORM partner states. Having served in the seniormost positions, these advisers were able to help teams overcome most of the operational constraints, access and dialog with relevant state government officials, and educate the rest of the team members on appropriate protocols and sensitivities.

Prior experience within state government with reform program implementation at the state level is helpful.

GoK has been exposed to fiscal reform initiatives for over 10 years now. By the time REFORM began implementation in Karnataka, the state had already implemented treasury computerization, passed laws regarding introducing Transparency in Procurement, Ceiling on Government Guarantees, the Fiscal Responsibility Act and preparation of Medium Term Fiscal Plan. Consequently, when REFORM implementation began in April 2004, the GoK was well-positioned to accept, adopt and implement the initiatives.

Ongoing Implementation Factors

Once an initiative is launched, both the state government and the project team needs to be aware of and be sensitive to the following factors if they are to maximize impact and the speed of project implementation:

Approaches must be localized, therefore, early recognition of "initial conditions" is important.

The interdisciplinary nature of REFORM assistance implied that additional training had to be provided to bring staff skills up to the required level in the areas of managerial and quantitative (*e.g.,* economic, finance, and statistics) skills. In some cases, computer literacy and English proficiency skills also had to be enhanced. At times, it may even merit having critical documents translated into the local language to facilitate better comprehension and wider dissemination. In hindsight, a preliminary survey should have been conducted to document such initial conditions to help facilitate uninterrupted progress once project implementation had commenced.

A demand-driven process is important.

Design interventions so as to feed into or connect with an existing state or central government priority. This will help to create demand for the new practices. Similarly, a champion (a senior government official or department) will also help to drive demand for the intervention due to their belief in reform benefits.

- The PPB was introduced under REFORM in all three states as an important expenditure management tool in 2003-04. However, in two out of the three states, implementation was slow and government ownership weak. The introduction of the Outcome Budget by the GoI in 2005 for reporting on centrally-sponsored schemes at the state level helped state governments to recognize the merits of the PPB methodology and, subsequently, expedite its implementation. Similarly, the recommendations of the Twelfth Finance Commission to state governments to better manage their debt portfolios helped bring home the importance of debt management tools such as the *CS-DRMS* debt management software.
- In Jharkhand, the Finance Department's receptivity to ideas from outside the state and a willingness to make the needed changes led to early successful implementation of several interventions. For example, the personal interest taken by the Principal Finance Secretary, Jharkhand, has resulted in the introduction of the PPB in 39 out of 42 departments (covering more than 95 percent of the state budget). The establishment of the *Center for Fiscal Studies (CFS)*, despite the lack of officers to staff it, was made possible because of the innovative thinking on the part of the Secretary to recruit resource persons from nearby local nongovernment technical institutions to fill positions. However, unless the new practices are institutionalized, once the champions move on, there is a danger of losing the progress made to date.

Raising awareness with a larger segment of the population (civil society, state legislature) and creating a critical mass is important.

For example, the adoption of *a greater governmentwide approach* (both in terms of sectors covered and levels of governance) helped to quickly bring everyone on board in Uttarakhand. It created greater buy-in and ownership with respect to the introduction and implementation of the best practice project appraisal technique. Critical mass may be built in two ways: First by selecting one department and then extending down to include all levels (vertical linkage) helps everyone in that department in understanding the rationale, the implementation steps and their role in the reform process. And second, by selecting all nodal departments at a single governance level (horizontal linkage) so that all the interlinked can attain cost and time efficiencies through economies of scale and by leveraging interdepartmental comparative advantages (resources, skills, and infrastructure). Uttarakhand, however, failed with respect to introducing the PPB since it was incrementally introduced with neither horizontal nor vertical coverage. As a result, district officials are not owners of the PPB that was prepared at the secretariat level and, in turn, does not bind them to the deliverables.

Frequent transfers of government officers is disruptive.

Frequent transfers imply that the new person has to be convinced again on the benefits of the new practice—and then trained anew. Nascent states are particularly exposed to this phenomena, largely due to the scarcity of human capital within the state machinery. During the course of project implementation, for the three REFORM partner states taken together, the immediate counterparts changed 20 times within a course of five years. If officials at all levels are counted, this number is daunting.

Public recognition of reform initiatives and officials participating in reform programs is important. Public recognition through press coverage, public inaugurations, and recognition of officers may help to engender public and political interest in these reform efforts and, in turn, reinforce and persuade the state government to continue down the reform path. For example, the inauguration of the Center for Fiscal Studies by Jharkhand's Finance Minister, gave fillip to the acceptance of this institution. Similarly, officials completing particular training programs could be recognized through suitable mentions in their annual performance reports, posted to the FPAC on deputation at a higher pay, etc. In two out of the three REFORM partner states, officers serving in the FPAC did not receive either additional recognition or compensation. As a result, motivation was low with reluctance to participate or continue in the FPAC.

Regular monitoring of project implementation progress at various levels is critical.
There is a need for supplemental *detailed quarterly rolling plans* in addition to any annual work plans developed in order to enable ongoing M&E framework. For example, in Uttarakhand, the actual use of the REFORM project appraisal methodology was institutionalized only after delayed discussions with the Principal Finance Secretary that resulted in the issuance of a necessary government order (GO). Had there been stringent quarterly reviews, the need for a GO would have been realized sooner.

Future Sustainability Factors

In order to sustain any fiscal reform initiatives, the new practices must be institutionalized and mainstreamed into the daily work habits of the state government, the following factors were found to be especially important:

Early identification of local supporting organization is important.
Jharkhand is fortunate to have the presence of SKIPA and SIRD (state-level training institutions inherited from Bihar) in Ranchi. This geographical proximity allows REFORM and the Finance Department to work with these civil servant training institutes to host and train courses in PPB and project appraisal. In addition, the physical convenience of the institutes facilitated use of REFORM-trained GoJ officials to lecture and serve as adjunct faculty in each institute. For long-term promotion and sustainability of the new practices, early and full involvement of state training institutions are needed to incorporate the fiscal reform tools, techniques and training courses into their mainstream curricula.

Issuance of formal state government mandates to institutionalize new practices is important.
Without issuance of government orders, circulars and notifications, it is difficult for officers to apply new practices. In Uttarakhand, for example, although a number of training programs were conducted on project appraisal, the new practices were not being applied. During the course of joint discussion with the Department of Finance, it was discovered that since no Government order was issued, the officers lacked the official mandate for its application.

Finally, it is important to recognize that capacity strengthening and strategic change is a continuous process and not just in times of fiscal distress. It will take time to realize the desired results therefore patience and persistence is a must with close monitoring to implement necessary mid-course correction to stay relevant to the changing needs.

Part 9: Conclusion

Despite spending large sums of money, governments and donors in many countries have been limited in their ability to develop successful, sustainable programs due to the inadequacy of fiscal management expertise and infrastructure. Such inadequacies prevent the productive absorption of funds. They also prevent states from equipping themselves with the necessary fiscal shock absorbers to cushion them against unexpected fiscal challenges—some arising out of discretionary, unplanned decision-making and others as a result of increased globalization. More often than not, these unexpected challenges can and have served, as the tipping points, seriously affecting the fiscal condition of even fiscally healthy states, as seen in India especially post-1995-96.

Thus, while REFORM was designed to address some of the inadequacies noted above, the approach taken was not to advise or guide Indian state governments on specific policy decisions but rather to enhance their ability to evaluate and to address crucial policy choices and implementation options, based on an understanding of the environment—*i.e.,* its potentials, its limits and its perceived needs. For example, the fiscal crisis experienced by Indian states over the last two decades clearly signal the need for improving their revenue-raising ability, expenditure quality management, enhanced investment productivity, and control of their public debt. Such enhanced capacity will become even more important in light of the emerging challenges that Indian states will face with the gradual opening up of the Indian economy and with the state finances being increasingly linked to market forces.

The tangible results from such capacity-strengthening will take time to become visible. Therefore, considerable patience and persistence will be required. Critical to successful capacity building is the institutionalization of new fiscal management practices to ensure they will be implemented "on a consistent, continuous, transparent and accountable basis" to promote effective change as against on a temporary, *ad hoc*, "fits and starts" basis.

In hindsight, REFORM has been very successful in terms of knowledge transfers, attitudes changed, and practices initiated and early results of the REFORM initiative from Jharkhand, Karnataka and Uttarakhand are encouraging harbingers of what can be achieved from such capacity strengthening efforts and its interventions are expected to continue to be complementary and relevant to all fiscal reform endeavors. Indeed, this was the first time such a comprehensive effort was undertaken at the state level to strengthen fiscal management practices, efforts that would also help to improve the quality of service delivery to India's citizens.

The following sections of this volume and the following volumes in this compendium provide a detailed account of the experiences, achievements, and tools and techniques of the REFORM Project. A detailed description of the *REFORM Project Compendium with Practitioners' Guide* follows.

Part 10: Compendium Layout

Introductory Section

Volume I, Section I presents a detailed overview of the REFORM project covering the following: An introduction; a brief overview of the fiscal scenario when REFORM started; rationale of why fiscal management capacity strengthening is important; the objective of REFORM and its terms of reference; an impact analysis of project implementation in the three states; the importance of institutionalization and the REFORM experience; and the key lessons learned.

The Introductory section includes these Annexures: detailed results frameworks used to monitor and track REFORM progress during the course of implementation and evaluate final project impact: a specialized report on *Competency-development (Training)* with a comparative analysis of the REFORM experience; a paper on the establishment of the *Russian Center for Fiscal Policy*, an FPAC-like institution established with USAID support in February 2000; and, a Guide to establishing a Fiscal Policy and Analysis Cell.

State Case Studies

Volume I, Section II presents the Jharkhand, Karnataka and Uttarakhand case studies. Over 52 months of actual implementation, REFORM attempted, on a pilot basis, to field test selected international best practice tool and techniques to improve fiscal management reform in the three Indian states of Jharkhand, Karnataka and Uttarakhand. The objective was to strengthen their ability to take fiscal decisions based on sharper analytical skills, more accurate and updated information, and using modern analytical methodologies. The outcomes from this initiative were expected to serve as "lessons learned" for nonREFORM partner states embarking on similar fiscal management reform.

The case studies present the experience of the three respective REFORM partner states with respect to: Their initial socioeconomic conditions (2001-02); emerging fiscal challenges at the state level; initiatives taken by the three respective states to respond to the emerging challenges; rationale for REFORM interventions; the impact from the introduction of reform interventions; lessons learned; and immediate next steps.

Practitioners' Guides

Volumes II, III, IV and V provide four practitioners' guides: The Expenditure Planning & Management; The Revenue Management; The Debt & Investment Management; and The Project Appraisal. These have been developed with the aim of serving both as desk references for government officials already trained in the respective areas of fiscal competency to implement the new practices as well as training tools for future capacity-strengthening (training) programs. For officials not earlier exposed to the subject fiscal practices, the guidelines may need to be supplemented with form of technical support or guidance.

Volume II: The Expenditure Planning & Management Practitioners' Guide focuses on the Program and Performance Budgeting (PPB) methodology. It presents a step-by-step road map and timeline for introducing and implementing the PPB methodology. The primary users for this Guide will be officials in various state administrative departments learning how to prepare PPBs as well as officials from the state department of finance who will review and approve the PPB documents.

Part 1 of this Volume takes the practitioners through the rationale and importance of budgets, why the PPB methodology is considered a best practice tool, what is the PPB preparation process, what are some of the implementation challenges, and finally a detailed description of the PPB structure. Part 2 describes the 13 steps to implementing the PPB in a pilot department. These include: Selecting the pilot departments, gathering data and information, preparing an organizational chart and departmental mission statement, identifying and grouping activities into programs, preparing program goals and objectives, determining performance indicators to measure the achievements, preparing program narrative pages, converting the departmental budgets to program budgets, preparing a budget for each program, preparing work plans, and finally submitting the budget for consideration. The Annexure, among others, include several case studies on the introduction and implementation of the PPB, both within India (the experience of the three REFORM Partner states—Jharkhand, Karnataka, and Uttarakhand), as well as internationally (the case of Florida, U.S.A.). In addition, the PPB Database Software presented in Annexure 9 will assist government officials to track actual budget outlays in relation to planned outputs and expected outcomes.

Volume III: The Revenue Management Practitioners' Guide focuses on the introduction of revenue forecasting methodologies. This Guide is expected to help those who will be responsible for forecasting revenues, analyzing the impact of tax policy proposals, and assessing tax administration efficiencies.

The Guide begins with an overview of revenue management, including a brief discussion on the various sources of revenues at the state level. It is subsequently divided into six parts. Parts 1, 2, and 3 present the various forecasting models: Part 1—presents the alternative methods of forecasting; Part 2—presents the monthly receipts monitoring and forecasting; and Part 3—presents the VAT analysis and revenue forecasting. Subsequently, Part 4 of the Guide describes the needed fiscal capacity and tax efforts, including its determinants, measuring fiscal capacity, and the stochastic frontier production function approach. Finally, Parts 5 and 6 conclude with a discussion on revenue management, its implementation and emerging issues. The Annexure presents a quick reference guide on basic statistical concepts and regression analysis, including the Ordinary Least Square method.

Volume IV: The Debt & Investment Management Practitioners' Guide. This Guide is a supplement to training of those state government employees who are not familiar with but are responsible for debt, investment and guarantee management, including maintaining the state credit rating. The Guide is subdivided into six parts.

Part 1 presents a review of the Indian state government borrowing profile, including a discussion of the role of the central government and the Reserve Bank of India (India's central bank) and describes the constitutional provisions. Part 2 focuses on the states' debt management operations. Part 3, in addition to a discussion of the importance of credit ratings, also contains a robust discussion of the Debt and Investment Management Cell (DIMC), its funding process, its organization, and the path toward effective debt management. Part 4 looks at entering nonstatutory liquidity ratio bond markets. Part 5 discusses monitoring and oversight of state government debt which begins with an overview of the international experience (Argentina, Brazil, U.S.) and finally, Part 6 presents the concluding guidelines and observations. The 10 Annexures provide a collection of background information on as well as guidelines to debt management along with a discussion of the REFORM implementation experience in the three states of Jharkhand, Karnataka, and Uttarakhand.

Volume V: The Project Appraisal Practitioners' Guide has been developed to facilitate the application of international best practices Project Appraisal technique while approving public sector projects. Specifically, how to appraise projects with respect to their *financial, economic, and distributional* risk analysis. It is expected to serve as a guide for project analysts and decision makers within the ministries of planning and finance, but also those employed in the line ministries, and government departments and agencies that are involved with the formulation, evaluation and implementation of projects.

Section I of the Guide focuses on the theory and technique of project appraisal (*i.e.,* a detailed discussion on the financial, economic, and stakeholders' risk analysis). Examples are provided to illustrate many of the issues as well as some practical recommendations on how to proceed. Section II of the Manual presents sector-specific guidelines mainly for conducting the economic analysis of selected sectors.The key sectors that have been included are: Electricity; Road and Transportation; Irrigation; Water Supply; Agricultural extension; Housing; Tourism; Biomedical Waste Management; and Education and Health. Finally, the Annexure contains a discussion of the REFORM implementation experience in the three states of Jharkhand, Karnataka, and Uttarakhand.

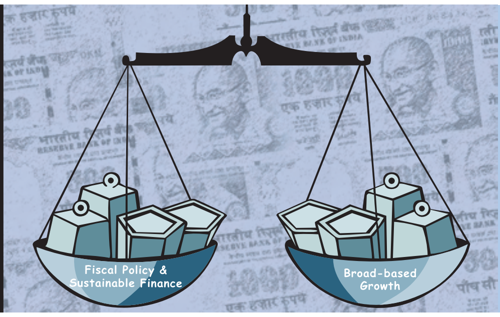
Invited Papers

Volume VI: Invited Papers. This volume contains three invited papers on various dimensions affecting state fiscal management in India and internationally.

Centrally-sponsored Schemes and Funds Flow from Centre to States. This paper by Mr. Subhash Garg, former Joint Secretary, Department of Expenditure, Ministry of Finance, and now Principal Finance Secretary, Rajasthan, was prepared for USAID in March 2006. It arose out of a concern that substantial levels of funds were largely by-passing the consolidated fund of state governments, especially through centrally-sponsored schemes. In light of this, how can state governments be held responsible for the growth and development of those sectors where substantial funds are not under their control? Such impairment of accountability of public funds and constructing new modes of financing continues to be a challenge for state fiscal managers.

India: Fiscal Condition of the States, International Experience, and Options for Reform. This paper by the faculty of Georgia State University was part of the USAID program "Facility," prepared in 2005, to provide inputs to the officers of the Government of India and, more particularly, those in the Ministry of Finance dealing with sub-national fiscal reforms. It provides a six-country international experience and best practices on various fiscal management issues with the objective of introducing and implementing "hard budget constraints." Among others, it includes descriptions of Canada Statistics, the Australian Grant Commission, and Brazil's debt management approaches. Some of the facts and figures are out-of-date. In addition, some of the recommendations are no longer operative due to changes in ground realities. However, the paper continues to have value as some of the recommendations are useful and valid even today and will interest government officials engaged in sub-national fiscal management reform such as the fiscal policy centre in Russia.

Sub-national Fiscal Reforms in India—Achievements and Apprehensions. This paper by Mr. Arunabha Maitra, former Director, Department of Expenditure, Ministry of Finance, and currently the Financial Advisor for the Government of Mizoram, was prepared for USAID in October 2008. It provides a historical overview of the progressive fiscal reform interventions undertaken by sub-national governments of India in the context of the federal financial structure. The paper, in particular, discusses the interventions implemented by the sub-national governments of India as a result of the recommendations of the Eleventh and Twelfth Finance Commissions. The paper also highlights the present fiscal scenario and issues that need to be addressed by the Thirteenth Finance Commission.



Section II

State Case Study

India State Fiscal Management Reform Project (REFORM)

1. Jharkhand
2. Karnataka
3. Uttarakhand

Jharkhand State Case Study

India State Fiscal Management Reform Project (REFORM)

List of Abbreviations

BE	Budget Estimate
CAG	Comptroller and Auditor General
CFS	Centre for Fiscal Studies
CS	Commonwealth Secretariat
CS-DRMS	Debt Recording and Management System (CS-DRMS)
CSO	Central Statistical Organisation
DCID	Duke Center for International Development
DCRF	Debt Consolidation Relief Facility
DE	Development Expenditure
DG	Director General
DIMC	Debt and Investment Management Cell
DoF	Department of Finance
DRMS	Debt Recording and Management System
EFC	Eleventh Finance Commission
FCP	Fiscal Correction Path
FD	Fiscal Deficit
FMIS	Financial Management Information System
FPAC	Fiscal Planning and Analysis Cell
FPC	Fiscal Policy Correction
FRBM	Fiscal Responsibility and Management Act
FRL	Fiscal Responsibility Legislation
FY	Fiscal Year
GDP	Gross Domestic Product
GFD	Gross Fiscal Deficit
GSDP	Gross State Domestic Product
GO	Government Order
GoB	Government of Bihar
GoI	Government of India
GoJ	Government of Jharkhand
GRF	Guarantee Redemption Fund
GST	Goods and Services Tax
IAS	Indian Administrative Service
ICAI	Institute of Chartered Accountants of India
INR	Indian Rupees
IO	Input-Output
IPHS	Indian Public Health Standards
JH	Jharkhand
JPSC	Jharkhand Public Services Commission
KAP	Knowledge, Attitudes, and Practices
MTFRP	Medium Term Fiscal Reform Program
MIS	Management Information System
MoF	Ministry of Finance
MoH	Ministry of Health
MoU	Memorandum of Understanding
MS	Microsoft
MTFF	Medium Term Fiscal Framework
NABARD	National Bank for Agriculture and Rural Development
NCAER	National Council of Applied Economic Research
NGOs	Nongovernmental Organizations
NIC	National Information Center
NIFM	National Institute of Financial Management
NRHM	National Rural Health Mission
PA	Project Appraisal
PD	Primary Deficit
PFAD	Project Formulation and Appraisal Division
PHC	Primary Health Centre
PIP	Program Implementation Plan
PPB	Program and Performance Budgeting
PPPs	Public-Private Partnerships
PRI	Panchayati Raj Institutions
PU	Project Unit
RBI	Reserve Bank of India
RD	Revenue Deficit
RE	Revised Estimate
REFORM	India State Fiscal Management Reform Project
RFP	Request for Proposal
SAG	State Accountant General
SC	Subcentre
SCS	Special Category State
SIRD	State Institute of Rural Development
SKIPA	Sri Krishna Institute of Public Administration
SOE	State Owned Enterprise
SoW	Statement of Work
TA	Technical Assistance
TARF	Tax and Revenue Forecasting
TD	Tender Documents
TFC	Twelfth (XII) Finance Commission
ToR	Terms of Reference
USAID	United States Agency for International Development
VAT	Value Added Tax
WB	World Bank

Box 1.1: Jharkhand Quality Expenditure Success Story

The Water Resources Department in Jharkhand is ranked second in terms of budgetary allocation and third in terms of manpower among the 42 ministerial departments of the state. It inherited a number of anomalies from undivided Bihar. Identification and resolution of some of these issues is progressing with the use of the Program and Performance Budgeting (PPB) methodology:

- A large number of irrigation projects were brought to financial closure with PPB application, some after more than two decades of cost and time overruns. PPB enabled a detailed review of each incomplete project and helped to bring financial closure within a specified time from institutions like the *National Bank for Agriculture and Rural Development (NABARD)*;
- A large number of hidden inefficiencies were unraveled, including the discovery that the Directorate of Irrigation Revenue was spending almost ten times more on salaries than was being collected as water charges. As a result, the Government of Jharkhand (GoJ) is seriously considering dissolving the Directorate and transferring its current responsibility for water charge collection to the Water Users Association, ushering in Public-Private Partnerships (PPPs) in agricultural water management; and
- The application of PPB has begun to help rationalize both manpower and distribution of work volume across offices and divisions of the Water Resources Department. The analysis of plan and nonplan expenditures under PPB is expected to continue to help the government correct this skewed distribution that affects both the efficiency and quality of the government to deliver improved services.

The cumulative effects of the above corrections are enhanced quality of expenditure of public funds, increased efficiency in government operations, and, finally, improved distribution of public resources, resulting in better public services.

Sudhir Tripathi, Secretary, Water Resources
(Annexure No. 9 contains the complete version of the letter from the Secretary Water Resources.)

The Challenge

Prudent fiscal management aims at achieving macroeconomic stability and manageable level of debt burden so that high growth of the economy is maintained. However, this is not an easy task. Several exogenous factors, some of them a matter of inheritance, as in the case of Jharkhand, impact upon the situation and make optimal fiscal management difficult.

In Jharkhand, a combination of factors began to transform the state from one of revenue surplus to one of growing revenue/fiscal deficit accompanied by rising debt burden: *First*, in order to accelerate its development agenda, the state sanctioned a large number of projects without adequate scrutiny of their economic viability. *Second*, in an attempt to quickly bring on board the necessary administrative structures required to address the needs of governance, the ministerial departments burgeoned from 19 to 42 within a span of three years. *Third*, given the initial political instability, experienced by most nascent states, unsustainable expenditures became a recurring feature. *Fourth*, Jharkhand's revenue base, which is largely dependent on the minerals, mines and forest-based industries and primarily subject to central government policies, limited its capacity to generate increased revenue from nontax sources. *Fifth,* in parallel with the above dynamics, the tax/Gross State Domestic Product (GSDP) ratio of the state was far from satisfactory due to a lack of tax rationalization and uncollected tax revenues over a number of years. As a result, one-third (33.3 percent) of the state's borrowing went to meet its current account deficit in 2002-03.

Clearly this situation could not continue. The GoJ realized that given the special needs of the region based on its population and socioeconomic profile and the absence of an adequate basic infrastructure base of the region, the answer laid not in curtailing investments but in improving revenue mobilization, the rate of return from investments and the quality of expenditure. (See Annexure 1 for the *Jharkhand State Socioeconomic Profile.) If* realized, this would help the state move towards a position of fiscal consolidation.[7]

However, the prevalent trends indicated otherwise: the annual budget deficits were increasing over time (see Table 1.1) leading to more and more unproductive borrowings, which, in turn, was increasing interest costs, thereby limiting the state's ability to invest in productive infrastructure and development projects. Consequently, the GoJ recognized the critical need to augment tax and nontax revenue collection, improve the quality of expenditure and stabilize debt. To achieve the above, the state would have to introduce a number of policy interventions and institutional reforms.

This posed an enormous challenge. Jharkhand, as a newly formed state, required the systems, experts, and adequate administrative and institutional structures to implement the required fiscal reforms. Governmental processes needed modernization, especially the financial control measures with respect to commitments, obligations, disbursements, and utilization of public funds. Capacity to accurately forecast and

[7] Fiscal consolidation is defined as a stage in which a balance exists between the expenditure and income of the state coupled with debt sustainability (i.e., possessing a debt level that can be serviced by the state government within the limits of its expected revenue base) without creating an adverse impact between expenditure and income.

analyze revenues and expenditures was also limited and *ad hoc* in nature. Computerization of the treasury system was in the preliminary stages. Further, the exponential expansion in the ministerial departments from 19 to 42 during the first 3 years of statehood was not accompanied by matching staff strength, skills and necessary institutional supporting systems. Finally, the Bihar legacy did not provide Jharkhand with a transparent and accountable public administrative system. For example, departmental officials were being transferred very frequently.

(See Annexure 1 for the *Jharkhand State Socioeconomic Profile*.) (For more information on key indicators for the State of Jharkhand, please see: Annexure No. 3 for a series of tables on key fiscal indicators for the State of Jharkhand for the period from FY 2001-02 to FY 2008-09 Budget Estimate (BE) and Annexure 4 for State Gross Domestic Product.)

State Fiscal Reform Initiatives

In 2001, on recommendation of the Eleventh Finance Commission (EFC), the Government of India (GoI) put in place a state Fiscal Reforms Facility to incentivize the states to undertake a Medium Term Fiscal Reform Program (MTFRP) for fiscal consolidation. This involved undertaking comprehensive reforms in a time-bound manner to achieve fiscal sustainability in the medium term. The GoJ came out with an MTFRP and signed a Memorandum of Understanding (MoU) with the GoI in 2003 in response to GoI's request in 2001. An earlier response was not possible due to the state's lack of capacity to implement the mandate.[8]

Table 1.1: Jharkhand State Fiscal Reform Milestones

Year	Important fiscal Legislations in Jharkhand
2003	Signing of a Memorandum of Understanding with the GoI introducing Medium-term Fiscal Program
2004	USAID REFORM Project Launched
2006	Value Added Tax Introduced
2007	Fiscal Responsibility and Budget Management Act

As per the Fiscal Reforms Facility, for all nonspecial category states such as Jharkhand, it was advised to bring down its ratio of revenue deficit to revenue receipts by five percentage points per annum from 2001-02 (in the case of Jharkhand, its first full budget after statehood) to 2004-05 in order to claim a grant from the Incentive Fund. However, due to its continued lack of capacity and somewhat political instability, Jharkhand could not achieve the stipulated reduction during this period, and its revenue deficit to revenue receipts fell by two percentage points as against the stipulated 15 percentage points.

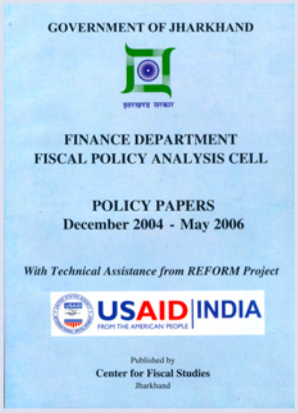
REFORM Interventions

The GoJ and the United States Agency for International Development (USAID) jointly designed the India State Fiscal Management Reform Project (REFORM) initiative in 2004 to assist the GoJ in strengthening its capacity to support its fiscal reform objectives and move toward overall fiscal consolidation.

REFORM pursued a robust fiscal management capacity-building program spanning the gamut

[8] Jharkhand only gained statehood in November 2000. Its bifurcation from its mother state of Bihar had left the state with limited capacity with respect to state government staff strength and overall expertise in public administration.

Box 1.2: Jharkhand Centre for Fiscal Studies



With the establishment of a *Centre for Fiscal Studies (CFS)* in August 2005, Jharkhand has helped pioneer the advancement of fiscal research for state governments. This fiscal think tank is one of the first of its kind in India to be established for continuous fiscal policy analysis and research.

The overriding goal of the GoJ is to maximize the impact and breadth of its development programs through the efficient and quality utilization of limited public funds. To this end, the GoJ needed fiscal discipline in its revenue generation, expenditure control, and public debt management. The CFS has provided the state government with the critical capacity it required to realize this goal.

In late 2004, following REFORM recommendations, the GoJ established a FPAC to undertake priority studies on fiscal management issues. This initiative was helped by a GoJ decision to involve part-time researchers in the work of the cell. As a result, more than a dozen state academicians, retired government officials, and other technical experts were recruited to work with Finance Department officers in the FPAC. The CFS then became the umbrella organization housing the FPAC and its companion cell, the Debt and Investment Management Cell (DIMC).

To date, the FPAC and the DIMC have been commissioned by the state government to undertake a total of 15 studies on various revenue, regulatory, and debt-related issues affecting Jharkhand. Some of these studies have exposed discrepancies between stated government policy and actual implementation of that policy (such as administration of the state excise tax policy).

Finally, five of the completed studies have been published in a compendium that is available to the public on the GoJ Web site as part of the Right to Information Act.

of fiscal activity: Revenue Management (tax and nontax policy analysis and revenue forecasting); Expenditure Management (budgeting, treasury, pension); Debt and Investment Management (debt, contingent liability/guarantees, investment and state creditworthiness); and, Project Appraisal. REFORM also recommended the establishment of a Fiscal Policy and Analysis Cell (FPAC) to institutionalize a culture of continuous analysis of state revenue and expenditures to promote better informed decisions.

As a result of the joint consultation process with REFORM, the GoJ identified the following areas in order of priority for technical assistance under REFORM:

- Establishing a fiscal policy think tank that would serve as the nodal agency to create a culture of fiscal analysis and informed decision-making in the state government;
- Improving GoJ capacity to conduct revenue analysis in order to develop alternative tax policy measures;
- Introducing a budgeting process to ensure stronger link between outlays and outcomes for greater accountability of public funds in delivering results on the ground on a sustainable basis;
- Computerizing treasury operations and redesign of related business processes:
- Recommending implementation of state pension reform;
- Establishing a debt and investment management framework to improve quality and profile of debt and investment; and
- Institutionalizing best practice project appraisal methodology to ensure selection of viable capital projects.

Below, the rationale for the selection of these particular best practice tools and techniques as well as implementation methodology is presented.

Fiscal Policy and Analysis Cell

Interestingly, GoJ's first priority became the establishment of a fiscal analytical cell to assist the government to improve informed decision-making capacity. Departmental secretaries, including Finance, were left to take critical policy and procedural decisions in absence of any form of rigorous analysis. To fill this gap, REFORM recommended the establishment of a formal structure with dedicated qualified experts in various economic and financial disciplines with access to timely quality data/information and analytical tools to generate Issue Papers to assist decision makers.

The FPAC was to serve as cornerstone of this capacity-building effort as it was the institutional structure that would serve as the nodal agency for coordinating and reporting on the fiscal reform practices being introduced into the GoJ administrative apparatus.

Revenue Management

The newly established FPAC played a critical role in strengthening Jharkhand's capacity to improve revenue management. Jharkhand needed a robust revenue base to respond to its investment needs. Thus, tax and nontax revenue reform became and continued to be a key area of concern for the GoJ and demonstrates the need to continuously conduct analysis to strengthen decision-making capacity. However, its nontax/GSDP ratio, averaged 3.1 percent for the years 2001-04, was far below its potential given the state's natural resources endowment. Figure 1.1 highlights the sources of GoJ revenue from different sources as a percentage of GSDP over

The GoJ decision to establish an FPAC as its first fiscal reform initiative was pivotal to its future fiscal reform efforts. This decision showed that its attitude toward fiscal reform was in consonance with the ultimate objective of REFORM to leave behind a nodal agency to drive and document fiscal management. Establishment of the Jharkhand state FPAC was undertaken in a comprehensive manner. In sequential order, the steps followed to establish the FPAC were:

- Providing the blueprint by REFORM for the establishment of the FPAC, this included detailed description of the expertise required and possible mandate;
- GoJ's accepting the blueprint, demonstrated by the release of a Government Order (GO) to formalize establishment of the FPAC with accompanying staffing and funding from its own budgetary resources;
- Identifying the Shri Krishna Institute of Public Administration (SKIPA, the state administrative training institute, Ranchi) to provide the physical location for the proposed FPAC under the name of the Centre for Fiscal Studies (CFS);
- Appointing a full-time Director, seconded by the Department of Finance (DoF), to head the CFS;
- Identifying and inducting part-time resource persons in the FPAC along with full-time GoJ officials. Given the lack of staff strength within the GoJ, joint concerted effort was made by GoJ and REFORM to identify appropriate researchers from state academic and professional institutions (Birla Institute of Technology, Ranchi University, Xavier Institute of Social Services, St. Xaviers College and State Institute of Rural Development [SIRD]). The benefit of involving experts from outside GoJ was to maintain continuity even when frequent transfers of government officials occurred and to quickly staff FPAC with qualified researchers;
- Commissioning papers by DoF to FPAC to conduct analysis in several critical areas to assist in immediate decision-making;
- Launching FPAC studies through the use of REFORM experts working in concert with FPAC researchers to provide the analytical framework needed to begin the required analyses;
- Submitting completed studies to the Principal Finance Secretary for review, comment, and submission to the Chief Secretary and state cabinet for consideration;
- Launching a dedicated FPAC Web site by the Principal Finance Secretary for posting abstracts of accepted papers and other fiscal-related information for public dissemination;
- Introducing REFORM advised training programs in the SKIPA curriculum to upgrade capacity of FPAC staff on a continuous basis;
- Developing a desktop reference guide by REFORM on how to establish and operationalize an FPAC-like unit to sensitize and guide other state governments contemplating a similar initiative. (See *Volume III, Annexure 5 for the Fiscal Policy Analysis Cell Implementation Guide); and*
- Finally, and currently, encouraging the GoJ to publish its completed studies in a compendium to strengthen sustainability of the effort.

the years 2001-04. (See Figure 1.1 for Jharkhand revenues by source from FY 2001-02 to 2003-04.)

After creation of the state, the immediate problem on the revenue front was to encounter with low own tax-GSDP ratio of the state. The negative trend was that the ratio was not showing any improvement over the first three years after statehood, rather, it had fallen below the level of 2001-02. The GoJ has the potential for generating nontax revenues from tourism and mining royalties.

In order to improve both the capacity and practice of revenue management in the GoJ, REFORM responded to state government requests to assist it to prepare its tax departments, businessmen, labor unions, and general citizenry on the introduction of Value Added Tax (VAT). This REFORM did in a series of public seminars held throughout the state in 2004. In addition to this effort, REFORM worked to strengthen the GoJ revenue management capacity by:

- Working with the DoF to identify staff across state ministerial departments including members of the FPAC for training in revenue forecasting and revenue analysis. This approach included: formal classroom training, individual and small group mentoring sessions, shadowing of officials as they discharged their daily duties, and, finally, reviewing research and White Papers under preparation. Together, these skill development efforts attempted to upgrade the skills of government officers in analyzing the tax policies, revenue forecasting and assessing the efficiency of tax administration;
- Developing and designing a macroeconomic database to support the proposed Input-Output Table for revenue analysis. An existing macroeconomic database with National Council of Applied Economic Research (NCAER) was used as the template for this exercise. Necessary data was extracted from GoJ's existing socioeconomic database and modified, accordingly;
- Developing a desktop reference manual for use by government officers on revenue forecasting along with a desktop reference manual was developed for use by government officers in constructing and using both the I-O Table and its supporting macroeconomic database. (See *Volume III for the Revenue Management Practitioners' Guide* for more details);
- Designing and establishing a draft I-O Table to enable GoJ to analyze the implications of revenue policy decisions, especially VAT, on the state economy;
- Immediately after developing these revenue management tools, training was provided to GoJ officials on how to access the macroeconomic database to support the I-O analysis; and
- Currently, GoJ is in the process of identifying a nodal department to promote use of the above tools (I-O Table and macroeconomic database) with technical and financial support from the Central Statistical Organization (CS0) of the GoI.

The nontax revenue-GSDP ratio also did not show any appreciable improvement and was less than three per year or less during the first three years. The Central transfers also showed a decrease during this period and ranged from between 6.01 percent of GSDP to just over 10 percent. Under the circumstances, optimum exploitation of the elasticity of sates own revenue resources to fiscal efforts was imperative and towards this end there was need to equip the staff of the revenue collection department with latest techniques and tools for revenue management and forecasting.

A priority for the GoJ was the introduction of the value added tax (VAT). The recommended target date for its introduction, as communicated by the GoI, was April 2005. Therefore, sequentially, this became the second priority under REFORM. The task was to sensitize a large number of stakeholders on the implications and sequencing of the introduction of state VAT. The actual training and preparatory work for its introduction was left to the World Bank (WB), which at that time had shown interest in supporting this initiative.

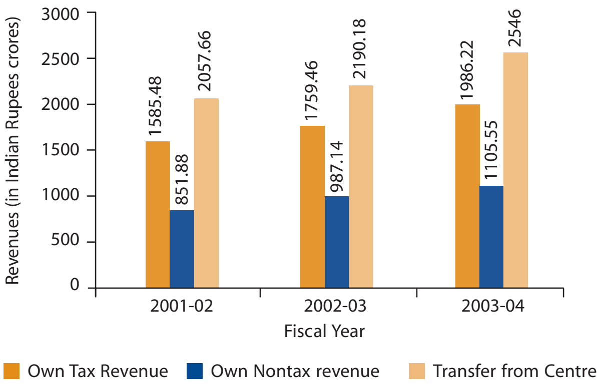
The CFS (in the process of being established under REFORM) became the primary vehicle for undertaking a number of analyses on revenue-related issues.

REFORM was further requested to help build GoJ's capacity in assisting and determining appropriate levels of tax and nontax revenues. An input-output (I-O) table (internationally considered a useful tool in achieving this objective). To promote quality analysis and forecasting with the use of the I-O table, a macroeconomic database was also developed.

Expenditure Management

As stated above, the GoJ made development of Jharkhand's social and economic infrastructure a top priority following bifurcation from Bihar.

Figure 1.1: Jharkhand State Revenue: 2001-04



Sources: 2001-2004

Over the first eight years of statehood (from 2001-02 to 2008-09) as against a steep rise in total expenditures (revenue plus capital outlay) of 317 percent, growth in GSDP was 210 percent. Total expenditures grew from INR 6016.4 crores in 2001-02 to INR 17,548.33 crores in 2008-09 BE.[9] The corresponding increase in GDSP was from INR 32706.05 crores to INR 68894.41 crores. Figure 1.1 depicts the steady rise in expenditures in relation to revenue receipts. As indicated in Annexure 3A.1, the trends for capital expenditures and capital receipts more or less mirrored one another. As did total receipts and revenue receipts and total expenditures and revenue expenditures respectively. Essentially, the GoJ was spending all of its various receipts on corresponding expenditures items.

Thus, one important intervention under REFORM was to transform the existing budgetary process into a system where the allocation of public funds was based on performance indicators to enable GoJ to track the productivity of publicly-funded programs on the ground and, in the process, to increase accountability of public fund usage. The result was the introduction of the program and performance budget (PPB).[10]

Although implementation of the PPB was initiated by REFORM in July 2005, due to other GoJ priorities such as the establishment of the FPAC and the introduction of VAT, GoJ ownership of the process did not take place until early 2006. The introduction of the PPB was partially influenced by the central government's introduction of Outcome Budgeting and Performance Budgeting.

Once started, the PPB implementation began slowly but accelerated to the point where today, almost 95 percent of state budget is covered with this methodology. (See Annexure 5 for a complete list of GoJ departments and directorates.) The PPB roll-out took place over a period of 36 months in a four-phase implementation as described below:

- *1st Phase-July 2005 to March 2006:* Two Pilot Departments (Social Welfare and Water

[9] BE represents Budget Estimate.

[10] The PPB methodology enables linage between budget outlays and program outcomes, in the process, enabling easier measurement of program delivery against specific deliverables.

Box 1.3: Jharkhand Tax Enforcement


GOVERNMENT OF JHARKHAND
FINANCE DEPARTMENT
FISCAL POLICY ANALYSIS CELL

TRAINING MANUAL

ON

TAX ANALYSIS AND
REVENUE FORECASTING

With Technical Assistance from USAID India REFORM Project

USAID

Following a study carried-out by the Centre for Fiscal Studies, the Government of Jharkhand (GoJ) was able to dramatically expose tax evasion that had occurred with the implementation of its new excise tax policy on the sale of liquor

The study, on the impact of the new state excise policy, uncovered a system of tax evasion by liquor merchants that led to an estimated loss of more than INR 80 crores in the first two years of the new policy.

The study found that the tax policy, published in the state Gazette in February 2004, was not implemented properly due to the issuance of a separate government notification that effectively exempted liquor merchants from the tax.

The study findings caused serious political upheaval in the state legislature that resulted in an audit of the Excise and Prohibition Department by order of the Chief Minister.

Since this study was released in early 2007, the state constituted a high level committee under the chairmanship of the Member, Board of Revenue, to look into the entire gamut of the new Excise Policy.

Resources) were trained in PPB Methodology and submitted 2006-07 budgets in PPB format to Finance Department in February and August 2007, respectively;

- *2nd Phase-2006-07:* Commercial Taxes; Road Construction; Mines and Geology; Welfare; Health ,Medical Education and Family Welfare; Urban Development; Human Resources Development; Energy; Rural Development; and Building Construction Departments were trained in the PPB Methodology and mentored while preparing their 2007-08 budgets using the PPB format;
- *3rd Phase-2007-08:* Planning and Development; Finance; Home; Excise and Prohibition; Registration; Agriculture; Industries; Cabinet Secretariat and Coordination ; Institutional Finance and Programme Implementation; and Cooperation Departments were trained in the PPB Methodology and mentored while preparing their 2008-09 budgets using the PPB format; and
- *Fourth, and Final Phase- April 2008:* Tourism; Drinking Water and Sanitation; Public Relations; Science and Technology; Information Technology; Civil Aviation; Forest and Environment; Food Supply and Commerce; Revenue and Land Reforms; Labor and Employment; Art, Culture, Sports and Youth Affairs; Panchayati Raj; Disaster Management; Housing; Cabinet (Election); Cabinet (Vigilance); and Law (Justice) Departments were trained in PPB methodology in early 2008. These departments have been mentored to prepared their 2009-10 budgets using the PPB methodology.

In response to the GoJ's request for assistance in treasury reform, REFORM provided assistance in the analysis of the current operational structure and practice. REFORM also provided GoJ with a road map to help introduce necessary steps toward reform. Limited resources (time and finance) prevented REFORM from providing assistance in actual treasury reform implementation. Given a choice, the PPB was considered a more urgent and critical intervention (especially in light of the assistance that was already being provided by the National Informatics Centre (NIC) in treasury computerization and reform as well as the steps already taken by the GoJ.

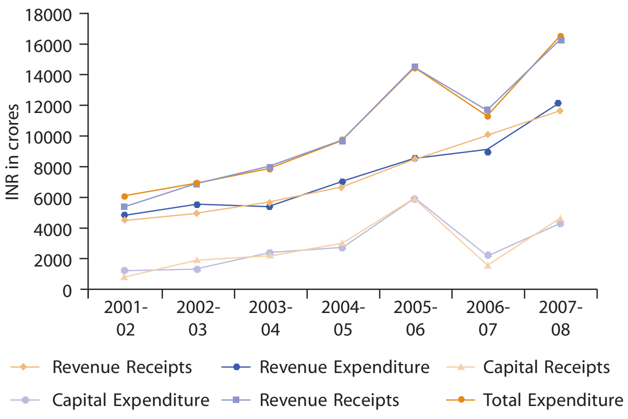
Debt and Investment Management

At the time of bifurcation from its mother state, Bihar, Jharkhand inherited a number of liabilities and assets. These are still under negotiation with the Government of Bihar (GoB). The challenge was to strengthen GoJ's ability to better manage its debt and investment portfolios especially in light of its nascent statehood and the expected unquantified liabilities and assets inheritance from Bihar.

REFORM worked with the GoJ to reverse the negative fiscal trends defined above. Reversing the fiscal (debt, investment, contingent liability) trends required several different kinds of assistance including:

- Defining new organizational structures—Debt and Investment Management Unit;
- Suggesting amendments to existing laws or procedures to add more discipline to financial management and the development of policies with financial effects;
- Developing analytical tools (databases and models);
- Training staff in analytical and debt management techniques; and
- Defining more effective governmental information systems and communication processes *(Commonwealth Secretariat Debt Recording and Management System (CS-DRMS)*.

Figure 1.2: Expenditure and Receipts of Government of Jharkhand (2001-02 to 2007-08)



The REFORM vision was to have in place in each state the organizational structures, debt management analytical tools, decision processes, communication channels, information sources, and trained staff that will enable the states to maintain a prudent debt, contingent liability and investment management (balanced fiscal posture) on a sustainable basis. Achieving this outcome would enable the states to reverse the debt spiral and, over time, be able to gradually allot additional public resources to the more productive development and infrastructure needs.

Government of Jharkhand (GoJ) began the task of collecting its GoI debt and other outstanding debt information *ex ante* to REFORM's intervention. However, the data collection task was incomplete and not comprehensive and consisted largely of recording transactions either in handwritten ledgers or in *Microsoft (MS) Excel* spreadsheets. REFORM provided state government officials with debt data templates to begin the task of collecting debt, contingent liability and

The PPB roll-out in Jharkhand was designed and executed as outlined in the manner recommended in the REFORM guide on PPB Implementation (See *Volume II* of the *REFORM Project Compendium with Practitioners' Guide* for the *Program and Performance Budgeting Implementation Guide*.) The following are the highlights of the nearly universal coverage of the GoJ ministerial departments with PPB:

- The first set of training workshops conducted included two major spending departments: Social Welfare and Water Resources, which both prepared PPB documents for the 2005-06 fiscal year (FY) and submitted these to the Finance Department for presenting to the state legislature;
- Following this start, the GoJ made an early and critical decision to extend the PPB methodology to all its ministerial departments before the close of the REFORM project. As a result, every February for the last three years, a government order has been issued mandating which departments would have to form PPB task forces, be trained, and prepare departmental PPB documents for the following fiscal year. This attitudinal change and mandated practiced proved to be very effective in extending the PPB methodology throughout the government;
- All department PPB task forces participated in an initial two-day orientation and training workshop that was then followed by a series of mentoring sessions within each ministerial department task force to ensure uniformity, quality and timely completion of their PPB documents;
- In early 2007, the Principal Finance Secretary met with all the PPB task forces and their respective departmental secretaries to assess progress and finalize the documents for all departments; and
- As a result of this accelerated roll-out of the PPB methodology at the ministerial department level, the GoJ prepared and submitted a plan to the Ministry of Finance, GoI (MoF), to extend its PPB roll-out to all 24 district health resource centers in the state; this proposal has been approved by the MoF and with USAID funding, the health sector initiative, which is the first of its kind in India, began in August 2008 with a March 2009 target completion date.

Jharkhand District Health Sector Fiscal Management Initiative

In an ambitious plan that is the first of its kind in India, the Government of Jharkhand (GoJ) has launched an initiative to ensure the use of program and performance budgets (PPB) in all 24 of its district health offices.

As a result of the successful coverage of almost 100 percent of its ministerial departments with PPB (*e.g.*, outcome budgets), the GoJ has decided to extend this budget planning and tracking methodology to the entire public health sector in the state.

This initiative is being implemented by the Jharkhand State REFORM team with financial assistance from the ITAPS project of the United States Agency for International Development (USAID). The work plan calls for training secretariat-level National Rural Health Mission (NRHM) budget officers along with teams of four officers from each of the 24 NRHM district health resource centers by the end of Fiscal Year 2008-09.

The PPB methodology will enable the Jharkhand NRHM program to improve its health service program delivery by enabling the rational distribution of manpower and work responsibilities across its various offices. PPB makes this possible because it allows for the monthly mapping and tracking of budget utilization by programs, subprograms, and schemes, which, in turn, helps managers to identify those programs and schemes experiencing time and cost delays in budget and work execution.

When completed, this ambitious fiscal reform initiative will make Jharkhand the first state in India to have implemented an outcome budgeting methodology for the health sector in all of its districts. This will make the state a pioneer in meeting the Government of India recommendation for extending this budget methodology to the district level. It will also make Jharkhand the first Indian state to demonstrably respond to the *13th Finance Commission* recommendation for state governments to improve their social sectors expenditure quality.

investment data more systematically. This effort enabled the GoJ to mainstream its internal debt, guarantee and investment management procedures.

Project Appraisal Management

A major challenge faced by Jharkhand at its inception, and given its nascent status and difficult socioeconomic profile, was to quickly identify and bring on board relevant and appropriate economically viable projects to accelerate the establishment of an appropriate socioeconomic infrastructure base. In the absence of good project appraisal capacity, the concern was that a number of economically unsustainable and unviable projects would be funded that would both fail to achieve the intended results as well as erode the state's initial surplus base (which was already beginning to happen).

Thus, the REFORM was asked to help develop a cadre of state officials trained in modern project appraisal techniques (quantitative and qualitative), also to introduce an "international best practice" project appraisal manual to serve as a desk reference for all officials responsible for project selection.

Institutionalization

In order institutionalize the REFORM fiscal reform toolkit, the GoJ decided to use its two apex training institutions, SKIPA and the State Institute of Rural Development (SIRD) to become the Centers of Excellence for training activities in the state. To realize this goal, an implementation plan was executed by REFORM in close coordination with the DoF.

In May 2007, GoJ enacted the Fiscal Reforms and Budget Management (FRBM) Act as part of the recommendation of the Twelfth Finance Commission (TFC). The FRBM Act required state governments to embark on a path of fiscal corrections, which required them to conduct rigorous analysis and forecasting of the state finances. This further demonstrated the need for many of the REFORM tools and techniques introduced. Under the FRBM Act, by 2008-09, the states were to eliminate the revenue deficit and reduce the fiscal deficit to 3 percent of the GSDP. In turn, the states would be allowed to avail a central loan consolidation facility for a fresh term of 20 years immediately on enactment of FRBM legislation.[11] Further, a facility of debt write-off linked to absolute amount of reduction of revenue deficit would also be available to the states during the award period of the TFC (from 2005-06 to 2009-10). Although, as per the scheme, the states were required to enact the FRBM Act in 2005-06, the GoJ could only complete the drill in 2007, faced with a dilemma of the benefits accruing from the fiscal consolidation and availing of the Facility on the one hand, as against the cost of sacrificing the much needed investment in infrastructure on the other.

> As the liabilities of the undivided state (Bihar) begin to devolve onto Jharkhand over time, its debt/GSDP is expected to substantially increase. Currently, in 2008-09 it stands at around 36 percent of GSDP (INR 24605.75 crores), unacceptable by the TFC standard, which recommends that this ratio not be more than 28 percent by 2009-10. As a consequence, the danger of a rise in nonplan revenue expenditure commitments will also impact on state finances and its development agenda.

[11] The TFC recommended that the central loans contracted up to March 2004 and outstanding as on March 2005 maybe rescheduled for a fresh term of 20 years with a reduced annual interest rate of 7.5 percent per annum.

The following steps, in sequential order, were undertaken by REFORM to strengthen the debt and investment management capacity of the GoJ:

- Preparing the terms of reference and securing GoJ approval for a state Debt Investment Management Cell (DIMC) as part of the FPAC to help promote and sustain debt reform efforts, especially through continuous analysis. The FPAC GO included the required job descriptions for the proposed DIMC staff as well as its budget authorization;
- Sensitizing GoJ officials on the need and rationale for a state DIMC;
- Assisting the GoJ to collect information on debt before the start of REFORM initiatives, however, the data collection and management efforts were neither comprehensive nor well-structured in their implementation. Under REFORM the consolidation of all GoJ debt, contingent liability, and investment data was initiated into one comprehensive *Microsoft (MS) Excel* data set;
- Developing a comprehensive toolkit to assist practitioners with the monitoring and management of state government debt, investments, government guarantees and state creditworthiness;
- Sensitizing GoJ officials on debt sustainability, new debt instruments, state creditworthiness, and international experiences/best practices through a series of national-level workshops held in New Delhi, featuring topical presentations by experts from the Reserve Bank of India (RBI), Planning Commission and Ministry of Finance (MoF) (*i.e.*, Aid Accounts);
- Designing and submitting debt data templates to begin the task of collecting debt, contingent liability and investment data for more systematic reporting; and
- Introducing and implementing the *Commonwealth Secretariat (CS) Debt Recording and Management System (DRMS)* software to track and manage debt. The software was modified to include contingent liabilities. Subsequently, GoJ officers were trained in use of the software, including migration of earlier datasets to the software database.

Box 1.4: Improving Jharkhand Public Investment Returns

Responding to worsening revenue deficit, the Government of Jharkhand (GoJ) is attempting to reverse its fiscal distress by using its excess liquidity to increase state revenue.

Currently, the GoJ is investing its cash holdings in low interest Treasury Bills that pay out at 4 percent per annum with an average rate of return of only 3 percent. Based on suggestions from REFORM, the government is now seriously considering shifting its short-term investments to Fixed-Deposit Bonds marketed by HDFC Bank that pay out at 9.5 percent per annum with an average rate of return of more than 10 percent for maturities over three years.

Should the GoJ follow through with this investment option, they could realize an annual yield of INR 57 crores as opposed to the current return of INR 5 crores. Such a dramatic increase in state return on investment revenues would help to not only lower the state revenue deficit but it might also provide additional funds for development programs.

REFORM Achievements

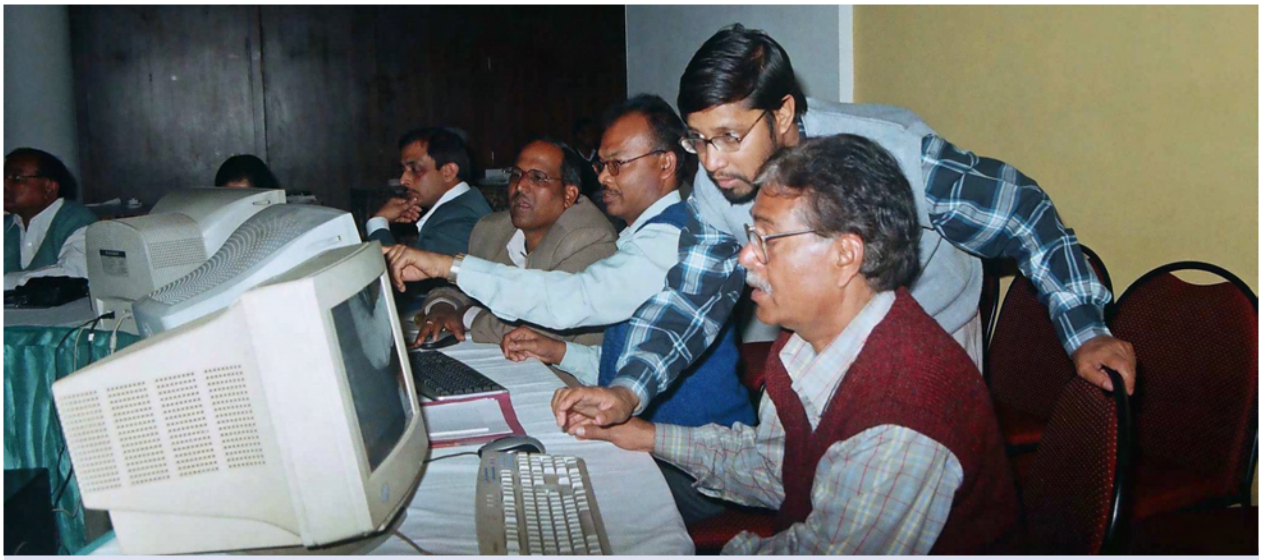
The REFORM achievements have been evaluated in terms of *appropriate capacity* (i.e., expertise of state officials and strength of fiscal infrastructure) and the *practices* (i.e., consistent, transparent, and accountable processes) to perform relevant, economic and statistical analyses to make sound fiscal policies and implementation choices at the

In sequential order, the REFORM project appraisal capacity-building effort involved the following steps:

- Developing a proposal by REFORM to upgrade the project appraisal skills of the GoJ officials and having accepted by the state government;
- Identifying GoJ officials to attend the project appraisal capacity-building training courses;
- Formal classroom training for GoJ officials in international best practice project appraisal methodology including analysis techniques previously not used in the state such as advanced risk modeling using the *Crystal Ball* software, economic and financial cost-benefit analyses, and stakeholder analysis;
- Introducing the case-study methodology of training immediately following the formal instructions to develop a series of sector-specific guidelines based upon actual GoJ project proposals;
- Developing a comprehensive project appraisal manual (with 11 sector-specific guidelines) to serve as a desk reference guide on how to analyze, appraise, select, and evaluate projects. (See *Volume V* for the *Project Appraisal Practitioners' Guide* for more details.);
- Drafting and recommending GoJ issuance of a GO that would require use of the REFORM project appraisal methodology for all GoJ projects exceeding INR 50 million; and
- Finally, recommending extension of the process beyond project appraisal to include project formulation, monitoring and evaluation. The terms of reference were prepared by REFORM for the establishment of a Project Appraisal and Formulation Division (PFAD) to be located in the Planning department. Currently, this proposal is under GoJ consideration.

state level. The social science construct *Knowledge*, *Attitudes*, and *Practices* (KAP) was deployed for this purpose. Since it was important to capture the efficiencies and effectiveness that are beginning to accrue from the introduction of the new practices, *Impact* was added to the KAP construct. REFORM was therefore evaluated in terms of *K-A-P-I*—knowledge transferred, attitudes changed, practices introduced and their initial impact. KAPI may be defined as follows:

- **K**nowledge Transferred: Skill sets enhanced through international best practices. This includes training provided, manuals developed, databases established, and reporting templates designed and introduced;
- **A**ttitudes Changed: This signals acceptance of the need for reform, understanding the changed methodology and a willingness to practice it. This includes cabinet decisions/ approvals, government orders and circulars issued, notifications released, curricula introduced and, funds, staff, and facility allocated by the respective state governments;
- **P**ractices Introduced: Actual application of the new practices introduced. This includes the commissioning of FPAC studies, project selection based on project appraisal methodology introduced under REFORM, international best practices introduced in annual curricula of state civil service training institutes, development of departmental PPB documents, report on debt using REFORM designed reporting templates, etc.
- **Initial I**mpacts Noted: Applications of new practices translating into efficiencies in the



Box 1.5: Jharkhand Project Appraisal Reform Initiative

In order to improve its project selection capabilities, the Government of Jharkhand (GoJ) established an Empowered Committee (EC) chaired by the Chief Secretary or Development Commissioner. Other EC members include the Secretaries of Finance and Planning and the secretaries of departments submitting project proposals for review and approval. The recommendations of EC shall be submitted to the State Cabinet by the concerned department for a final decision.

The EC is in the process of establishing its operational arm, to be called the Project Formulation and Appraisal Division (PFAD), which will house the State Planning Department. This initiative is a result of a REFORM recommendation to improve GoJ project preparation and appraisal. In addition to setting up the PFAD, the GoJ will issue a government order (GO) requiring a structured appraisal process for all projects costing more than INR 5 crores.

Once it is operationalized in late 2008, the PFAD will enable the GoJ to ensure optimal utilization of state resources by examining the different project (investment) alternatives and their funding options. It is also expected that the substantial cost and time overruns, which have become a common feature of public sector projects, will abate as projects approved for implementation will have the necessary funding arrangements in place to ensure their timely completion. Finally, the institutionalization of a structured project formulation and appraisal process will enable the GoJ to meet its obligations to the people of Jharkhand by delivering major projects in a consistent and competent manner.

Sequentially, REFORM proposed the following steps toward establishment of a Centre of Excellence:

- Undertaking a detailed needs assessment of the two state training institutes—SKIPA and SIRD—to be conducted that would include a road map for transforming these institutions into Centers of Excellence for public finance training;
- Identifying trainers (faculty) from its various capacity-building programs who would impart the training, especially using the case study methodology; and
- Encouraging the SKIPA and SIRD to adapt and include REFORM training course materials and manuals in their curricula and annual training calendars.

Box 1.6: Jharkhand Capacity-building for Sustained Fiscal Reform

In order to maintain the momentum generated by REFORM, the Government of Jharkhand (GoJ), took ownership of the program and performance budgeting (PPB) and project appraisal (PA) capacity-building programs. The GoJ Shri Krishna Institute for Public Administration (SKIPA) allocated its own budget funds to conduct courses in modern PPB and PA techniques as part of its *Foundation Training Program* for Jharkhand Administrative Service (JAS) and Jharkhand Finance Service (JFS) personnel. These courses were led by GoJ officials trained by REFORM and developed as trainers.

As of mid-2008, two training courses (one in each fiscal area) that were fully funded by the GoJ were completed. Further course offerings are scheduled for the remainder of the year. This should result in the training of up to 100 JAS and JFS personnel every fiscal year.

In addition, the GoJ State Institute for Rural Development (SIRD) is also preparing to fund its own training courses in PPB and Project Appraisal.

The net effect of GoJ support for these capacity-building programs has been their assumption of full ownership for the funding and conduct of these training courses using the trainers developed by REFORM. This ownership, coupled with reliance on GoJ trainers, ensures the long-term sustainability of these fiscal capacity-building programs and their institutionalization into the regular annual training calendars of these two state training institutions.

allocation and use of public funds. Examples include the savings accrued, poor projects filtered out, quality expenditures improved.

With respect to Jharkhand, initial reports on the impact of the REFORM interventions on the state's fiscal management capacity are harbingers of what can happen if there is a serious and sustained effort to re-engineer fiscal management practices based on international best practice standards.

Achievements in Terms of Knowledge Transfers

Expenditure Planning and Management

- More than 300 GoJ officials have been trained at all secretariat as well as district levels in PPB. (See Annexure 7 for the PPB rollout report.)
- A core group of six trainers and mentors have been identified, trained and are available to serve as trainers/mentors.

- *PPB Implementation Guide* and *Procurement Guide* developed and accepted by GoJ.
- S/W database developed and presented to GoJ for converting general budget data into program/scheme data.

Revenue Management

- More than 200 GoJ officers have been trained in various tax and revenue management topics.
- A *Revenue Management Guide* has been developed for use by the GoJ.
- An Input-Output Table along with a supporting macroeconomic database has been developed and presented to the GoJ for its use.

Debt and Investment Management

- Implementation of the *CS-DRMS* software.
- Debt and investment reporting and tracking templates developed and presented.
- Six officers have been have been identified, trained and are available to serve as trainers/mentors.
- A *Debt Toolkit* and other manuals have been developed and accepted for use.

Project Appraisal

- More than 70 officers have been trained in the Harberger project appraisal methodology.
- A core group of 10 officers have been identified, trained and are available to serve as trainers/mentors.
- More than 70 officers trained in *Crystal Ball* software.
- A *Project Appraisal Guide* with sector-specific guidelines has been provided for GoJ reference and training at both the SKIPA and SIRD.
- The ToR for a project formulation and appraisal division (PFAD) has been submitted for consideration by the GoJ.

Institutionalization

- Training of FPAC resource persons in how to conduct good analysis have been completed and these FPAC members are on duty conducting fiscal research for the GoJ. (See Annexure 8 for a list of FPAC studies.)

Achievements in Terms of Attitude Changes

Expenditure Planning and Management

- The PPB methodology has been institutionalized through GoJ issuance of 3 annual budget circulars since 2006.
- The PPB methodology is currently being extended to all 24 state district health resource centers.

Revenue Management

- Structured analysis of revenue management issues is being undertaken by the Centre for Fiscal Studies and the FPAC.
- Public acceptance of VAT and its subsequent introduction was facilitated by awareness-raising seminars conducted by REFORM.

Debt and Investment Management

- The GoJ has accepted the need for structured analysis, comprehensive database, reporting structures for improved debt/contingent liabilities management to facilitate timely tracking.

Project Appraisal

- The GoJ has accepted need for a structured analysis of major capital projects has led to GoJ considering establishment of an Empowered Committee (EC) chaired by Chief Secretary/Development Commissioner to review and approve project proposals before submission to the state cabinet.

Institutionalization

- A 16-member FPAC/DIMC has been established and provided with supporting staff, budget, facility and a dedicated Web site.
- A high power committee has been established with Development Commissioner serving as its Chair along with the Principal Finance and Planning secretaries as additional members in order to review FPAC policy papers.
- The *SKIPA* has allocated its own budget funds to conduct courses in PPB and project appraisal techniques as part of its annual training program.

Achievements in Terms of Practices Introduced

Expenditure Planning and Management

- Thirty-nine (39) out of the 42 GoJ ministerial departments have established and are fielding PPB task forces that have prepared PPB documents covering more than 95 percent of the budget.
- The PPB methodology institutionalized through GoJ issuance of three consecutive annual budget circulars.
- The GoJ is using the *Implementation Guide* as a training tool at the SKIPA and SIRD and as a desk reference for its PPB Task Forces.

Debt and Investment Management

- Responding to worsening revenue deficit, the GoJ is actively considering shifting its short-term investments to fixed deposit bonds marketed by the *HDFC Bank* to increase its annual yield to INR 57 crores from the current return of INR 5 crores.
- The GoJ DIMC/FPAC has begun to collect and feed data in the *CS-DRMS* format following the training and mentoring received in use of the CS-DRMS software.

Project Appraisal

- The GoJ is using the *Project Appraisal Practitioners' Guide* as training tools at the SKIPA and SIRD and as a desk reference for its project appraisal trainees and mentors.

Institutionalization

- The FPAC has completed seven out 15 studies and five have been published by the GoJ in a compendium for circulation throughout the state government and posting on the GoJ FPAC Web site.
- The SKIPA PPB and project appraisal courses are being led by GoJ officials trained by REFORM.
- The GoJ has been publishing an annual state "Economic Survey Report" on the state government Web site for the last three years.

Achievements in Terms of Initial Impact

Expenditure Planning and Management

- The Water Resources Department has used the PPB methodology to: complete long-delayed and cost overrun irrigation projects; discover inefficiencies, (*e.g.*, spending almost 10 times more on Irrigation Revenue Directorate salary than actual water charges). GoJ is now considering closure of directorate and transferring its responsibilities to the Water Users Association.

Revenue Management

- An FPAC study on the GoJ Excise Tax Policy uncovered an estimated loss of more than INR 80 crores in the first two years of the policy due to poor implementation. This led to the formation of a High Level Committee under Chair of Member Board of Revenue for further review.
- REFORM-led VAT training facilitated introduction of the tax in the state and, today, this revenue source has enabled the GoJ to increase its own tax revenues from 4.99 percent of GSDP (INR 1986.22 crores) in 2003-04 to 8.03 percent of GSDP (INR 5535.65 crores) in 2008-09 BE.

Debt and Investment Management

- The GoJ has consolidated all of its public debt data into one dataset and migrated it to the *CS-DRMS* database enabling its DIMC to better manage and report on the state public debt portfolio.

Institutionalization

- The establishment of the *Centre for Fiscal Studies* and the affiliated FPAC has enabled the GoJ to conduct important fiscal policy research leading to changes in public finance policy.

REFORM under Achievements

Time constraints prevented the REFORM project from completing its entire agenda for improving and strengthening the fiscal structures and systems of the GoJ.

Firstly, despite patient and persistent encouragement by REFORM, the GoJ did not establish a project unit (PU) that would be responsible for ensuring comprehensive project analysis, appraisal, selection and monitoring on a continuous, regular basis. Even though this task remains incomplete, the GoJ does have a pool of experts who have already begun to conduct analysis, appraisals and recommend selection of projects using REFORM project appraisal guidelines and the *Crystal Ball* software. It is expected that the GoJ will issue a government order in 2008 establishing a Project Formulation and Appraisal Division that will also require use of the REFORM project appraisal methodology for all capital projects costing more than INR 50 million.

Secondly, the capacity-building effort to strengthen the ability of the GoJ to better forecast its future revenues and expenditures was not fully completed. Although the project did provide the GoJ with a rudimentary input-output table and an initial macroeconomic database, these revenue management tools are still not being used by the FPAC to analyze the implications of tax policy options on the state economy especially as it relates to VAT and GST in the future.

Lessons Learned

During its 52 month effort in Jharkhand, REFORM was able to generate a number of lessons learned, which can benefit other state governments embarking on similar fiscal reform programs. These lessons learned, which either facilitated or delayed implementation, adoption and sustained use of the tools and techniques introduced fall into three main categories:

1. State Government Factors.
2. Government of India Factors.
3. Fiscal Reform Team Factors.

More specifically:

State Government Factors

The key internal factors a state government needs to be aware of when it embarks on a path of fiscal reform are these:

First and most importantly, an attitude toward fiscal reform that embodies critical vision, support and sanction for serious and sustained effort.

In Jharkhand, this was provided through the Finance Department leadership by its receptivity to ideas from outside the state and India. This was demonstrated by the willingness of GoJ to make changes and use the REFORM Project as a resource to build strong organizational structures and decision processes. For example, the personal interest taken by the Principal Finance Secretary in launching REFORM initiatives from the establishment of budget lines for the FPAC, to acquisition of a facility to house this institution (CFS), to his development of a concept paper on key fiscal issues and its subsequent publication.

Second, once a strategic decision is taken to mandate use of a particular fiscal reform tool or technique through a government order (GO) or circular.

In Jharkhand, this approach enabled and ensured introduction of the PPB methodology in a time-bound manner to all secretariat-level departments. Use of the GO raised the profile of the initiative and provided the referent authority PPB task forces needed to implement the fiscal reform initiative. Finally, the release of annual GOs ensured its continued and time-bound use by line departments.

Third, the institutionalization of fiscal reform capacity-building programs needs to start in parallel with their adoption in the state bureaucracy.

The GoJ was fortunate to have the presence of SKIPA and SIRD (state-level training institutions inherited from Bihar) located in Ranchi. This geographical proximity allowed REFORM and the Finance Department to work with these civil servant training institutes to host and fund training courses in PPB and project appraisal. In addition, the physical convenience of the institutes facilitated the use of REFORM-trained GoJ officials as lectures and adjunct faculty in each institute. In the process, providing the fillip and progress required to make these institutes agents for continuous and sustained fiscal management training.

Fourth, a demand-driven process (at either the secretariat or departmental levels) is a must in order to ensure the smooth, complete and sustained implementation of all fiscal reform efforts.

In Jharkhand, REFORM efforts were state government driven and, as such, they will continue without disruption or stagnation even after REFORM closes. As examples: the PPB roll-out described above, has been followed by a GoJ request to the MoF and Ministry of Health to endorse and recommend international donor funding for extension of PPB to all 24 state district health centers; and, continued GoJ requests to the FPAC for studies relating to revenue estimates, tax expenditures, buoyancy and elasticity of sales tax, implementation of VAT, reduction in stamp duty and registration fees reinforce its role as the premier state fiscal studies institution.

Fifth, and last, pursuit of creative and innovative resource mobilization efforts increases the expertise available for fiscal research and capacity-building.

The GoJ-approved policy of including part-time staff into the FPAC/DIMC as well as seconding officers as adjunct faculty at SKIPA and SIRD has helped fill vacancies in all of these institutions. At the same time, it has opened opportunities for public-private partnerships as many of the part-time FPAC researchers and adjunct faculty are affiliated with in-state institutes and universities, which increases the information, expertise and personnel available to the GoJ.

Government of India Factors

State governments should be aware of all of the support options available to them at the central government level. In addition, they should use GoI recommendations to justify and progress any fiscal reform initiatives undertaken. As examples:

First, GoI adoption of both Outcome Budget and Performance Budget process and reporting coupled with its subsequent recommendation to states, provided a timely and critical boost to REFORM efforts to introduce PPB in Jharkhand; and

Second, implementation of the *CS-DRMS* was given a critical boost by the request by the GoI MoF to the GoJ to nominate officers to participate in the initial software training at the National Institute for Financial Management (NIFM) in 2007. Before this request, the GoJ had been unable to finalize a list of officers to be responsible for the *CS-DRMS* implementation. However, the MoF request expedited a critical activity of the REFORM debt and investment management initiative.

Fiscal Reform Team Factors

The REFORM project experience has shown that of constitution of a dedicated team to serve as the nodal agency for fiscal reform helps to sustain the effort. In this vein, appointment of a retired Indian Administrative Service (IAS) officer as the project manager is important. The reasons are their public service experience and credentials enable them to understand the constraints that confront state officials when they try to introduce new fiscal management practices. In addition, their retired IAS status provides them with the credibility and access they need to promote and implement fiscal reform initiatives as well as to overcome any operational constraints experienced during activity execution.

Recommended: Immediate Next Steps

In view of the above unfinished agenda, REFORM has recommended to the state Government of Jharkhand the following "immediate next steps" in order to complete the initial fiscal reform effort, sustain the initiative introduced as well as build and strengthen other GoJ fiscal reform endeavors:

Expenditure Management

- The program and performance budget should be developed for all 39 state departments and submitted to the Legislative Assembly. All PPB task forces need to be sustained to promote this process.
- As per the December 2007 letter from the Chief Secretary to the MoF, Ministry of Health (MoH), and USAID, training on PPB should be initiated for officers working in the Health Resource Centers in 24 districts of the state.

- An Expenditure Budget Analyst should be appointed to the FPAC to study budget execution trends at different governance levels (Districts, Blocks, and Panchayati Raj Institutions) as well as for key sectors (*e.g.*, Education, Health, Power, and Agriculture).
- Lastly, the GoJ needs to ensure use of the socioeconomic database developed under REFORM by all PPB task forces to generate quality analysis.

Revenue Management

- All ongoing FPAC studies should be completed and published; GoJ has already published five such studies so far.
- Regular (annual) revenue forecast reports should be generated using the revenue forecasting techniques introduced under REFORM.
- The Fiscal Policy State Resources wing of the Finance Department should be expanded to include Expenditure Analysts, Tax Policy Analysts, Debt Managers and Investment Specialists. Clear job descriptions and areas of responsibility should be provided for this purpose.
- The Central Statistical Organization (CSO) has offered to train state government officials in the use and upkeep of its input-output table and supporting macroeconomic database; the GoJ needs to follow-up on this offer.
- Use of the Input-output table (and the supporting Macroeconomic database) should be promoted for reviewing sectoral resource allocations and their implications on state GDP; dialog is required with the CSO and NCAER, to help update and maintain the I-O Table as required.

Project Appraisal Management

- A GO should be issued by the end of the third quarter (Q3) of 2008 to establish a Project Formulation and Appraisal Division. The mandate of this division will be to appraise, analyze, and recommend selection of all capital projects costing more than INR 50 million, starting with fiscal year 2009-10.

Debt and Investment Management

- Ensure continued involvement of all state officers trained in use of the *CS-DRMS* software, especially to fill the void during transfers and train-up of replacements.
- Reporting has not yet started. Issues such as sustainability levels, benchmarks and debt "traffic signals" will take some time to be studied and firmed up. However, debt and guarantee reporting has not started as yet.
- Use of the *CS-DRMS* format should be continuously promoted to monitor and maintain debt data and for reconciling the data with the State Accountant General's office.
- GoJ should identify and enlist a larger number of full-time personnel for the DIMC.
- Complete studies on "Strategic Benchmarks" and "State Level Debt Sustainability."

Institutionalization:

- Resurrection and activation of the High Power Committee (chaired by the Development Commissioner and including the Principal Finance Secretary, Principal Secretary and other rotating departmental secretaries) to review and submit all completed FPAC studies for a GoJ cabinet decision.
- Continue to strengthen the capacity of the SIRD and SKIPA by: (i) appointing more faculty

in public finance; (ii) ensuring continued delivery of training programs developed (with REFORM assistance) on PPB and Project Appraisal at both the SIRD and SKIPA; and (iii) establishing a Chair of Professor of Public Finance at SKIPA.

Conclusion

Fiscal Indicator Impact

On the broader macroeconomic picture, the fiscal numbers of Jharkhand registered considerable improvement during the last four years (*e.g.*, since fiscal year 2004-05 to fiscal year 2008-09 BE). This is largely due to the revenue buoyancy in the overall Indian economy as a result of sustained high rates of growth over the same time period. Due to this buoyancy in revenues, the role of expenditure management has become less pressing in fiscal consolidation.

Table 1.2 shows the key fiscal trends for three time periods:

1. All fiscal years (2001-02—2008-09 [BE]) since Jharkhand attained statehood;
2. The fiscal years (2001-02—2004-05) before REFORM really began its capacity-building effort; and
3. The fiscal years (2005-06—2008-09 [BE]) after REFORM began its capacity-building effort.

As indicated in Table 1.2, there has been considerable increase in the state's revenue receipts during the eight fiscal years of Jharkhand's statehood. Buoyancy of own tax revenue stands at 2.0 coupled with a 19 percent growth in central transfers. The growth in own tax revenue has grown faster during the four year REFORM period (27 percent) than in the first four preREFORM years (14 percent). During the same time period, central government transfers have also shown an increase from 16 percent to 19 percent. This buoyancy can be attributed to a number of factors most importantly a generally buoyant national economy and the introduction of VAT in 2005.

In terms of total expenditures, a higher growth rate was visible during the REFORM period as opposed to the preREFORM period (13 percent *versus* 21 percent). These expenditures were a function of revenue growth and central government transfers combined with the GoJ's constitutional obligation to allocate more funds for development and social infrastructure such as education and health services.

In summary, state income has been growing during the REFORM period and this justified the increased spending. Thus, the urgent need for expenditure quality control arose to ensure well-utilization of the additional resources. Thus, in part to meet this need, the GoJ and REFORM made the PPB methodology a key component of the REFORM capacity-building program.

Capacity-building Impact

According to its mandate, REFORM was a fiscal management capacity-building project that was tasked with introducing international best practice tools and techniques to promote informed fiscal decision-making. In this respect, REFORM succeeded in introducing and transferring new fiscal knowledge and skills to the Government of Jharkhand. This was the only dimension of the KAP construct that REFORM totally controlled. The attitudinal change and actual practice of new fiscal management tools and techniques were and remain the domains of the state government. In the case of Jharkhand, a robust package of fiscal knowledge skills in

Table 1.2: State Finances of Jharkhand: Summary Growth Indicators

Summary Indicators	2001-02—2008-09	2001-02—2004-05	2005-06—2008-09
GSDP Trend Growth Rate	10.97%	9.61%	13 5%
Expenditure Trend Growth Rate			
• Total Expenditure Trend Growth Rate	18 30%	12.99%	21.35%
• Revenue Expenditure Trend Growth Rate	16.70%	11.66%	18.53%
• Capital Outlay Trend Growth Rate	26.22%	21.13%	34.05%
Own Tax Revenue (OTR) Trend Growth Rate	19.65%	14.38%	27.71%
Central GoI Transfer Trend Growth Rate	22 34%	16.17%	19.30%
Buoyancy[12] OTR	1.79	1 50	2.05

(Source: Finance Accounts and Budget Document—GoJ)

expenditure planning and management, revenue management, debt management, and project appraisal were transferred over a 52-month implementation period. This effort was facilitated by the vision and willingness to change pre-existing fiscal practices exhibited by the GoJ Finance Department officials who worked with REFORM. The most significant fiscal reform efforts of the GoJ were in order of importance:

Firstly, establishment of a robust FPAC with 16 resource persons meeting regularly to share fiscal study ideas and papers is the single greatest fiscal reform practice of the GoJ. The studies completed by the FPAC have had an impact on state fiscal governance and thought. Over time, expansion of the membership and scope of the FPAC to include budget analysis and capital budgeting and programming will help it to more fully support the fiscal decision makers of the state;

Secondly, coverage of almost all ministerial departments with the PPB methodology and the follow-on project to extend this to all 24 district health resource centers are hallmark achievements that will, in time, lead to better expenditure quality and public service delivery in the state;

Thirdly, implementation of the *CS-DRMS* database software and population of the database with the state's debt and guarantees data has made the state a pioneer in the field and practice of subnational debt management; and

At this time, the impact of the REFORM fiscal reform effort is anecdotal and isolated. Nevertheless, the initial results on the role of the FPAC in shaping informed fiscal policy decision-making and the role of the PPB methodology in enabling quality expenditure serve as harbingers of what can happen if Jharkhand continues down the path of fiscal reform.

Final Thoughts

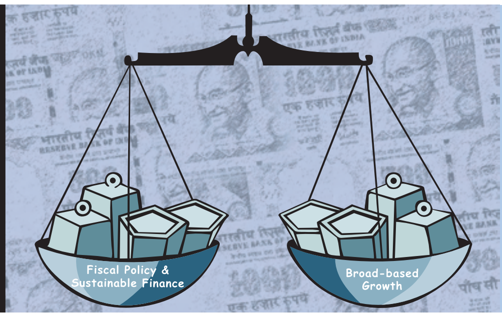
In closing, the systems, tools, and techniques that enable fiscal managers to make informed fiscal choices are critical to follow an appropriate development strategy to improve the lives of its citizens. Therefore, continued effort to introduce and institutionalize relevant fiscal management tools and techniques are critical for the sustainable development of any and all sectors of the state economy.

[12] Buoyancy is defined as the ratio of the growth of own tax revenue and growth of state gross domestic product.

Recent macroeconomic developments clearly indicate that the revenue buoyancy may considerable dampen in the not-too-distant future, due to several external factors (*e.g.*, increases in the global price of oil and food items), which have already impacted inflation rates. Against the backdrop of this scenario, the sustainability of the revenue buoyancy becomes highly uncertain. Similarly, high inflation rates are bound to put pressure on expenditure management. With the cost of capital further expected to rise, the dilemma for the states to choose between fiscal prudence and development becomes a challenge.

It is not enough to initiate the process of fiscal reform. What is required is a steadfast commitment to it; otherwise broad-based growth cannot be achieved. The FRBM Act does signal acceptance of fiscal responsibility but also requires consensus to move along the fiscal correction path. Sustainability of fiscal targets cannot be achieved unless transparency is introduced in mobilizing resources and in pubic expenditure management, creating greater accountability to the state citizen.

Lastly, for more information on the fiscal reform project tools implementation experiences implemented by the REFORM project (*please see the various tool reports, which are located in the following Volumes—II, IV and V of the REFORM Project Compendium with Practitioners' Guide*.



Annexures

Annexure 1:
Jharkhand State Socioeconomic Profile

Table 1A1.1: Jharkhand State Social Indicators

Indicator	Jharkhand	All-India
Total Geographical Area	79.70 lakhs of hectares	3287263 sq. kms.
Percentage of Arable Land	48.56%	
Percentage of Forest Cover	29% of Total Area	23 38%
Percentage of Hilly Terrain	80%	
Major Water Resources	North Koel, South Koel, Damodar, Swarnrekha, Barakar, Sankh Rivers	Rivers
Major Energy Base (Hydro, Coal, Oil, Gas, Wind…)	Hydro and Coal	
No. of Districts	24	593
Total No. of Villages	32,620	638,588
No. of Villages connected by Roads: Both National and State Highways	8,484 or 26%	
Number of State Elections since 2001	Once: 2005	Two: 2000 and 2004
Population 2001 Census	26,909,428	1,026,443,540
Major Religions (as a percentage of overall state population)	Hindu—68.57% Muslim—13.85% Christian—4.06%	Hindu—80.5% Muslim—13.4% Christian—2.036% Sikh—1.9% Buddhist—0.08% Jain—0.04%
Percentage of Indigenous Population	26 3%	8.1%
Percentage of Population Below Poverty Line— Official Estimate	44%	26%
Literacy Rate: 6 Years and Above	54%	65%
Unemployment Rate: 20-24 Years 25-29 Years	 30% 11.4	 13% 6.4
Number of Health Centers	506	22,400
Infant Mortality Rate: 2005-06	69 per 1,000 Births	57 per 1,000 Births
Electrification: No. of Villages Electrified	14,667 or 45% of Total	NA
No. of Villages Connected by Roads: Both National and State Highways	8,484 or 26%	
Drinking Water	120,473 Units	
Clean Water Sources	Well, Tube Well, Rivers and Streams	1,628,269 Units

Sources:
- Census 2001, Govt. of India.
- Jharkhand: A Statistical Profile—2005, Directorate of Statistics and Evaluation.

Annexure 2:
Jharkhand State Finances

Table 1A2.1: State Finances of Jharkhand

Fiscal Parameters	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 RE	2008-09 BE
Gross Fiscal Deficit	-1474	-1310	-1487	-1665	-2643	-1930	-2609	-2219
As % of GSDP	-8.17	-6.45	-6.70	-6.86	-9.88	-6.58	-8.11	-6.28
Revenue Deficit	-334.32	368.67	457.5	562.47	394.43	1914	2789	-2200.28
As % of GSDP	-0.87	-1.50	0.55	-0.55	-0.04	1.36	-1.84	2.35
Primary Revenue deficit	-427	-215	-241	-562	-1528	-145	-578	-619
As % of GSDP	-2 37	-1.06	-1.08	-2.32	-5.71	-0.49	-1.79	-1.75
Debt and Liabilities	10433	12269	13027	14188	16790	166.26	152.15	152.34
As % of GSDP	57.83	60.36	58.70	58.47	62.74	63.40	65.73	66.09
Revenue Expenditure as % of Revenue Receipts	106.787274	111.6005	95.88791	104.7354	100.3183	110.744	90.55038	104.365
Capital Outlay	732.5	865.91	975.72	1333.43	1893.03	1461.34	2976.94	3966.47
As % of GSDP	2.24	2.38	2.45	3.09	4.02	2.73	4.90	5.76
Revenue Deficit as % of Fiscal Deficit	22.3625476	33 29012	-26.541	14.2197	0.480814	20.73163	-103.886	11.34239
Revenue Deficit as % of Revenue Receipts	-6.79	-11.60	4.11	-4.74	-0.32	9.45	-12.78	13.94

(Source: Finance Accounts and Budget Document—GoJ).

Annexure 3:
Jharkhand State Fiscal Trend Data

Table 1A3.1: Expenditure Trends in Jharkhand

Sectors	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 BE	2008-09 BE
Education, Sports and Culture Expenditure	1283	1860	1379	1740	2115	2394	2615	
As % of GSDP	3.92	5.11	3.47	4.04	4.49	4.48	4.31	
Health Expenditure	386	410	402	435	930	1022	911	
As % of GSDP	1.18	1.13	1.01	1.01	1.97	1.91	1.50	
Water and Sanitation	284	333	218	334	396	455	370	
As 5% of GSDP	0.87	0.91	0.55	0.77	0.84	0.85	0.61	
Roads Expenditure	330	279	265	369	420	647	569	
As % of GSDP	1.01	0.77	0.67	0.86	0.89	1.21	0.94	

(Source: RBI Report on State Finances).

Table 1A3.2: Investments and Return on Investments: Trends in Jharkhand

Fiscal Parameters/ Fiscal Years	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 RE	2008-09 BE
Interest Payments	567.81	1419	1182.3	1141 3	1419.6	1613.38	1801.9	2136.9
As % of GSDP	1.74	3.90	2.97	2.65	3.01	3.02	2.97	3.10
Investment at Year-end								
INR crores								
Return on Investment								
INR crores								
Return on Investment								
Return in %								

(Source: Finance Accounts and Budget Document—GoJ).

Table 1A3.3: Sources of State Revenue in Jharkhand

Fiscal Parameters/ Fiscal Years	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 RE	2008-09 BE
Own Tax Revenue	5535.65	1585.48	1759.46	1986.22	2382.79	2758.04	3188.25	4550.56
As % of GSDP	8.03	4.85	4.83	4.99	5.53	5.85	5.96	7.50
Own Nontax Revenue			2912.73	987.14	1105.55	1052.45	1426.52	1250.4
As % of GSDP	4.23	2.60	2.71	2.78	2.44	3.03	2.34	3.46
Transfer from Centre			7333.76	2190.18	2546	3225.27	4279.32	5571.17
As % of GSDP	10.64	6.29	6.01	6.40	7.48	9.08	10.42	10.65
Total Revenue Receipt	4495.02	4936.78	5637.77	6660.51	8463.88	10009.82	13112.07	15782.14
As % of GSDP	13.74	13.56	14.17	15.45	17.96	18.72	21.60	22.91

(Source: Finance Accounts and Budget Document—GoJ).

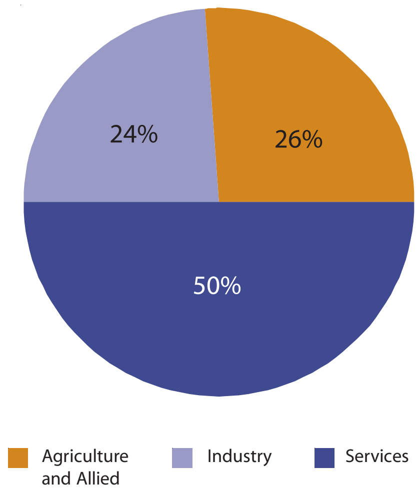
Annexure 4:

Jharkhand Gross State Domestic Product Data

Table 1A4.1: Share in GSDP by Sector (2002-03)

Sector	Share In GSDP
Agriculture and Allied	26%
Industry	24%
Services	50%

Figure 1A4.1: Share in GSDP by Sector (2002-03)



Annexure 5:

Government of Jharkhand Departments and Directorates

Table 1A5.1: List of Jharkhand Departments and Directorates

1.	Department of Cabinet Secretariat and Coordination
2.	Cabinet (Election) Department
3.	Cabinet (Vigilance) Department
4.	Home Department
	i. Office of the Director General of Police
	ii. Office of the Inspector General of Prisons
5.	Department of Personnel, Administrative Reforms and Raj Bhasha
	i. Sri Krishna Institute of Public Administration
	ii. Directorate of Raj Bhasha
6.	Finance Department
	i. Directorate of Provident Fund
	ii. Directorate of Treasuries
	iii. Directorate of National Small Savings
7.	Civil Aviation Department
8.	Planning and Development Department
	i. Directorate of Statistics and Evaluation
9.	Department of Institutional Finance and Programme Implementation
10.	Urban Development Department
11.	Housing Department
12.	Drinking Water and Sanitation Department
13.	Department of Food, Public Distribution and Consumer Affairs
14.	Human Resources Development Department
	i. Directorate of Higher Education
	ii. Directorate of Secondary Education
	iii. Directorate of Primary Education
	iv. Directorate of Adult Education
15.	Science and Technology Department
	i. Directorate of Technical Education
16.	Information Technology Department
17.	Mines and Geology Department
	i. Directorate of Mines
	ii. Directorate of Geology
18.	Forest and Environment Department
	i. Office of the Principal Chief Conservator of Forest
19.	Agriculture Department
	i. Directorate of Agriculture
	ii. Directorate of Horticulture
20.	Animal Husbandry and Fisheries Department
	i. Directorate of Animal Husbandry
	ii. Directorate of Dairy
	iii. Directorate of Fisheries
21.	Water Resources Department
22.	Energy Department
23.	Road Construction Department
24.	Building Construction Department
25.	Transport Department
	i. Commissionerate of Transport
26.	Revenue and Land Reforms Department
	i. Directorate of Land Records and Survey
	ii. Directorate of Land Acquisition
27.	Registration Department
28.	Excise and Prohibition Department
29.	Disaster Management Department
30.	Department of Cooperation
	i. Office of the Registrar of Cooperative Societies
31.	Department of Information and Public Relations
32.	Department of Tourism
33.	Law Department
34.	Department of Labour, Employment and Training
	i. Commissionerate of Labour
	ii. Directorate of Employment and Training
35.	Department of Health, Medical Education and Family Welfare
	i. Office of Director General of Health Services
36.	Commercial Taxes Department
37.	Welfare Department
	i. Directorate of Welfare
	ii. Directorate of Tribal Welfare
38.	Social Welfare Department
39.	Rural Development Department
	i. Commissionerate for Rural Employment Guarantee
	ii. State Institute of Rural Development
40.	Panchayati Raj Department
	i. Directorate of Gram Panchayat
41.	Industries Department
	i. Directorate of Industries
	ii. Directorate of Handicrafts and Sericulture
42.	Department of Art, Culture, Sports and Youth Affairs
	i. Directorate of Sports

Annexure 6:

Jharkhand Training Statistics Report

Table 1A6.1: Jharkhand State Social Indicators

No.	Project Appraisal	Duration	No. of Participants	Training Hours
1	Workshop on Project Appraisal	23-28 Aug 2004	42	36
2	Refresher Workshop on Project Appraisal	27 Sept-01 Oct. 2004	14	36
3	Refresher Workshop on Project Appraisal	25-30 Oct 2004	41	36
4	Refresher Workshop on Project Appraisal	6-7 Dec 2004	21	12
5	Workshop on Project Appraisal	25 Apr-7 May 05	25	72
6	Handholding Workshop on Project Appraisal	11-17 July 2005	15	43
7	Programme on Project Appraisal and Programme Evaluation "Risk Management"	5-16 Sept 2005	18	66
8	Workshop on Project Appraisal (Final Phase)	20-28 April 2006	20	48
9	One-week training programme in Project Appraisal at State Institute for Rural Development (SIRD)	29 Aug-3 Sept 2005	8	36
10	Workshop on Project Appraisal at SIRD	12-17 Dec 2005	41	36
11	Workshop on Project Appraisal "Risk Management" at SIRD	16-21 Jan 2006	20	36
12	Workshop on Project Appraisal "Economic and Stakeholders Analysis" at SIRD	3-8 July 2006	16	36
13	Workshop on Project Appraisal	5-10 Feb 2007	43	36
14	Workshop on Project Appraisal	16-21 April 2007	31	36
15	Half-day Workshop on Project Appraisal	06 Sept 2007	14	3
16	Mentoring Workshop on Project Appraisal	3-5 Oct 2007	12	18
17	Workshop on Project Appraisal at SKIPA	19-23 Nov 2007	19	30
18	Workshop on Project Appraisal at SKIPA	4-8 Feb 2008	10	30
	Total 18 Workshops		**410**	**646**

Table 1A6.2: Tax Analysis and Revenue Forecasting Workshops

No.	Tax Analysis and Revenue Forecasting (TARF)	Duration	No. of Participants	Training Hours
1	Workshop on Tax Analysis and Revenue Forecasting	8-15 Sept 2004	30	36
2	Refresher Workshop on Tax Analysis and Revenue Forecasting	25 Nov 2004	9	6
3	Workshop on Tax Analysis and Revenue Forecasting	17-21 April 2007	21	30
	Total 3 Workshops		**60**	**72**

Table 1A6.3: VAT Policy Workshops

No.	Value Added Tax	Duration	No. of Participants	Training Hours
1	One- day Workshop on VAT	30 Nov 2004	89	6
2	One- day Workshop on VAT	2 Dec 2004	122	6
3	One- day Workshop on VAT	4 Dec 2004	82	6
4	One- day Workshop on VAT	7 Dec 2004	149	6
5	Workshop on VAT Policy and Administration	24-31 Jan 2005	36	36
6	Workshop on VAT Policy and Administration	2-7 Mar 2005	79	30
7	Workshop on VAT Policy and Administration	25-30 Apr 2005	39	36
	Total 7 Workshops		**596**	**126**

Table 1A6.4: Debt Management Workshops

No.	Debt Management	Duration	No. of Participants	Training Hours
1	Workshop on Introduction to Debt Management	26 Apr 2005	10	6
2	National Workshop on Debt Management at Delhi	24-26 Aug 2005	4	18
3	National Workshop on Debt Management at Delhi	17-19 Nov 2005	1	18
4	National Workshop on Debt Management at Delhi	31 Aug-2 Sept 2006	6	18
5	Workshop on State Creditworthiness and Bond Issuance	12-13 Sept 2006	23	12
6	Workshop on Subnational Debt in CS-DRMS	23 Apr-3 May 2007	4	60
	Total 6 Workshops		**48**	**132**

Table 1A6.5: Debt Management Workshops

No.	Macroeconomics and Tax and Revenue Forecasting	Duration	No. of Participants	Training Hours
1	Workshop on Macroeconomic Issues	30 May-3 Jun 05	13	30
2	Workshop on Macroeconomic Issues	11-16 Nov 2005	31	30
3	Half-day Workshop on Revenue Forecasting	24 Jan 2007	11	4
4	Half-day Workshop on I-O Analysis and Tax and Revenue Forecasting	24 Jan 2007	11	4
	Total 4 Workshops		**66**	**68**

Table 1A6.6: PPB Workshops

No.	Program and Performance Budgeting	Duration	No. of Participants	Training Hours
1	Workshop on PPB	11-12 Jul 2005	13	12
2	Workshop on PPB—Water Resources and Social Welfare Depts.	6 Sept 2005	9	6
3	Workshop on PPB—Water Resources Department	24-25 Oct 2005	8	12
4	Workshop on PPB—Social Welfare Department	26-27 Oct 2005	5	12
5	Workshop on PPB Orientation	23 Feb 2006	13	6
6	Workshop on PPB—Urban Development and Rural Development Department	24-25 Apr 2006	7	12
7	Workshop on PPB—Health, Mines and Geology Departments	27-28 Apr 2006	20	12
8	Workshop on PPB—Commercial Taxes Department	29 Apr-02 May 06	10	12
9	Workshop on PPB—Road Construction and Building Construction Departments	03-04 May 2006	26	12
10	Workshop on PPB—Energy and Welfare Departments	05-06 May 2006	18	12
11	Workshop on PPB—HRD and Rural Development Depts.	22-23 May 2006	10	12
12	Follow-up Workshop on PPB—Building Construction, Commercial Taxes and Road Construction Depts.	18 Sept 2006	14	6
13	Follow-up Workshop on PPB—Mines, Welfare and Health Departments	19 Sept 2006	19	6
14	Follow-up Workshop on PPB—Urban Development and Rural Development Departments	20 Sept 2006	17	6
15	Follow-up Workshop on PPB—Social Welfare and Water Resources Departments	21 Sept 2006	16	6
16	Handholding Workshop on PPB	04 Dec 2006	9	6
17	Handholding Workshop on PPB	05 Dec 2006	15	6
18	Handholding Workshop on PPB	06 Dec 2006	15	6
19	Handholding Workshop on PPB	07 Dec 2006	22	6
20	Orientation Workshop on PPB	24 Apr 2007	25	4
21	Workshop on PPB	7-8 May 2007	12	12
22	Workshop on PPB	9-10 May 2007	11	12
23	Workshop on PPB	11 & 14 May 2007	18	12
24	Workshop on PPB	15 & 17 May 2007	17	12
25	Follow-up Workshop on PPB	10 Sept 2007	13	6
26	Follow-up Workshop on PPB	11 Sept 2007	7	6
27	Follow-up Workshop on PPB	12 Sept 2007	7	6
28	Follow-up Workshop on PPB	13 Sept 2007	9	6
29	Follow-up Workshop on PPB	14 Sept 2007	11	6

Table 1A6.6: PPB Workshops (Contd.)

No.	Program and Performance Budgeting	Duration	No. of Participants	Training Hours
30	Handholding Workshop on PPB	19 Nov 2007	19	6
31	Handholding Workshop on PPB	22 Nov 2007	9	6
32	Handholding Workshop on PPB	23 Nov 2007	10	6
33	Handholding Workshop on PPB	27 Nov 2007	9	6
34	Workshop on PPB at SKIPA	10-14 Dec 2007	27	30
35	Workshop on PPB at SKIPA	11-15 Feb 2008	13	30
36	Workshop on PPB	9-10 Apr 2008	14	12
37	Workshop on PPB	16-17 Apr 2008	10	12
38	Workshop on PPB	24-25 Apr 2008	36	12
	Total 38 Workshops		**543**	**370**

Table 1A6.7: PPB Mentoring Sessions

No.	Title	Duration	No. of Participants	Training Hours
1	PPB Mentoring—Water Resources Department	12 Aug 2005	9	4 hrs.
2	PPB Mentoring—Social Welfare Department	5 Sept 2005	6	4 hrs.
3	PPB Mentoring—Water Resources Department	13 Sept 2005	9	4 hrs.
4	PPB Mentoring—Water Resources Department	18 Oct 2005	4	4 hrs.
5	PPB Mentoring—Water Resources Department	19 Oct 2005	4	4 hrs.
6	PPB Mentoring—Social Welfare Department	20 Oct 2005	3	4 hrs.
7	PPB Mentoring—Water Resource Department	30 Aug 2006	10	4 hrs.
8	PPB Mentoring—Building Construction Department	21 Jun 2006	9	4 hrs.
9	PPB Mentoring—Water Resource Department	26 Jun 2006	4	4 hrs.
10	PPB Mentoring—Commercial Taxes Department	28 Jun 2006	5	4 hrs.
11	PPB Mentoring—Road Construction Department	29 Jun 2006	3	4 hrs.
12	PPB Mentoring—Mines and Geology Department	5 Jul 2006	7	4 hrs.
13	PPB Mentoring—Welfare Department	17 Jul 2006	8	4 hrs.
14	PPB Mentoring—Health, Medical Education and Family Welfare Department	18 Jul 2006	7	4 hrs.
15	PPB Mentoring—Urban Development Department	26 Jul 2006	8	4 hrs.
16	PPB Mentoring—Energy	27 Jul 2006	5	4 hrs.
17	PPB Mentoring—Agriculture and Sugarcane Department	Jun 15 2007	4	4 hrs.
18	PPB Mentoring—Department of Registration	21 Jun 2007	5	4 hrs.
19	PPB Mentoring—Department of Home	26 Jun 2007	8	4 hrs.
20	PPB Mentoring—Excise and Prohibition Department	13 Jul 2007	2	4 hrs.
21	PPB Mentoring—Department of Cooperation	19 Jul 2007	7	4 hrs.
22	PPB Mentoring—Department of Cabinet Secretariat	23 Jul 2007	1	4 hrs.
23	PPB Mentoring—Department of Industries	25 Jul 2007	4	4 hrs.
24	PPB Mentoring—Disaster Management	11 Jun 2008	6	4 hrs.
25	PPB Mentoring—Tourism	12 Jun 2008	5	4 hrs.
26	PPB Mentoring—Civil Aviation	23 Jun 2008	5	4 hrs.
27	PPB Mentoring—Information and Public Relations	30 Jun 2008	4	4 hrs.
28	PPB Mentoring—Civil Aviation	7 July 2008	4	4 hrs.
29	PPB Mentoring—Information and Public Relations	11 July 2008	4	4 hrs.
	Total 29 Mentoring Sessions		**160**	**116**

Table 1A6.8: Workshops Organized by Government Institution (SIRD/ SKIPA)

No.	Name	Duration	No. of Participants	Training Hours
	Project Appraisal			
1	One-week Training Program in Project Appraisal at State Institute for Rural Development (SIRD)	29 Aug-3 Sept 2005	8	36
2	Workshop on Project Appraisal at SIRD	12-17 Dec 2005	41	36
3	Workshop on Project Appraisal "Risk Management" at SIRD	16-21 Jan 2006	20	36
4	Workshop on Project Appraisal "Economic and Stakeholders Analysis" at SIRD	3-8 Jul 2006	16	36
5	Workshop on Project Appraisal at SKIPA	19-23 Nov 2007	19	30
6	Workshop on Project Appraisal at SKIPA	4-8 Feb 2008	10	30
	Program and Performance Budgeting			
7	Workshop on PPB at SKIPA	10-14 Dec 2007	27	30
8	Workshop on PPB at SKIPA	11-15 Feb 2008	25	30
	Total 8 Workshops		**156**	**264**

Annexure 7:

Jharkhand PPB Rollout Report

Table 1A7.1: PPB Mentoring Sessions

S. No.	Department Name	Task Force Appointed (Date)	Training (Session Dates)	Manual Distribution (Date)	Mentoring for 2006-07—2007-08	Completion of PPB Document for 2007-08	Comments
1.	Water Resources Department	6 Aug 05	11-12 Jul 2005 6 Sept 2005 24-25 Oct 2005 23 Feb 2006 21 Sept 2006	11-12 Jul 2005 6 Sept 2005 24-25 Oct 2005	12 Aug 2005 30 Aug 2006 13 Sept 2005 18 Oct 2005 19 Oct 2005 26 Jun 2006	by 28 Feb 2008	Submitted PPB Document for FY 2006-07 to Finance Department on 2 Sept 2006
2.	Social Welfare	2 Aug 05	11-12 Jul 2005 6 Sept 2005 26-27 Oct 2005 23 Feb 2006 21 Sept 2006	11-12 Jul 2005 6 Sept 2005 26-27 Oct 2005	5 Sept 2005 20 Oct 2005	by 28 Feb 2008	Submitted PPB Document for FY 2006-07 to Finance Department on 15 Feb 2006
3.	Building Construction	28 Mar 06	11-12 Jul 2005 23 Feb 2006 03-04 May 2006 18 Sept 2006 04 Dec 2006	11-12 Jul 2005 03-04 May 2006	21 Jun 2006	28 Feb 2008	
4.	Mines and Geology	20 Apr 06	11-12 Jul 2005 23 Feb 2006 27-28 Apr 2006 19 Sept 2006 05 Dec 2006	11-12 Jul 2005 27-28 Apr 2006	5 Jul 2006	by 28 Feb 2008	Submitted Draft to the Departmental Secretary for review
5.	Welfare	9 Mar 06	11-12 Jul 2005 23 Feb 2006 05-06 May 2006 19 Sept 2006 07 Dec 2006	11-12 Jul 2005 05-06 May 2006	17 Jul 2006	28 Feb 2008	Work in Progress
6.	Health, Medical Education and Family Welfare	19 Apr 06	11-12 Jul 2005 23 Feb 2006 27-28 April 2006 19 Sept 2006 05 Dec 2006	11-12 Jul 2005 27-28 Apr 2006	18 Jul 2006	28 Feb 2008	Submitted Draft to Deputy Secretary for Budget Figures
7.	Urban Development	5 May 06	11-12 Jul 2005 23 Feb 2006 24-25 Apr 2006 20 Sept 2006 06 Dec 2006	11-12 Jul 2005 24-25 Apr 2006	26 Jul 2006	28 Feb 2008	Work in Progress
8.	Human Resources Development	20 May 06	11-12 Jul 2005 23 Feb 2006 22-23 May 2006 07 Dec 2006	11-12 Jul 2005 22-23 May 2006		28 Feb 2008	Work in Progress
9.	Energy	19 Jul 06	11-12 Jul 2005 23 Feb 2006 05-06 May 2006 07 Dec 2006	11-12 Jul 2005 05-06 May 2006	27 Jul 2006	28 Feb 2008	Work in Progress
10.	Rural Development	17 May 06	11-12 Jul 2005 23 Feb 2006 24-25 Apr 2006 22-23 May 2006 20 Sept 2006 06 Dec 2006	11-12 Jul 2005 24-25 Apr 2006 22-23 May 2006		28 Feb 2008	Submitted draft to Finance Department on 29 Jun 2008

Table 1A7.1: PPB Mentoring Sessions (Contd.)

S. No.	Department Name	Task Force Appointed (Date)	Training (Session Dates)	Manual Distribution (Date)	Mentoring for 2006-07/ 2007-08	Completion of PPB Document for 2007-08	Comments
11.	Commercial Taxes	17 Jun 06	11-12 Jul 2005 23 Feb 2006 29 Apr - 02 May 2006 18 Sept 2006 04 Dec 2006	11-12 Jul 2005 29 Apr-02 May 2006	28 Jun 2006	28 Feb 2008	Submitted Draft to Secretary for Review
12.	Road Construction	26 Apr 06	11-12 Jul 2005 23 Feb 2006 03-04 May 2006 18 Sept 2006 04 Dec 2006	11-12 Jul 2005 03-04 May 2006	29 Jun 2006	28 Feb 2008	Submits Draft to Secretary for Review
13.	Agriculture	16 Apr 2007	24 Apr 2007 9-10 May 2007 12 Sep 2007	24 Apr 2007 9-10 May 2007	15 Jun 2007	by Feb 2008	Work in Progress
14.	Animal Husbandry and Fisheries	TBD	X	X		TBD	Delayed
15.	Cabinet Secretariat and Coordination	17 Apr 2007	24 Apr 2007 7-8 May 2007 10 Sept 2007	24 Apr 2007 7-8 May 2007	23 Jul 2007	by Feb 2008	Work in Progress
16.	Cooperation	7 May 2007	11&14 May 2007 14 Sept 2007	11&14 May 2007	19 Jul 2007	by Feb 2008	Work in Progress
17.	Excise and Prohibition	18 Apr 2007	24 Apr 2007 9-10 May 2007 11 Sept 2007	24 Apr 2007 9-10 May 2007	13 Jul 2007	by Feb 2008	Work in Progress
18.	Finance	30 Apr 2007	24 Apr 2007 7-8 May 2007 13-14 Sept 2007	24 Apr 2007 7-8 May 2007	10 Jul 2007	by Feb 2008	Work in Progress
19.	Home	20 Apr 2007	24 Apr 2007 15&17 May 2007 13 Sept 2007	24 Apr 2007 15&17 May 2007	26 Jun 2007	by Feb 2008	Work in Progress
20.	Industries	10 Apr 2007	24 Apr 2007 11&14 May 2007 12 Sept 2007	24 Apr 2007 11&14 May 2007	25 Jul 2007	by Feb 2008	Work in Progress
21.	Institutional Finance and Program Implementation	4 May 2007	24 Apr 2007 15&17 May 2007 13-14 Sept 2007	24 Apr 2007 15&17 May 2007	21 Aug 2007	by Feb 2008	Work in Progress
22.	Personnel and Administrative Reforms and Rajbhasa	TBD	X	X	TBD	TBD	Delayed
23.	Planning and Development	21 May 2007	15&17 May 2007 14 Sept 2007	15&17 May 2007	23 Aug 2007	by Feb 2008	Work in Progress
24.	Registration	16 Apr 2007	24 Apr 2007 11& 14 May 2007 11 Sept 2007	24 Apr 2007 11& 14 May 2007	21 Jun 2007	by Feb 2008	Work in Progress

Table 1A7.1: PPB Mentoring Sessions (Contd.)

S. No.	Dept. Name	Task Force Appointed (Date)	Training (Session Dates)	Manual Distribution (Date)	Mentoring for 2006-07/ 20 07-08	Completion of PPB Document for 2007-08	Comments
25.	Personnel, Adm. Reforms and Rajbhasha						Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
26.	Animal Husbandry and Fisheries						Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
27.	Drinking Water and Sanitation	29 Mar 2008	11-15 Feb 2008	11-15 Feb 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
28.	Science and Technology	7 Apr 2008	9-10 Apr 2008	9-10 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
29.	Information Technology	7 Apr 2008	9-10 Apr 2008	9-10 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
30.	Civil Aviation		9-10 Apr 2008	9-10 Apr 2008	23 Jun 2008 7 Jul 2008	October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
31.	Forest and Environment		24-25 Apr 2008	24-25 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
32.	Cabinet (Election)		24-25 Apr 2008	24-25 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force

Table 1A7.1: PPB Mentoring Sessions (Contd.)

S. No.	Dept. Name	Task Force Appointed (Date)	Training (Session Dates)	Manual Distribution (Date)	Mentoring for 06-07/ 07-08	Completion of PPB Document for 07-08	Comments
33.	Tourism		24-25 Apr 2008	24-25 Apr 2008	12 Jun 2008	October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
34.	Information and Public Relation	7 Apr 2008	24-25 Apr 2008	24-25 Apr 2008	26 Jun 2008 11 Jul 2008	October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
35.	Food and Civil Supplies	12 Apr 2008	24-25 Apr 2008	24-25 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
36.	Revenue and Land Reforms		16-17 Apr 2008	16-17 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
37.	Labour Employment and Training	10 Apr 2008	16-17 Apr 2008	16-17 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
38.	Transport		24-25 Apr 2008	24-25 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
39.	Art, Culture and Sports	11 Apr 2008	24-25 Apr 2008	24-25 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
40.	Panchayat Raj		16-17 Apr 2008	16-17 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force

Table 1A7.1: PPB Mentoring Sessions (Contd.)

S. No.	Dept. Name	Task Force Appointed (Date)	Training (Session Dates)	Manual Distribution (Date)	Mentoring for 06-07/ 07-08	Completion of PPB Document for 07-08	Comments
41.	Disaster Management	19 Mar 2008	24-25 Apr 2008	24-25 Apr 2008	11 Jun 2008	October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
42.	Cabinet (Vigilance)		24-25 Apr 2008	24-25 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
43.	Housing	21 Apr 2008	24-25 Apr 2008	24-25 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force
44.	Law (Justice)	28 Feb 2008	24-25 Apr 2008	24-25 Apr 2008		October 2008	Finance Department Issue Circular No. CFS-06/23/2007-305/F Dated 04-02-2008 to Constitute PPB Task Force

Annexure 8:

Jharkhand FPAC and DIMC Studies

Table 1A8.1: Final State FPAC/DIMC Study Report (As on 28-05-2008)

Paper No.	Subject	Requested By	Assigned To	Date Started	Date Finished	Date Submitted	Current Status	Other Comments
1J FPAC 2005	Estimation of Tax Expenditure In Jharkhand	GoJ	Dr. Ramakant Agrawal	Dec-04	Jun-05	Jun-05	Accepted	Under Review and Action
2J FPAC 2005	Elasticity and Buoyancy of Sales Tax in Jharkhand	GoJ	Dr. S. P. Mishra	Dec-04	Aug-05	Sep-05	Accepted	IBID
3J FPAC 2005	Realistic Revenue Forecasts for Jharkhand	GoJ	Dr. Ranjana Srivastava	Dec-04	Jul-05	Sep-05	Accepted	IBID
4J FPAC 2006	Impact of the New Excise Policy of the State and Ways and Means of Boosting Revenues in the Medium Term	GoJ	Mr. Bihari Prasad; Mr. Niranjan Prasad Srivastava	Nov-05	Mar-06	Apr-06	Accepted	IBID
5J FPAC 2006	Impact of Reduction of Land Registration Fee and Stamp Duties on Government Revenues	GoJ	Mrs. Sweta Kumari; Dr. Ranjana Srivastava	Nov-05	Apr-06	May-06	Accepted	IBID
6J FPAC 2006	Introduction of Integrated Check Post System in Jharkhand and its Impact on Growth of Tax Revenues	GoJ	Mr. Rajiv Arun Ekka; Mr. Vinay Sinha; Dr. Ramakant Agrawal	Nov-05			Ongoing	Information has been collected through meetings with officials of the Commercial Taxes Department and the Department of Mines and Geology. Approval of advance for cost of field survey awaited from GoJ for further work
7J FPAC 2006	Benefit Incidence of Public Expenditure: A Case of Sarva Shiksha Abhiyan	GoJ	Dr. Ramakant Agrawal; Dr. Hareshwar Dayal; Mr. A. K. Mallick	Feb-06			Ongoing	Methodology discussed in detail, and plan for data collection prepared. Cost estimates for approval of advance sent to GoJ for approval

Table 1A8.1: Final State FPAC/DIMC Study Report (As on 28-05-2008) (Contd.)

Paper No.	Subject	Requested By	Assigned To	Date Started	Date Finished	Date Submitted	Current Status	Other Comments
8J FPAC 2006	Benefit Incidence of Social Welfare Schemes	GoJ	Dr. R.R. Sinha; Dr. Govind Sharma; Ms. Kalpana Palit	Feb-06			Ongoing	Methodology discussed in detail and primary data collection in the field started
9J FPAC 2006	Impact of Excise Policy on Tribal Welfare	GoJ	Mr. Niranjan Prasad Srivastava; Mr. Bihari Prasad	Feb-06			Ongoing	Methodology discussed in detail and primary data collection in the field to be started
10J FPAC 2006	Cost Benefit Analysis of Irrigation Schemes in Jharkhand	GoJ	Dr. R. K. Mishra; Mr. J. P. Singh	Apr-06		27-02-2007	Submitted	Under review and action
11J FPAC 2006	Revenue and Nonrevenue Aspects of Excise Policy: A Comparative Analysis of Indian States	GoJ	Mr. Niranjan Prasad Srivastava; Mr. Bihari Prasad	6-Jun-06			Ongoing	Methodology discussed in detail and data collection started
12J FPAC 2006	Impact of Dead Assets on Revenues in Jharkhand	GoJ	Dr. Hareshwar Dayal ; Mr. Niranjan P. Srivastava	6-Jun-06			Ongoing	Methodology discussed in detail and data collection started
13J FPAC 2007	Revenue Implications of VAT Implementation in Jharkhand	GoJ	Dr. Ramakant Agrawal	Jan-07		14-06-2007	Submitted	Under review and action
14J FPAC 2007	Strategic Benchmarks for Debt Sustainability	GoJ	Mr. Dinesh K. Pradhan-DIMC	Aug-07			Ongoing	Synopsis discussed in detail and data collection done. The author requires certain clarifications which will be provided soon
15J FPAC 2007	State-level Debt Sustainability and "Traffic Light" Warning Signals	GoJ	Mr. Dinesh K. Pradhan-DIMC	Aug-07			Ongoing	Synopsis discussed in detail and data collection done. The author requires certain clarifications which will be provided soon

Annexure 9:
Jharkhand Testimonial Letter

GOVERNMENT OF JHARKHAND
Department of Energy
Nepal House, Doranda, Ranchi-834002, Jharkhand

From:
Shri Sudhir Tripathi
Secretary Energy

Respected Shri Lal,

Please recall our discussions in regard to the implementation of Program and Performance Budgeting (PPB) in Water Resources Department, Government of Jharkhand, which I had the opportunity to oversee as the then Departmental Secretary.

As you are aware, Water Resources Department is one of the most important departments of the State Government as it ranks second (1st being Rural Development) in terms of budgetary allocation and third in terms of manpower on its rolls (i.e., after HRD and Health & Family Welfare). Besides, the Water Resources Department of Jharkhand is plagued with some peculiar problems, of its own, which have arisen due to the legacy from undivided Bihar, of a large number of incomplete major and minor irrigation projects that have been under execution for more than two decades and have gone through multiple cost and time revision.

In view of the above, the analytical framework and discipline enforced through the execution of Program and Performance Budgeting was of great significance in highlighting, and thereby, facilitating resolution of several chronic issues, such as:

(1) Unraveling of hidden inefficiencies, for example, it was found that Directorate of Irrigation Revenue was spending almost 10 times more on its salary than what was being collected by way of water charges for irrigation. Pursuant to this finding, proposal for dissolution of Directorate of Irrigation Revenue and transfer of the responsibility for collection of water charges for irrigation to Water Users Association was initiated.

(2) Rational distribution of manpower across the various offices. The analysis of plan and nonplan expenditure of the departmental units under PPB revealed that several offices with less work had more staff, whereas offices with more work were starved of requisite manpower.

(3) Rational distribution of volume of work across different work divisions. PPB revealed that the volume of work, both physical and financial, being handled by different work divisions was highly skewed which was affecting both the efficiency and quality of execution. This automatically led to a review and reallocation of work in accordance with the capacity to deliver.

(4) The large backlog of incomplete irrigation projects, in respect to which the budgetary resources used to be thinly spread resulting in time and cost over runs, were individually reviewed so as to bring about financial closure within specified time by arranging requisite funds from financial institutions like NABARD, so that these projects could be expeditiously completed and operationalized.

In crux, therefore, the implementation of PPB in Water Resources Department has been of great help in building capacity for efficiency in performance on one hand and translating budgetary outflows into concrete outcomes on the other.

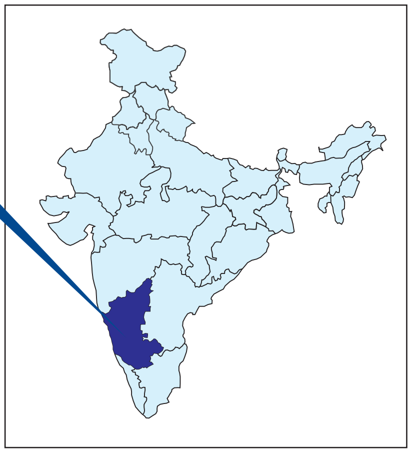
Yours sincerely,

(Sudhir Tripathi)

Pc.1/md/sec.energy letters/gen.ltrs.doc

Karnataka State Case Study

India State Fiscal Management Reform Project (REFORM)



Map not to Scale

List of Abbreviations

ATI Administrative Training Institute
BMP Bengaluru Mahanagara Palike
BPO Business Process Outsourcing
CEO Chief Executive Officer
CS Commonwealth Secretariat
CSO Central Statistical Organization
CTO Commercial Tax Office
DIMC Debt and Investment Management Cell
DMTFP Departmental Medium Term Fiscal Plan
DoF Department of Finance
DRMS Debt Recording and Management System
EFC Eleventh Finance Commission
EMD Earnest Money Deposit
FD Finance Department
FDI Foreign Direct Investment
FPAC Fiscal Planning and Analysis Cell
FPI Fiscal Policy Institute
FRBM Fiscal Responsibility and Management Act
GDP Gross Domestic Product
GESCOM Gulbarga Electricity Supply Company
GIA Grant-in-aid
GSDP Gross State Domestic Product
GO Government Order
GoI Government of India
GoK Government of Karnataka
HLC High Level Committee
HMIS Health Management Information System
INR Indian Rupees
I-O Input-Output
IT Information Technology
KTPPA Karnataka Transparency in Public Procurement Act
LoC Letter of Credit
MIS Management Information System
MoU Memorandum of Understanding
MTFF Medium Term Fiscal Framework
MTFP Medium Term Fiscal Plan
NCAER National Council of Applied Economic Research
NSDP Net State Domestic Product
PA Project Appraisal
PFAD Project Formulation and Appraisal Division
PPB Program and Performance Budgeting
PRI Panchayat Raj Institutions
PSUs Public Sector Undertakings
PWD Public Works Department
RD Revenue Deficit
REFORM India State Fiscal Management Reform Project
SAL Structural Adjustment Loan
SOE State Owned Enterprise
SOW Statement of Work
TFC Twelfth Finance Commission
TOR Terms of Reference
TD Tender Document
UNDP United Nations Development Programme
USAID United States Agency for International Development
VAT Value Added Tax
WB World Bank

Box 2.1: The Government Order Creating the Fiscal Policy Analysis Cell states

"The state of Karnataka is one of the few states which have successfully initiated fiscal reform programs targeted towards faster economic growth by ensuring that public expenditure in high priority development sectors is maintained at a high level and not crowded out by nondevelopment expenditure….with an objective to provide continuity and a focus to the fiscal reforms program, Finance Minister, in his budget speech for the year 2005-06 proposed formation of a Fiscal Policy Analysis Cell.

The cell is expected to act as the analytical brain providing inputs and analytical support for the ongoing reforms program." The FPAC is expected to be a focal point for implementing the USAID-assisted state fiscal reform program.

Source: Government Order No. FD BGL 2005 Bangalore 10th June 2005)

The Challenge

REFORM initiated Program Performance Budgeting (PPB) methodology has been successfully adopted by the Government of Karnataka by seeking the clearance of the appropriate legislative body, i.e., the Estimates Committee. Government of Karnataka is in the process of institutionalizing the same through an executive order in the making. Attempt to orient the officers from the district sector, from select districts and departments, to PPB methodology and help them prepare the same is the first of its kind in the country.

Karnataka state experienced a severe fiscal stress in the late twentieth (decade of nineties) and early twenty-first century. This crisis was essentially due to slow growth in the revenues coupled with unbridled revenue expenditure growth. As a result, the state, which had achieved revenue surplus in the mid nineties (1993-94 and 1995-96), relapsed in to rising revenue deficits. Serious concerns were present on the expenditure front such as rapid growth in the revenue expenditure at the cost of capital investments especially in the areas of economic infrastructure. Diversion of borrowed funds to current consumption had resulted in an erosion of capital expenditure and further the gross capital formation from budgetary sources. The state government also experienced grave problems on the revenue front. The first report of the Tax Reforms Commission (Government of Karnataka, 2001) reported that the state experienced a fall in the tax buoyancy during the decade of nineties as compared to the previous decade. Resource position was also adversely affected on account of the small and declining nontax revenue and growing implicit subsidies (Rao, 2003).

Karnataka's state finances turned from one of revenue surplus (0.28 percent of Gross State Domestic Product (GSDP) in 1993-94) to one of revenue deficit (3 percent of GSDP in 2001-02). A rapid growth of revenue expenditure that increased at 15.9 per annum during the decade of nineties outgrew that of revenue resources which revealed 14.9 percent rate of growth per annum resulting in rising revenue deficits. Revenue-GSDP ratio declined from 16.2 percent (1995-96) to 15.8 percent (1998-99) and that of Revenue Expenditure-GSDP increased from 15.9 percent to 17.5 percent during the reference period.

The immediate results were:

- A diversion of budgetary funds from investments to current expenditure to finance largely the contractual expenditures (*e.g.,* salaries, interest payments, pension liabilities);
- Increased borrowing at the expense of development expenditure and infrastructure investments;
- Increased contingent (potential future) liabilities as a result of government guarantees that needed to be provided; and
- Inability to mobilize sufficient revenue resources to finance revenue expenditure.

The growing revenue deficit amounted to using borrowed funds for current consumption. The committed expenditure in the form of salary, pension and interest payments was sizeable and on the increase- from 6.5 percent (1995-96) of GSDP to 8.5 percent (1998-99) of GSDP. The volume of subsidies increased from 0.3 percent in 1990-91 to 1.33 percent in 1998-99.

Such sharp increases resulted in less funds for development expenditures, especially for social services, which remained stagnant. Finally, there was a decline in overall economic services. Social services are largely a state responsibility and the state could not afford to sacrifice expenditure given the fact that human development in the state had not revealed great progress; they were just at the level of national average. Capital expenditure-GSDP ratio declined from 3.33 percent in 1995-96 to 3.27 percent in 1997-98. This was a serious blow to a state which was already reeling under shortage of socioeconomic infrastructure. The state also experienced a decline in the gross capital formation from budgetary sources.

Due to the mismatch between receipts and expenditure as well as budgetary outgo to meet the deficits of the state-owned public sector undertakings (PSUs), the state experienced an increased debt burden from 20.74 percent (1990-91) to 26.54 percent (1999-00). The state also had been raising loans from the market through various corporations (off-budget borrowings) by assuming the responsibility to repay the interest and loan. Such a liability which was not existent in 1990-91 reached a level of 1.29 percent of GSDP in 1998-99.

> There was apprehension that, if these trends were not corrected, future state socioeconomic development would have been jeopardized.

Promotion of growth and poverty reduction required an easing of socioeconomic infrastructure bottlenecks by investing more in these areas. The stagnant levels of social service expenditure needed to be stepped up to raise the state's human development level above the national average. The declining economic service investments needed to be reversed in order to promote growth which also would impact on poverty reduction. Specific areas to be addressed included among many others, the infrastructure bottlenecks faced by the state in the form of acute power shortage, inadequate utilization of irrigation potential and the poor transport infrastructure availability.

(For more information on key indicators for the State of Karnataka, please see: Annexure No. 1 for a series of Tables on key socioeconomic indicators for the Karnataka State Socioeconomic Profile; and, Annexure No. 2, 3 and 4 for a series of Tables on key fiscal indicators for the State of Karnataka for the period from FY 2001-02 to FY 2008-09 Budget Estimate (BE).)

State Fiscal Reform Initiatives

The Government of Karnataka (GoK) initiated a number of interventions for a fiscal turnaround during the initial years of the current decade.

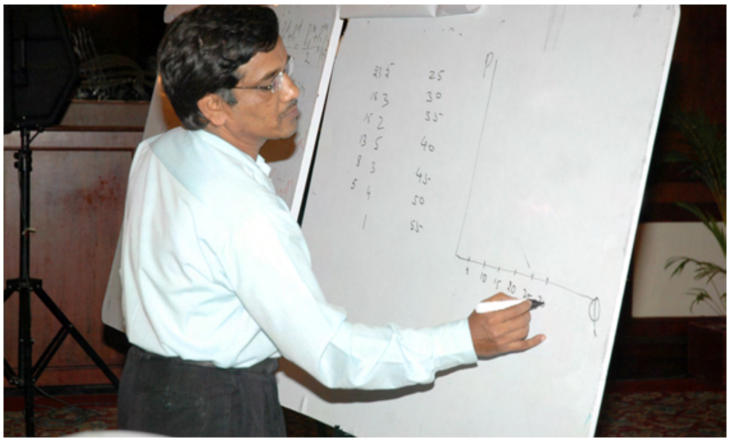
Table 2.1: Karnataka State Fiscal Reform Milestones

Year	Important Fiscal Legislations in Karnataka
1999	Karnataka Transparency in Public Procurement Act
1999	Ceiling on Government Guarantee and Contingency
2000	White Paper on State Finances
2001	Tax Reforms Commission
2001	Karnataka Economic Restructuring Loan Reform Initiatives
2002	Medium-term Fiscal Reforms Program and MoU with the GoI
2002	Fiscal Responsibility Act
2001-02	Medium-term Fiscal Framework
2003	Revenue Reforms Commission
2004-08	USAID REFORM Project

Government of Karnataka (GoK) fiscal reform initiatives were launched in 1999 with the framing of the Karnataka Transparency in Public Procurement Act (KTPPA). The purpose was to increase transparency in public procurement of goods and services by streamlining the procedures in inviting, processing and acceptance of tenders by procurement entities. The Act aimed at curbing the past irregularities in the processing of tenders observed in the various government departments, public sector undertakings (PSUs), statutory boards, etc., due to inadequate publicity of tenders, restricted supply of tender documents and lack of transparency in evaluation and acceptance of tenders.

In the same year, the GoK enacted a legislation, "Ceiling on Government Guarantees Act" to provide for limits on Government Guarantees issued on behalf of the government departments, PSUs, local authorities, statutory boards and corporations and cooperative institutions etc., to limit the unabated quantum of guarantees being issued by the state.

In March 2000, a White Paper on state finances was published. It tracked the state's fiscal weaknesses and recognized the importance of addressing these issues by effecting reforms in both policies and institutions. Reforms in tax policy and administration, rational pricing of public utilities and restructuring of public enterprises were contemplated to enhance revenue productivity. It was felt that a reversal in expenditure trends to contain unproductive expenditure and enhance allocations to human and physical infrastructure would improve productivity of expenditure. Introduction of a zero-based budgeting and governance reforms were considered as a tool to improve service delivery. These measures served well to wade through the crisis in the short run; however, mechanisms preventing repeated occurrences of such fiscal crisis by effecting institutional reforms and equipping the officers managing the states finances were not addressed.



With the objective of improving the revenue resources available with the state, a Tax Reforms Commission was constituted by the Government of Karnataka in 2000 and the Commission submitted its final report in 2001 October. The key recommendations of the Commission included expansion of tax base by increasing coverage and removing exemptions, improved compliance, rationalization of tax structure, and strengthening of the tax administration. The reforms progressively introduced by the state has taken due cognizance of these recommendations. (Medium Term Fiscal Framework (MTFF, 2003) The steps initiated by the Government of Karnataka based on the recommendations made by the Commission enabled the State to improve the revenue mobilization over the years. Government of Karnataka was one of the first states to introduce value added tax (VAT) in pursuance of the decision taken at the State Finance Ministers' meet for introduction of VAT in the country.

In 2001, the GoK availed a structural adjustment loan (SAL) from the World Bank and initiated several reform initiatives for the structural adjustment such as reducing nonplan revenue expenditure, bringing down the fiscal deficit, and capturing all off-budget borrowings in the budget. Based on the recommendations of the Eleventh Finance Commission (EFC) recommendations, the GoK formulated its medium-term fiscal rolling plan under the scheme of the state Fiscal Reform Facility, constituted by the GoI, and entered in to Memorandum of Understanding (MoU) with the GoI in October 2001 and released its first Medium Term Fiscal Plan (MTFP) for the period 2001-02 to 2004-05. The GoK could obtain the entire amount of the incentive fund recommended by the EF) by achieving the stipulated reduction in revenue deficit as a percentage of revenue receipts (see Annexure 2 for details). MTFP is a rolling annual report and has been regularly prepared by the GoK, the latest one being 2008-2012. On recommendations of the Twelfth Finance Commission (TFC), the GoI constituted a debt consolidation and Relief Facility (2005-10). The GoK was a leading state to avail the facility as most of the trigger points were already achieved by the state.

Finally, in 2002, the GoK framed the Fiscal Responsibility Act (FRA) Act to ensure fiscal discipline much before the Government of India (GoI) enacted the same. The Act stipulates that:

Box 2.1: Key Stipulations of Karnataka State FRA

- Revenue deficit to be reduced to nil within a period of four financial years beginning from April 2002.
- Reduce fiscal deficit to not more than 3 percent of the estimated GSDP with in a period of four financial years beginning 2002.
- Not to give guarantee for any amount exceeding the limit stipulated under the Karnataka Ceiling to Government Guarantee Act 1999.
- Total liability not to exceed 25 percent of GSDP by the financial year 2015.

The enactment of the FRA subsequently helped GoK, in 2006, to avail the Debt Consolidation and Relief Facility constituted by the GoI.

REFORM Interventions

In response to a request from the GoI and the GoK, the United States Agency for International Development (USAID) began a series of dialogs at the state level to jointly identify international best practice solutions to narrow a selected number of gaps identified above. The result was the design of the India State Fiscal Management Reform Project (REFORM). The purpose of REFORM was to assist the GoK in strengthening its capacity to support its fiscal objectives towards fiscal consolidation.[13]

Following the discussions, the GoK signaled the following priorities in order of sequence for implementation by REFORM:

- Introducing the Program and Performance Budgeting (PPB) to raise accountability for public fund management;
- Implementing the Karnataka Transparency in Public Procurement Act (KTPP) to promote transparency and accountability in the purchase of goods and services;
- Introducing a Fiscal Policy and Analysis Cell (FPAC) to provide a rational basis for better revenue
and expenditure analysis and to promote interdepartmental dialog for allocations and investments;
- Strengthening both Revenue Forecasting and tax policy analysis methodologies;
- Developing and introducing a state

[13] Fiscal consolidation is defined as a stage in which a balance exists between the expenditure and revenue of the state coupled with debt sustainability (i.e., possessing a debt level that can be serviced by the state government within the limits of its expected revenue base).

macroeconomic database to serve as the information base for macroeconomic forecasting and revenue mobilization;

- Introducing a rigorous project appraisal methodology to ensure selection of socioeconomically viable projects;
- Developing guidelines and report templates to improve state debt and investment management and reporting as well as overall state credit worthiness;
- Developing guidelines for issuance of subnational guarantees; and
- Introducing a software to track and manage public debt including contingent liabilities and guarantees at the subnational level.

The above can be grouped under four (4) critical areas of fiscal management: Expenditure Management (budgeting, treasury, procurement); Revenue Management (tax and nontax policy analysis and revenue forecasting); Debt and Investment Management (debt, contingent liability/guarantees, investment and state creditworthiness); and, Project Appraisal. Finally, REFORM recommended establishment of an FPAC to enable the GoK to institutionalize a culture of continuous analysis of state revenue and expenditures in order to promote better informed decisions.

Below, the rationale for the selection of these particular best practice tools and techniques as well as implementation methodology is presented.

Expenditure Management

Expenditure management (including expenditure planning and procurement) was a priority for the GoK to help improve allocation of public resources towards more productive sectors of the state economy especially infrastructure. The introduction of the program and performance budget methodology and assistance in implementing procurement guidelines were intended to introduce consistent and transparent practices to better account for public resource management. (See Annexure 5 for a complete list of GoK departments and directorates.) The specific institutional weaknesses the GoK hoped to strengthen, under REFORM, were as follows:

- The capacity of staff to allocate resources on the basis of robust financial, policy and program analyses including funding trade-offs as well as a stronger focus on program outcomes;
- The presence of a budget process that considered policy or program outcomes in addition to the required focus on inputs and historical trends;
- The use of a multiyear budget structure that would provide the state with a framework that helps decision makers balance the state's priorities, make decisions in the context of hard budget constraints, and provide line departments with greater responsibility for resource allocation decisions;

- The integration of Plan and Nonplan budgets that would help focus on both the short- and long-term financial implications of new initiatives;
- The capacity of budget officers to systematically evaluate programs and use the information to fine-tune and/or make financial and programmatic adjustments to the budget; and
- The improved capacity of GoK Finance and Planning Department officers to conduct higher-level financial and policy analyses.

Fiscal Policy and Analysis Cell

The second GoK priority was the establishment of a fiscal analytical cell to assist the government to improve informed decision-making capacity. Departmental secretaries, including Finance, were left to take critical policy and procedural decisions in absence of any form of rigorous analysis. To fill this gap, REFORM recommended the establishment of a formal structure with dedicated qualified experts in various economic and financial disciplines with access to timely quality data/information and analytical tools to generate Issue Papers to assist decision makers.

Revenue Management

To bring consistency in revenue forecasting and analysis, the GoK requested assistance from REFORM to introduce appropriate best practice tools and techniques such as revenue forecasting models, input-output Table, and a supporting macroeconomic database. Before REFORM began its work in the state, revenue forecasting was being done without using modern statistical or econometric techniques. Further, use of the latest economic and statistical techniques needed strengthening. Monitoring of Revenue was being done only with respect to what the revenue

In order to close the institutional gaps identified, the REFORM project introduced the following sequence of specific interventions to improve the Expenditure Management capabilities of the GoK:

- Sensitizing and training GoK secretaries and departmental budget officers on budget preparation using the Program and Performance Budget methodology;
- Developing budget page templates that capture program, financial, and performance information in a single document—to bridge the gap between the Plan and Nonplan budgets and support the PPB initiative;
- Rendering advise regarding further Treasury Reforms and development of MIS based on the improved treasury system;
- Mentoring and capacity-building of officials in the Finance Department and other line departments that would be using PPB;
- Training of officers who are hired or deputed to the FPAC on program budgeting skills and analytical techniques in order to enable the FPAC to serve as vehicle for more robust fiscal reform efforts;
- Developing program outcome indicators to measure how well budgets and programs are meeting stated service delivery needs and desired socioeconomic outcomes; also development of other performance indicators (input, output, efficiency, etc.,) that support budget reform;
- Preparing public procurement management guidelines on a demand-driven basis for GoK offices; and
- Lastly, developing and submitting a practical guide for constructing PPB documents was developed and distributed to GoK departmental task forces. (See *Volume II* for the *Expenditure Planning and Management Practitioners' Guide* for further details.)

The GoK decision to establish an FPAC as its first fiscal reform initiative was pivotal to its future fiscal reform efforts. FPAC development and establishment was undertaken in a comprehensive manner. In sequential order, the steps followed to establish the FPAC were:

- Providing the blueprint by REFORM for the establishment for the FPAC, this included detailed description of the expertise required and possible mandate;
- GoJ's accepting the blue print, demonstrated by the release of a government order (GO) to formalize establishment of the FPAC with accompanying staffing and funding from its own budgetary resources;
- Appointing full-time members to the FPAC along with dedicated support staff, facilities and budget line and collocating the FPAC with the REFORM team;
- Commissioning papers by DoF to FPAC to conduct analysis in several critical areas to assist in immediate decision-making;
- Launching FPAC studies through the use of REFORM experts working in concert with FPAC researchers to provide the analytical framework needed to begin the required analyses;
- Submitting completed studies to Principal Finance Secretary for review, comment, and submission to the Chief Secretary and state cabinet for consideration; and
- Developing a desktop reference guide by REFORM on how to establish and operationalize an FPAC-like unit to sensitize and guide other state governments contemplating a similar initiative. (See *Annexure 5* for the *Fiscal Policy Analysis Cell Implementation Guide*.)

collection *is* and not what it *should be*. There was no analysis of markets or consumer behavior in respect of different commodities. Any *ex post* analysis of existing tax structure (tax base analysis, sectorwise analysis, fiscal cost of incentives, tax incidence, etc.) for use for future policy debate was commissioned to one-off expert committees (like the Tax Reform Committee), and no capacity had been built in the Finance Department to carry out these activities on a regular basis.

The pre-existing GoK effort to computerize its revenue data, represented an important first step and information baseline macroeconomic and revenue analysis and forecasting. However, when the REFORM Project was conceived, the GoK required additional trained manpower needed for macroeconomic or fiscal analysis in the State Government. Thus, there was need for awareness raising and capacity-building on fiscal reform initiatives at all government levels, especially as related to information organization and supply for fiscal policy scenario analysis.

During initial discussion, the GoK showed considerable interest in establishing a fiscal analytical cell attached to the Department of Finance to help guide informed decision-making. Although, REFORM had recommended the cell be used for expenditure as well as revenue analysis, GoK priorities called for greater focus on revenue management-related issues.

In addition, REFORM was further requested to help build GoK's capacity in assisting and determining appropriate levels of tax and nontax revenues. An input-output (I-O) Table (internationally considered a useful tool in achieving this objective). To promote quality analysis and forecasting with the use of the I-O Table, a macroeconomic database was also developed.

The REFORM project introduced the following sequence of specific interventions to improve the Revenue Management capabilities of the GoK:

- Creating a specialized dedicated unit (*i.e.*, FPAC) with a trained cadre of full-time analysts to assist the GoK to improve its fiscal management efficiency and consistency and promote informed decision-making;
- Training officials from the FPAC, selected staff of Planning Department as well as the Tax Departments in international best practice revenue forecasting techniques in order to improve the fiscal marksmanship of the state government between budget estimates of revenue, revised estimates of revenue, and finally actual revenues revenue forecasting techniques;
- Training the above GoK officials in basic analytical techniques, provide advanced training in GDP-based modeling, typical taxpayer model and microsimulation modeling including hands-on practical training in real issues requiring macroeconomic and revenue analysis;
- Mentoring FPAC officers in their conduct of fiscal research studies requested by the GoK;
- Developing a state macroeconomic database and a state input-output (IO) Table for use in fiscal analysis and tax revenue forecasting;
- Training GoK taxation policy makers on the importance of macroeconomic data and the use of input-output Tables for revenue forecasting; and,
- Finally, developing a desktop reference guide on revenue management for use by GoK officers to help them better forecast revenues. (See *Volume IV* for the *Revenue Management Practitioners' Guide*.)

(See Figure 2.1 for Karnataka revenues by source from FY 2001-02 to 2003-04.)

As indicated in Table 2A3.3 in Annexure 3, the growth of both tax and nontax revenue was enormous in the three fiscal years preceding the REFORM Project. This was largely due to a surge in foreign direct investment (FDI) in the information technology sector (IT) as well as a profusion of business process outsourcing (BPO) operations in the state. In short, there was great growth in the state's economy and this general buoyancy had a positive impact on state government revenue receipts.

Project Appraisal

Given the large number of capital projects in the GoK pipeline, of particular interest to the government was the introduction of a rigorous and comprehensive project appraisal methodology. A longstanding practice in Karnataka was the review and approval of major project by the High Level Committee (HLC) chaired by the Chief Secretary with the Principal Finance and Planning secretaries as members. Unfortunately, the main tool that was available to aid in the project selection process was a rudimentary cost-benefit analysis that lacked analytical sophistication and a standard format for the review of proposals. The lack of annual cash-flow analyses, prevented identification of potential liquidity-related issues during the project operational phase. Finally, the *ad hoc* selection process resulted in unforeseen financial burden on the state treasury due to the hidden future costs of projects that were not analyzed at the time of their selection and sanction. The above was largely due to the insufficient capacity to conduct the necessary economic, financial, risk and stakeholder analysis.

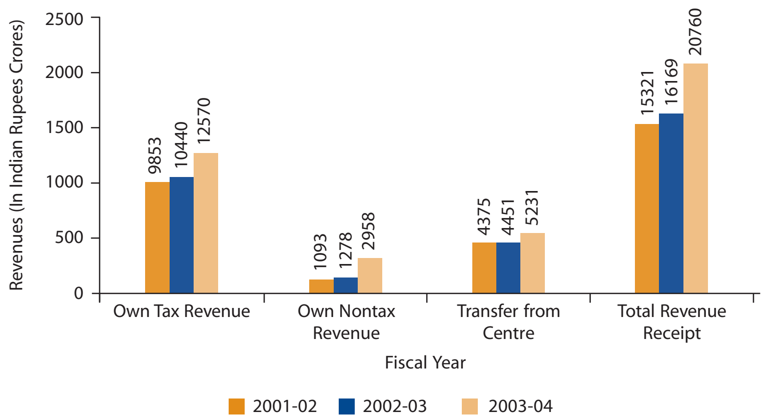
Debt and Investment Management

The priorities under debt and investment reform were to: (i) Develop a consolidated, refined, debt recording and reporting system; and (ii) Frame and introduce rules for the issuance of government guarantees. As REFORM began its state operations, Karnataka possessed a pre-existing time series on GoI and other related debt. It had also assembled a collection of its guarantees in a series of paperbound volumes. Both of these data sets were submitted to the state legislature as Annexures to the state budget. However, not all potential GoK liabilities were comprehensively documented. Finally, the GoK lacked comprehensive information regarding its investments in large, medium and small government undertakings and other institutions.

REFORM Achievements

The REFORM achievements have been evaluated in terms of *appropriate capacity* (*i.e.* expertise of state officials and strength of fiscal infrastructure) and the *practices* (i.e. consistent, transparent, and accountable processes) to perform relevant, economic and statistical analyses to make sound fiscal policies and implementation choices at the state level. The social science construct *Knowledge*, *Attitudes*, and *Practices* (KAP) was deployed for this purpose. Since it was important to capture the efficiencies and effectiveness that are beginning to accrue from the introduction of the new practices, *Impact* was added to the KAP construct. REFORM was therefore evaluated in terms of *K-A-P-I* – knowledge transferred, attitudes changed, practices introduced and their initial impact. KAPI may be defined as follows:

Figure 2.1: Karnataka State Revenue Sources: 2001-04



- **K**nowledge Transferred: Skill sets enhanced

The REFORM project introduced the following sequence of specific interventions to improve the Project Appraisal capabilities of the GoK:

- Introducing a rigorous, international best practice project appraisal methodology covering, financial, economic, risk and distributive analysis to ensure selection of socioeconomically viable projects;
- Introducing the case study method of training; the trainee officials were asked to select projects — either actual or planned for funding by their respective departments — for analysis and subsequent classroom presentation. Such presentations promoted appreciation of the inter-related socioeconomic factors as well as application of different parameters for different sectoral proposals;
- Training GoK officials on the use of the software *Crystal Ball* for risk analysis; and
- Developing and submitting a comprehensive project appraisal manual (with 11 sector-specific guidelines) to serve as a desk reference guide that would enable its users to appraise projects using the REFORM project appraisal methodology. (See *Volume V* for the *Project Appraisal Practitioners' Guide* for the methodology introduced.)

through international best practices. This includes training provided, manuals developed, databases established, and reporting templates designed and introduced.

- **A**ttitudes Changed: This signals acceptance of the need for reform, understanding the changed methodology and a willingness to practice it. This includes cabinet decisions/ approvals, government orders and circulars issued, notifications released, curricula introduced and, funds, staff, and facility allocated by the respective state governments.
- **P**ractices Introduced: Actual application of the new practices introduced. This includes the commissioning of FPAC studies, project selection based on project appraisal methodology introduced under REFORM, international best practices introduced in annual curricula of state civil service training institutes, development of departmental PPB documents, report on debt using REFORM designed reporting templates, etc.
- **Initial I**mpacts Noted: Applications of new practices translating into efficiencies in the allocation and use of public funds. Examples include the savings accrued, poor projects filtered out, quality expenditures improved.

With respect to Karnataka, initial reports on the impact of the REFORM interventions on the state's fiscal management capacity-are harbingers of what can happen if there is a serious and sustained effort to re-engineer fiscal management practices based on international best practice standards.

Achievements in terms of Knowledge Transfers

Expenditure Planning and Management

- More than 220 GoK officials have been trained at all secretariat as well as district levels in

The REFORM project introduced the following sequence of specific interventions to improve the Debt and Investment Management capabilities of the GoK:

- Developing training, reference and reporting material for the effective management of state government debt, investment and guarantees to government officers to enable the Government of Karnataka to carry these operations in a sustainable manner;
- Proposing the design of a Debt and Investment Management Cell (DIMC) located in the FPAC that would be responsible for analyzing, evaluating, monitoring and managing the State's debt, investments and guarantees (contingent liabilities);
- Developing operation and procedures manuals to assist practitioners with the monitoring and management of state government debt, investments, government guarantees and state creditworthiness;
- Introducing an international best practice debt management software to improve management of state debt and contingent liabilities at the subnational level;
- Developing guidelines developed for issuance of state guarantees;
- Awareness-raising of state government officials on how to improve state credit worthiness through international best practice approaches;
- Constructing reporting structures to enable the GoK to track and improve its investment portfolio management; and
- Identifying the Commonwealth Secretariat (CS) Debt Recording and Management System (DRMS) software to manage and report on state debt and modification of the software to track and manage contingent liabilities.

PPB.[14,15,16] (See Annexure 7 for the PPB rollout report.)

- At total of 35 GoK officials have been trained on various issues related to public procurement management.
- *PPB Implementation Guide* has been developed for use by the *Fiscal Policy Institute* as a training tool and desk reference.
- Procurement guidelines have been developed for the "Social Welfare Department," "Bengaluru Mhanagara Palike" and "Gulbarga Electricity Supply Company." (See Annexure 8 for the list of procurement studies.)

Revenue Management

- More than 250 GoK officers have been trained in various tax and revenue management topics.
- A *Revenue Management Guide* has been developed for use by the *Fiscal Policy Institute* as a training tool and desk reference.
- An Input-Output Table along with a supporting macroeconomic database has been developed and presented to the GoK for their use.

Debt and Investment Management

- Implementation of the *CS-DRMS* software;
- Debt and investment reporting and tracking templates developed and presented.
- Six officers have been have been identified, trained and are available to serve as trainers/mentors.
- A *Debt Toolkit* and other manuals have been developed and accepted for use.

Box 2.3: District-level PPB Extension in Karnataka

The Government of Karnataka (GoK) is one of the first Indian state governments to extend the outcome budgeting methodology (also known as program and performance budgeting (PPB)) to the district and Panchayat Raj Institute level.

This PPB extension was a joint Department of Finance and Department of Planning initiative to improve program performance and quality expenditure for three key social service departments: Education, Health and Family Welfare, and Women and Child Development. PPB was introduced to four districts (Bijapur, Gulbarga, Mysore, and Udupi) in early 2008. To date, more than 120 district-level officers from the above departments have been trained in how to prepare, track, and report on budget execution using the PPB methodology. Department-specific task forces were established and these are now completing their PPB documents for the 2008-09 fiscal year. There are plans to extend the PPB implementation to all 29 districts of the state.

Finally, use of PPB at the district level is a Government of India recommendation and it has the potential to enable the GoK to ensure quality expenditure on important social development program thereby improving its ability to meet its *United Nations Millennium Development Goals*.

[14] The eight departments are: Health, Higher Education, Home, Irrigation, Primary Education, Public Works, Secondary Education, and Transport.
[15] The three departments are: Education, Health and Family Welfare, and Women and Child Development.
[16] The four districts are: Bijapur, Gulbarga, Mysore and Udipi.

Project Appraisal

- More than 100 officers have been trained in the Harberger project appraisal methodology.
- A core group of 25 officers have been identified, trained and are available to serve as trainers/mentors.
- More than 100 officers trained in *Crystal Ball* software.
- A *Project Appraisal Manual* with sector-specific guidelines is being provided for GoK reference and training programs to be conducted at the FPI.

- The TOR for a project formulation and appraisal division (PFAD) has been submitted for consideration by the GoK.

Institutionalization

- Training of FPAC resource persons in how to conduct good analysis have been completed and these FPAC members are on duty conducting fiscal research for the GoK. (See Annexure 9 for the list of FPAC studies.)

Achievements in terms of Attitude Changes

Expenditure Planning and Management

- The Karnataka State Legislature Estimates Committee decided on 10 January 2007 that PPB documents should be extended throughout the government – final legislation is awaited.
- The PPB methodology has been implemented for district Education, Health and Family Welfare, And Women and Child development officers in Bijapur, Gulbarga, Mysore, and Udupi districts.

Box 2.4: Fiscal Policy Institute Establishment

The Government of Karnataka (GoK) has always expressed the viewpoint that further institutionalization of the REFORM initiatives will be done through a Fiscal Policy Institute (FPI), currently being set up by the state government and expected to be functional by April 2009. A Government Order (GO) was issued setting up a Fiscal Policy Institute (vide No FD33 GIE 2006(ii) on 29 January.

It states *"…Setting up of a state level academic institution with the objective of providing specialized training and research opportunities to the officers of Government of Karnataka and other state governments in the areas of financial planning, administration and management with a view to enhance their planning and decision making skills was under the active consideration of the state government…"*

A sanction was also accorded for creation of 52 posts. There has also been a notification issued by the Finance Department appointing the Director, who has already assumed charge.

The REFORM team has been working with the Director and suggesting the necessary measures to be initiated by him based on the REFORM recommendations. The FPI Campus is being built in the outskirts of the city. Spacious lecture halls and a hostel facility are being built for the accommodation of officers on training and for the faculty to permit residential training.

Revenue Management

- Structured analysis of revenue management issues are being undertaken by the FPAC.

Debt and Investment Management

- Creation of a *Department of Investment Tracking and Monitoring* to better its state investment portfolio.
- The GoK has accepted the need for structured analysis, comprehensive database, reporting structures for improved debt/contingent liabilities management to facilitate timely tracking.

Project Appraisal

- The GoK considering issuance of a GO to mandate a structured project appraisal process all capital projects costing more than INR 100 million in infrastructure and INR 20 million in social sector projects, starting with fiscal year 2009-10.

Institutionalization

- A fully-dedicated 8-member FPAC/DIMC has been established and provided with supporting staff, budget and facility.
- The *Fiscal Policy Institute (FPI)* was established

Box 2.5: Karnataka Revenue Forecasting Improvement

In order to improve its ability to forecast state revenues from various tax regimes, the Government of Karnataka (GoK) requested REFORM assistance to work with government officials in order to improve its ability to forecast revenues and analyze the alternative policy implications under various taxes.

REFORM worked with officers of the state Fiscal Policy and Analysis Cell (FPAC), Sales Tax, State Excise, Motor Vehicles Tax, and Stamp Duty and Registration Fee departments over a two year period. These capacity-building efforts were carried out through a series of activities that included:

- Class room lecturing to help participants understand the concepts and the basics of techniques of resource forecasting and impact analysis; and,
- Individual mentoring through interactive sessions with participants/ group of participants.

The classroom lecturing was arranged by the REFORM Project Karnataka State team and other local experts on estimation of elasticity and buoyancy of major taxes and applying the concepts of elasticity and buoyancy in forecasting revenue from these taxes.

Individual mentoring was provided to the officers in both formal and informal sessions using individual desktops. The mentoring covered: the fundamentals of regression analysis; building causal models between base of a tax and its various determinants to understand future policy implications; and, practical exercises using data from major taxes in Karnataka.

The forecasting capability is assessed in terms of a comparison made for the gap observed between the actual and estimated budgeted figures of the respective years. Though gaps between the actual and forecast figures remain, the difference has come down substantially. For example actual revenue deficits have been less than the level provided in the Budget Estimate.

As a result of these class room and individual mentoring sessions, the concerned GoK officials are better able to forecast potential tax revenues for the state.

in January 2007 to serve as GoK fiscal reform nodal agency, research and training is scheduled to start in 2009 once construction of its new campus is completed.

Achievements in terms of Practices Introduced

Expenditure Planning and Management

- A total of 8 out of 28 departments have PPB task forces and PPB documents accounting for about 50 percent of the overall state budgets.
- PPB implementation for the Education, Health and Family Welfare, and Women and Child Development officers in Bijapur, Gulbarga, Mysore, and Udupi districts.
- GoK is using the *PPB Implementation Guide* and as a desk reference for its PPB Task Forces at both the secretariat and district levels.

Revenue Management

- FPAC studies have and are being used in revenue policy formulation as announced in state budget speeches.

Debt and Investment Management

- *Department of Investment Tracking and Monitoring* is actively management its state investment portfolio.
- DIMC personnel are using the *CS-DRMS* software for debt and guarantees reporting.

Box 2.6: Project Appraisal and Debt Management

The case study methodology used in project appraisal training under REFORM is beginning to allow public sector officials to realize substantial savings through better management of loan portfolios.

A good example is the Company Secretary and General Manager (F&A) of the Rajiv Gandhi Rural Housing Corporation Ltd., who is using better financial analysis to benefit the company, saving INR 18 lakhs for the quarter ending March 2005. As he explains, "the Company's outstanding loans from major financial institutions (FIs), was INR 41648.12 lakhs in January 1, 2005, with a quarterly repayment of INR 2321.61 lakhs. This consisted of INR 1268.25 lakhs as principal and INR 1053.36 lakhs as interest. The quarterly repayment details are listed below:

(INR in Lakhs)

Institution	Repayment			Rate of Interest
	Principal	Interest	Total	
HUDCO	854.55	747.07	1601.62	7.5% & 8%
Corporation Bank	89.30	97.07	186.37	8%
Union Bank of India	127.97	93.46	221.43	7.5%
Indian Bank	8.93	9.27	18.19	7.5%
Oriental Bank of Commerce	187.50	106.49	293.99	7.25%
TOTAL	**1268.25**	**1053.36**	**2321.6**	

As a result of the improved analysis, he was able to renegotiate a short-term loan at a lower rate of interest and partially prepay the principal to the FIs. A vital lesson learned by the trainee was to seek early repayment of the principal (and not interest). Similar analysis has resulted in further savings.

Anil B Shedbal, Company Secretary and General Manager (Finance and Administration) for the Rajiv Gandhi Rural Housing Corporation Ltd. (See Annexure 10 for the original testimonial.)

Institutionalization

- To date, 9 of 11 commissioned studies have been completed by the FPAC with a number of these studies having had an impact on state policy-making.

Achievements in terms of Initial Impact

Debt and Investment Management

- The development of a comprehensive public investment database has helped GoK to raise INR 100 crores as dividend and guarantee commission.

Project Appraisal

- The company Secretary and General Manager (F&A) of the *Rajiv Gandhi Rural Housing Corporation Ltd.* was able to put the financial analysis to the advantage of the company, saving INR 18,28,882 (INR 1.8 million) for the quarter ending March 2005.

Institutionalization

- The creation of *Fiscal Policy Institute* was the result of the catalytical effect of the REFORM Project in promoting fiscal management reform and capacity-building in the state government.
- The *Department of Investment Tracking and Monitoring* was established due to recommendations of REFORM Project.

The fiscal reform measures initiated by the GoK have favorably influenced fiscal trends in the state. (See Annexures 3 and 4 for details.) As a result, the GoK was able to avail GoI incentives that were designed to encourage improvements

in fiscal consolidation at the state level. The incentives availed are as follows:

- Full benefit of the incentive grants of Indian Rupees (INR) 286 crores for the EFC award period;
- Interest relief of INR 292 crores under debt consolidation and relief facility; and
- Waiver of central loans of INR 358 crores under debt write-off scheme for the year 2005-06 (Government of Karnataka, 2006).[17]

In summary, the various fiscal reform measures undertaken by the GoK have enabled it to pass through its earlier fiscal crisis. GoK's fiscal improvements were largely contributed by high tax buoyancy (in the center and in Karnataka). (See Table 2.2 for details.) As a cautionary note, the tax buoyancy experienced could dissipate over time and the GoK may find itself back in a state of fiscal distress unless continuous focus is placed on appropriate expenditure as well as revenue management.

[17] Government of Karnataka, 2006, Report of the Comptroller and Auditor General of India (Civil) 2006.

REFORM Under achievements

Time constraints prevented the REFORM project from completing its entire agenda for improving and strengthening the fiscal structures and systems of the GoK. Specifically:

- The macroeconomic database and Input-Output Table developed have yet to be utilized in revenue forecasting;
- The project unit to institutionalize the project appraisal methodology has yet to be established. However, REFORM has provided GoK with the terms of reference for a Project Formulation and Appraisal Division (PFAD) that would be located in the newly-established Fiscal Policy Institute (FPI); and
- The government order for the use of a structured project appraisal process for all projects costing more than INR 100 million in infrastructure and INR 20 million in social sector projects is yet to be issued.

Lessons Learned

As a result of 4.5 years work in the state of Karnataka, the REFORM Project is able to provide a comprehensive list of lessons learned that can be leveraged by other state governments engaged in fiscal reform. These lessons learned, which either facilitated or delayed implementation, adoption and sustained use of the tools and techniques introduced have been categorized in the following two broad categories:

- **Enabling factors**; and
- **Impeding factors**.

More specifically:

Enabling Factors

The key factors that can enable a state government to successfully implement fiscal reform initiatives are these:

- *A legacy of fiscal reform provided the required willingness and wherewithal to introduce and implement new fiscal reforms.* Due to its relatively long (more than ten years) history of introducing fiscal reform measures, the GoK had a high sense of awareness on the value and the need to pursue various fiscal reforms These earlier fiscal reform efforts were the result of either GoK initiatives or a part of the World Bank assisted Economic Restructuring Project. When the REFORM Project began in April 2004, the GoK was well-positioned to adopt and implement REFORM initiatives. The state had already implemented Treasury computerization, passed laws regarding introducing Transparency in Procurement, Ceiling on Government Guarantees, the Fiscal Responsibility Act and preparation of Medium Term Fiscal Plan. Hence, the government appreciated the value of REFORM initiatives in the areas of treasury management, procurement, debt management, program and performance budgeting as well as the need for a cell in the finance department that would undertake fiscal research work.. In addition, the GoK appreciated and acted on the REFORM suggestion that PPB should be part of the budget process in order to be of maximum value—not produced as just another document for the shelf after the "real" budget is done;

- *As a result of its reform legacy, GoK was in a position to use and assume subsequent ownership of REFORM tools and techniques to effectively meet its needs*. As examples:
  - The FPAC constituted by the GoK has been very successful due to the strong interest shown by the government as exemplified by assured office space and staffing, through dedicated and fully-funded state budget provision. More importantly, from its inception, GoK has utilized the FPAC by commissioning it to undertake important studies on matters of government priority (*e.g.*, mining royalties). As a result, the FPAC has grown into a robust fiscal think tank, with the capacity to serve the GoK for years to come;
  - Extension of the REFORM PPB methodology to the district level was a response to a joint request made by the Principal Finance and Planning Secretaries at the September 2007 GoK-USAID Coordination meeting. As result of this GoK initiative, the PPB methodology has been introduced to district officers of the Education, Health and Family Welfare, and Women and Child Development departments in four (4) priority districts of the state: Bijapur, Gulbarga, Mysore and Udupi. A benefit of this state-driven approach has been better coordination with other ongoing programs. For example, the introduction of PPB was done in four districts for which State Government is preparing District Human Development Reports as a part of a UNDP-funded Human Development initiative. The result was four (4) well-attended PPB orientation and training workshops that have resulted in the preparation of PPB documents for the *Zilla Panchayat Raj Institutions* in all four districts;
  - The personal interest displayed by a Secretary, (Budget and Resources) Finance Department , ensured the complete and proper development of PPB documents for the Education and Health and Family Welfare departments and their subsequent presentation, in Kannada, to the Estimates Committee of the state legislative Assembly. This dedicated effort by the Budget Secretary led to the Estimates Committee decision to recommend adoption of the PPB format and methodology for not only these two departments but, the entire GoK secretariat;
  - The GoK request for REFORM to draft the "Framing Rules for Developing Guidelines for Issuance of Government Guarantees" represented the first tangible REFORM debt and investment management deliverable to the GoK;
  - GoK adoption and ownership of the recommendations, presented in the REFORM debt and investment management manuals, were illustrated by, not only the establishment of a Debt management Cell within the FPAC but, also, through the establishment of the Department of Investment Tracking and Monitoring in 2006; and
  - The REFORM "Project Finance and Debt Management" training course was designed and delivered in response to a specific request from the GoK to combine the work of the REFORM debt and project appraisal interventions and teams into one robust course to assist project planners. (It is hoped that this will be a key course offering of the FPI once it commences its fiscal reform training programs in 2009.)

Impeding Factors:

The key factors that can impede implementation of fiscal reform activities and that a state government needs to be aware of when it embarks on a path of fiscal reform are these:

- *Frequent changes among the senior Finance Department officers resulted in either project implementation delays or changes in direction due to the change in GoK priorities.*

  For example, the initial Finance Department leadership supported preparation of PPB for six pilot departments. However, a subsequent change in incumbency led to the REFORM Team efforts being focused only on two (2) key departments: Education and Health and Family Welfare. This change of approach delayed extension of the PPB methodology to other departments. However, the Finance Department was able to convince the estimates committee of the Legislature about the usefulness of the PPB approach and obtained their approval to extend this methodology to all the Departments of Government;

- *The length of some REFORM capacity-building efforts (such as project appraisal, tax policy and revenue forecasting) prevented retention of the same participants for the entire series of training programs*; ideally, the same participants should have attended all the courses which were of a continuous nature. These frequent changes delayed the development of trainers and mentors to ensure the long-term sustainability of project initiatives;

  For example, the initial group of Project Appraisal trainees in 2004 numbered more than 30 persons. However, only 19 eventually completed the initial series of four (4) workshops when they ended in late 2005. As a result, the number of potential GoK project appraisal officers, trainers and mentors dropped by about 36 percent due to the extended time frame of the training courses;

- *Poorly synchronized and coordinated fiscal reform initiatives led to confusion and a lack of ownership in some GoK departments* — although, as seen above, a legacy of fiscal reform is clearly beneficial to adoption of further reforms. As examples:

  – Introduction of the PPB methodology closely followed introduction of the Departmental Medium Term Fiscal Plan (DMTFP) reporting format in the GoK. Some of the departments that had started working on DMRFP documents were reluctant to switch over to the PPB format. It took the Secretary-Budget quite some time to ensure that these departments took full ownership of their respective PPB implementations;

  – GoK departments are required to prepare other annual budget-related reports such as the Annual Performance Budget and Annual Administrative Reports. Both these reports need to be prepared immediately prior to legislative budget sessions. This timing is also shared by PPB and the cumulative effect has been that too many reporting formats reduce the amount of time officers have to prepare each report. As a result, new, nonmandated initiatives such as PPB do not receive the attention they require; and

  – The GoK Finance Department decision is to institutionalize REFORM interventions through the FPI instead of the Administrative Training Institutes (ATIs). The FPI building is under construction; the newly appointed Director has been operating from the FPAC office. There has been delay in initiating the process of institutionalizing the REFORM initiatives through State-level Training Institution.

Recommended: Immediate Next Steps

In view of the above unfinished agenda, and in order to maintain and build upon the fiscal reform achievements generated by the REFORM project, the Karnataka state team has recommended the GoK carry out the following immediate next steps:

Expenditure Management

- As articulated by the Principal Finance Secretary in the September 2007 GoK-USAID Coordination Meeting in Bangalore, PPB needs to be extended to all government departments and to this end a comprehensive PPB methodology roll-out plan needs to be finalized;
- The district-level PPB training programs begun under REFORM for Education, Health and Family Welfare, and Women and Child Development officers need to be continued and expanded to include as many of the state districts as possible.
- All GoK departments (*e.g.*, Education, Health and Family Welfare, and Home) with PPB task forces need to submit their PPB documents to the state legislature during the 2009-10 budget sessions; and
- As suggested by the Principal Finance Secretary in the September 2007 GoK-USAID Coordination Meeting in Bangalore, the GoK needs to mandate preparation of the PPB format in lieu of the currently required Annual Performance Budget Report. This change in government budgetary reporting procedure needs to be approved by the state legislative assembly and this legislative process should be initiated at the earliest and most timely date.

Revenue Management

- The preliminary state macroeconomic database needs to be promoted for analysis of implications of tax policy changes on the state budget;
- The Central Statistical Organization (CSO) offer to train state government officials in the use and upkeep of the macroeconomic database should be taken advantage of through a GoK request for support;
- The I-O Table prepared by the NCAER has to be periodically updated, improved and utilized for Revenue potential analysis and conducting impact study of major projects; and
- The GoK should initiate a dialog with the CSO and NCAER, to enable updating and maintenance of the I-O Table.

Project Appraisal

- A GO needs to be issued as soon as possible — preferably before the end of Q3 2008 — that mandates the Planning Department to appraise, analyze, and recommend selection of all capital projects costing more than INR 100 million in infrastructure and INR 20 million in social sector projects, starting with fiscal year 2009-10.

Debt and Investment Management

- The general recommendations given by the REFORM team regarding debt management, including contingent liabilities of the government still remain to be implemented;
- The GoK needs to take a final decision regarding the REFORM-drafted framing rules or issuing guidelines regarding preconditions to be fulfilled by agencies seeking government guarantees;
- The DIMC cell in FPAC needs to be augmented with additional staff and researcher appointments; and
- The *CS-DRMS* software and its reports need to be used not only to monitor and maintain debt data but also to provide medium- and long-term forecasts of debt servicing and interest income that feed into fiscal forecasts.

Institutionalization

- As suggested by the Principal Finance Secretary in the September 2007 GoK-USAID Coordination Meeting in Bangalore, the FPAC and DIMC need to become part of the FPI once the latter assumes its role as the fiscal reform nodal agency in the GoK.
- REFORM capacity-building training courses in debt PPB, project appraisal, project finance and debt management, and tax policy and revenue need to become part of the annual training calendar of the Fiscal Policy Institute.

Table 2.2: State Finances of Karnataka: Summary Growth Indicators

Summary Indicators	1999-00/ 2008-09	2001-02/ 2008-09	1999-00/ 2004-05	2001-02/ 2004-05	2005-06/ 2008-09
GSDP Trend Growth Rate	11.21%	12.42%	8.99%	10.67%	13.06%
Expenditure Trend Growth Rate					
Total Expenditure Trend Growth Rate	14.03%	15.57%	10.67%	12.09%	15.44%
Revenue Expenditure Trend Growth Rate	12.47%	13.83%	9.33%	9.98%	15 28%
Capital Outlay Trend Growth Rate	23.78%	26.01%	20.37%	27.42%	16.33%
Own Tax Revenue (OTR) Trend Growth Rate	17.49%	19.45%	14.05%	17.31%	18.83%
Central GoI Transfer Trend Growth Rate	16.36%	19.08%	10.13%	11.87%	17 58%
Buoyancy[18] OTR	1.56%	1.57%	1.56%	1.62%	1.44%

(Source: Finance Accounts and Budget Document — GoK).

[18] Buoyancy is defined as the ratio of the growth of own tax revenue and growth of state gross domestic product.

Conclusion

Fiscal Indicator Impact

On the broader macroeconomic picture, the fiscal numbers of Karnataka registered considerable improvement during the last four years (*e.g.*, since fiscal year 2005-06 to fiscal year 2008-09 BE). This is largely due to the revenue buoyancy in the overall Indian economy as a result of sustained high rates of growth over the same time period. Due to this buoyancy in revenues, the role of expenditure management has become less pressing in fiscal consolidation.

Table 2.2 shows the key fiscal trends for three time periods:

1. All fiscal years (2001-02/2008-09 (BE)) immediately before and during the REFORM project;
2. The fiscal years (2001-02/2004-05) before REFORM really began its capacity-building effort; and
3. The fiscal years (2005-06/2008-09 (BE)) after REFORM began its capacity-building effort.

As indicated in Table 2.2 there has been considerable increase in the state's revenue receipts during the last decade. Buoyancy of own tax revenue stands at 1.44 coupled with a 17.5 percent growth in central transfers. The growth in own tax revenue has grown slightly faster during the four-year REFORM period (18 percent) than in the four preREFORM years (17 percent). During the same time period central government transfers have also shown a marked increase from 11 percent to 17.5 percent. This buoyancy can be attributed to a number of factors most importantly a generally buoyant national economy and the fact that Bangalore

remains a priority destination for high technology foreign direct investment (FDI).

In terms of total expenditures, a higher growth rate is visible during the REFORM period as opposed to the preREFORM period (15 percent *versus* 12 percent). This expenditure increase was a function of revenue growth and central government transfers combined with the GoK's constitutional obligation to allocate more funds for development and social infrastructure such as education and health services in its less developed northern districts.

In summary, state income has been growing during the REFORM period and this justified the increased spending. Thus, the urgent need for expenditure quality control arose to ensure well-utilization of the additional resources. Thus, in part to meet this need, the GoK and REFORM made the PPB methodology a key component of the REFORM capacity-building program.

Capacity-building Impact

According to its mandate, REFORM was tasked with introducing international best practice tools and techniques to promote informed fiscal decision-making. In this respect, the project succeeded in introducing and transferring new

Box 2.1: Karnataka Public Investment Management Initiative

Despite being one of the leading Indian state governments with respect to foreign direct investment (FDI), the Government of Karnataka GoK) did not have complete and easy access to its investments in various public sector undertakings (PSUs). This deficiency was due to no dataset or formal reporting structure to track these investments. Therefore, to advance its state debt and investment management, the GoK worked with REFORM to develop more robust investment recording and reporting processes and templates.

REFORM recommended steps for improved state investment management in a manual that was provided to the GoK in 2005. In part, due to these recommendations, the GoK converted its Small Savings and Lotteries Department into the Department of Investment Tracking. Since its establishment in 2006, this department has been tracking GoK investments in various PSUs and recording dividend returns from these PSUs.

Today, the Department has succeeded in maintaining detailed financial information on all PSUs in which the GoK holds equity, especially those related to dividend payments. This GoK investment initiative has been very beneficial, as the department now has a detailed and current dataset on investments, dividends due the government, and loans released by the government. As a result, the overall GoK financial position has improved from one where it had been dependent on the PSUs themselves for dividend payments, to one where it receives these regularly. This new arrangement has enabled the GoK to recover more than INR 124.27 crores worth of unpaid dividends that can now be used to fund its development programs while reducing its public debt burden.

fiscal knowledge and skills to the Government of Karnataka. This was the only dimension of the KAP construct that REFORM totally controlled. The attitudinal change and actual practice of new fiscal management tools and techniques were and remain the domains of the state government. In the case of Karnataka, a robust package of fiscal knowledge skills in expenditure planning and management, revenue management, debt management, and project appraisal were transferred over a 52-month implementation period. This effort was facilitated by the vision and willingness to change pre-existing fiscal practices exhibited by the GoK Finance Department officials who worked with REFORM. The most significant fiscal reform efforts of the GoK were, in order of importance:

Firstly, establishment of the Fiscal Policy Institute that will serve as the nodal agency for fiscal reform, research and training once it becomes fully operational in 2009. This is the first known effort by an Indian state government to create an agency dedicated to progressing fiscal reform and fiscal research.

Secondly, establishment of an enduring FPAC with eight dedicated and full-time officers in their own facility, budget line and support staff. The studies completed by the FPAC have had an impact on state fiscal governance and thought. When the FPAC is subsumed into the FPI in 2009, it will be able to continue its fiscal think tank status with the assurance of additional support facilities and staff. Overtime, expansion of the membership and scope of the FPAC to include budget analysis and capital budgeting and programming will help it to more fully support the fiscal decision makers of the state.

Thirdly, the coverage of almost half the state budget with the PPB methodology and the pending state legislation to mandate this budgeting approach for the entire government are critical achievements in the are of expenditure quality capacity-building. In addition, the initial extension of PPB to four districts has provided a baseline from which the state government can extend PPB to all 29 districts of the state, in the process, helping to improve expenditure quality for social service departments in the state.

Fourthly, implementation of the *CS-DRMS* database software and population of the database with the state's debt and guarantees data has made the state a pioneer in the field and practice of subnational debt management.

At this time, the impact of the REFORM fiscal reform effort is anecdotal and isolated. Nevertheless, the initial results on the role of the FPAC in shaping informed fiscal policy decision-making and the role of the PPB methodology in enabling quality expenditure serve as harbingers of what can happen if Karnataka continues to maintain its long record of fiscal reform.

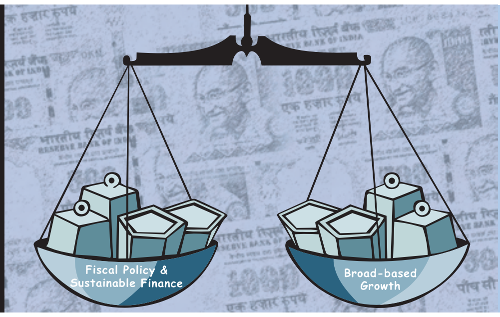
Final Thoughts

In conclusion, the systems, tools, and techniques that enable fiscal managers to make informed fiscal choices are critical to follow an appropriate development strategy to improve the lives of its citizens. Therefore, continued effort to introduce and institutionalize relevant fiscal management tools and techniques are critical for the sustainable development of any and all sectors of the state economy.

However, trends clearly indicate that the present revenue buoyancy may mot continue in the not-too-distant future, due to several external factors (*e.g.*, increases in the global price of oil and food items), which have already impacted on the rising inflation rates. Against the backdrop of this scenario, the sustainability of the revenue buoyancy becomes highly uncertain. Similarly, high inflation rates are bound to create pressure on expenditure management. With the cost of capital further expected to rise, the dilemma for the states to choose between fiscal prudence and development becomes a challenge.

Lastly, the USAID REFORM has succeeded in helping to accelerate fiscal reform in the GoK. The tools and techniques introduced will — if fully institutionalized through the Fiscal Policy Institute capacity-building programs — help the GoK to face the continuous challenge of balancing fiscal prudence with the need for greater investment to fuel state economic growth. Further, these tools and techniques will continue to benefit the GoK, especially in the event of reoccurrence of a mismatch between receipts and expenditure without it having to resort to unsustainable borrowings to bridge the gap as has happened in the past.

Lastly, for more information on the fiscal reform project tools implementation experiences implemented by the REFORM project (*please see the various tool reports, which are located in the following Volumes—II, IV and V of the REFORM Project Compendium with Practitioners' Guide*.



Annexures

Annexure 1:

Karnataka State Socioeconomic Profile

Table 2A1.1: Karnataka State Social Indicators

Indicator	Karnataka	All-India
Total Geographical Area	1.92 lakhs sq. kms	3287263 sq. kms.
Percentage of Arable Land	64.6%	
Percentage of Forest Cover	20% of total area	23 38%
Percentage of Hilly Terrain		
Major Water Resources	Rivers	Rivers
Major Energy Base (Hydro, Coal, Oil, Gas, Wind…)	Hydro and Coal	
No. of Districts	29	593
Total No. of Villages	37700	638588
No. of Villages Connected by Roads: Both National and State Highways	%	
Number of State Elections since 2001	Twice: 2000 and 2005	Two: 2000 and 2004
Population: 2001 Census	52.73 million	1026443540
Major Religions (As a Percentage of Overall State Population)	Hindu – 83% Muslim – 11% Christian – 4% Buddhist – .7% Jain – .7%	Hindu – 80.5% Muslim – 13.4% Christian – 2.036% Sikh – 1.9% Buddhist – .08% Jain – .04%
Percentage of SC Population	16 2	To be Verified
Percentage of ST Population	6.55	To be Verified
Percentage of Population Below Poverty Line: Official Estimate — 2004-05	25%	26%
Literacy Rate Six Years and Above	67%	65%
Unemployment Rate: (55 Round (NSSO 1999-2000 Daily Status) Rural	4.3	7.1
Urban	5.4	7.7
Number of Health Centers	1700	22,400
Infant Mortality Rate: 2006	48 per 1,000 births	57 per 1,000 births
Electrification: No. of Villages Electrified	37,400	56%
Drinking Water: Clean Water Sources	Well, Tubewell, Rivers and Streams	1,628,269 Units

Sources:
- Census 2001, Government of India.
- Karnataka Human Development Report accessible at: http://planning.kar.nic.in/khdr2005/eindex.htm

Annexure 2:

Karnataka State Finances

Table 2A2.1: State Finances of Karnataka

Fiscal Parameters/ Fiscal Years	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 RE	2008-09 BE
Gross Fiscal Deficit	5870	5281	4501	3600	3687	4688	6085	6926
As % of GSDP	5.36	4.40	3.40	2.42	2.16	2.49	2.77	2.84
Revenue Deficit	3284	2646	525	-1640	-2311	-4152	-2981	-2973
As % of GSDP	3.00	2.20	0.40	-1.10	-1.35	-2.21	-1.35	-1.22
Primary Revenue Deficit	602	-646	-3185	-5434	-6076	-8388	-7700	-8251
As % of GSDP	0.55	-0.54	-2.40	-3.66	-3.56	-4.46	-3.50	-3.38
Debt and Liabilities	32566	37234	41967	46940	52236	57278	60182	67142
As % of GSDP	29.75	31.01	31.67	31.60	30.59	30.42	27.35	27.51
Revenue Expenditure as % of Revenue Receipts	121.44	116.36	102.53	93.73	92.38	88.95	92.70	93.56
Capital Outlay	2106	2936	3029	4674	5822	8543	8886	9513
As % of GSDP	1.92	2.45	2.29	3.15	3.41	4.54	4.04	3.90
Revenue Deficit as % of Fiscal Deficit	55.95	50.10	11.66	-45.56	-62.68	-88.57	-48.99	-42.93
Revenue Deficit as % of Revenue Receipts	21.43	16.36	2.53	-6.27	-7.61	-11.05	-7.30	-6.44

(Source: Finance Accounts and Budget Document — GoK).

Annexure 3:
Karnataka State Fiscal Trend Data

Table 2A3.1: Expenditure Trends in State Finances of Karnataka

Sectors/Fiscal Year		2001-02	2002-03	2003-04	2004-05	2005-06	2006-07 RE	2007-08 BE
Education Expenditure		3506	3571	3772	4363	5942	5969	7110
As % of GSDP	3.20	2.97	2.85	2.94	3.48	3.17	3.23	3 3
Health Expenditure		1086	1005	996	1044	1191	1593	1935
As % of GSDP	0.99	0.84	0.75	0.70	0.70	0.85	0.88	0.9
Water and Sanitation		373	341	450	522	868	1005	1463
As % of GSDP	0.34	0.28	0 34	0.35	0.51	0.53	0.66	1.92
Roads Expenditure		622	744	782	1343	1683	2486	2193
As % of GSDP	0.57	0.62	0 59	0.90	0.99	1.32	1.00	

(Source: State Finances, RBI).

Table 2A3.2: Investments and Return on Investments: Trends in State Finances of Karnataka

Fiscal Parameters/ Fiscal Year	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 RE	2008-09 BE
Interest Payments	2012	2388	2683	3292	3710	3794	3765	4236
As % of GSDP	2.11	2.28	2.45	2.74	2.80	2.55	2.21	2.25
Investment at Year-end								
INR Crores	4215.27	4840.34	6150 37	7984.19	10741.4	14052.53		
Return on Investment								
INR Crores	8.9	10.6	21.9	18	16.7	16.9		
Return on Investment								
Return in %	0 2	0.2	0.4	0 2	0.2	0.12		

(Source: Finance Accounts and Budget Document — GoK).

Table 2A3.3: Sources of State Revenue in State Finances of Karnataka

Fiscal Parameters/ Fiscal Year	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 RE	2008-09 BE
Own Tax Revenue	9853	10440	12570	15769	18632	23300	27217	31445
As % of GSDP	9.00	8.70	9.49	10.62	10.91	12.38	12.37	12.89
Own Nontax Revenue	1093	1278	2958	4369	3875	4098	1802	1932
As % of GSDP	1.00	1.06	2 23	2.94	2.27	2.18	0.82	0.79
Transfer from Centre	4375	4451	5231	6025	7846	10188	11821	12812
As % of GSDP	4.00	3.71	3.95	4.06	4.60	5.41	5.373	5.25
Total Revenue Receipt	15321	16169	20760	26163	30353	37587	40840	46189
As % of GSDP	14.00	13.47	15.67	17.62	17.78	19.96	18.56	18.93

(Source: Finance Accounts and Budget Document — GoK).

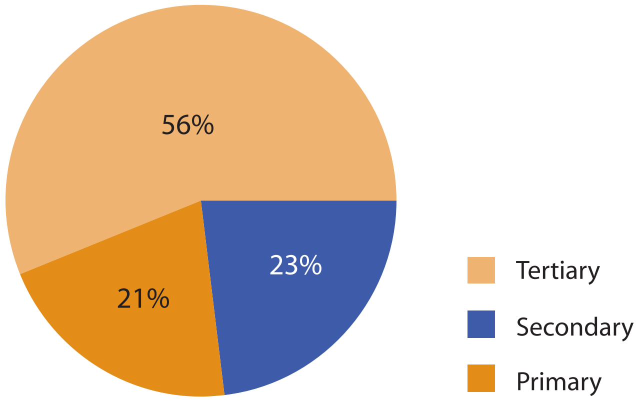
Annexure 4:

Karnataka Gross State Domestic Product Data

Table 2A4.1: Share in GSDP by Sector (2005-06)

Sector	Share in GSDP
Agriculture and Allied	21.17
Industry	22.95
Services	55.88

Figure 2A4.1: Karnataka—Share in GSDP by Sector—2005-06



Annexure 5:

Government of Karnataka Departments and Directorates

Table 2A5.1: List of Karnataka Departments and Directorates

1.	Department of Agriculture and Horticulture i. Commissioner of Agriculture ii. Director of Agriculture iii. Director of Watershed Department iv. Director of Horticulture
2.	Department of Animal Husbandry and Fisheries i. Director of Animal Husbandry ii. Director of Fisheries
3.	Rural Development and Panchayat Raj i. Chief Engineer, Rural Development Engineering Department ii. Karnataka Rural Water Supply and Sanitation Service Agency (KRWSSSA) iii. Director, Special Economic Plan iv. Director, Panchayat Raj v. Director, Plan Monitoring and Information vi. Director, Rural Infrastructure
4.	Forest Ecology and Environment i. Principal Chief Conservator of Forest (General) ii. P.C.C.F (Wild Life)
5.	Secretary, Ecology and Environment
6.	Commerce and Industries i. Department of Industries and Commerce (Commissioner) ii. Department for Textiles iii. Sugar Directorate iv. Mines and Geology Department v. Department of Sericulture
7.	Social Welfare i. Social Welfare Department ii. Backward Classes Welfare Department iii. Minorities Welfare Department
8.	Department of Women and Child Development i. Women and Child Development Department ii. Department for Disabled Welfare
9.	Housing
10.	Urban Development i. Department of Municipal Administration ii. Town Planning Department
11.	Department of Home Affairs i. Director General of Police ii. D.G.P. (COD) iii. D.G.P. and Commandant General of Home Guards and Civil Defense
12.	Department of Planning, Statistics, Science and Technology i. Director of Economics and Statistics ii. Director of Science iii. Director of Technology
13.	Department of Cooperation i. Registrar of Cooperation ii. Director of Agriculture Marketing
14.	Department of Higher Education i. Commissioner of Collegiate Education ii. Director of Technical Education
15.	Department of Primary and Secondary Education i. Commissioner of Public Instruction ii. Director of Public Instruction iii. Director of Primary Education iv. Director of Preuniversity College Education v. Director of Secondary Education vi. Director of Vocational Education vii. Director of State Educational Research and Training viii. Director of Printing and Publication
16.	Department of Finance i. Commissioner of Commercial Taxes ii. Commissioner of Excise iii. Director of Investment Tracking and Lotteries iv. Director of Insurance v. Chief Controller State Accounts Department vi. Director of Treasuries
17.	Department of Food and Civil Supplies i. Director of Food and Civil Supplies
18.	Department of Public Archives and Relations i. Department of E-Governance ii. Chief Editor, Karnataka Gazettes iii. Director of State Archives
19.	Department of Public Works i. Chief Engineer Roads and Bridges — North ii. Chief Engineer Roads and Bridges — South iii. Chief Engineer, Communications and Buildings
20.	Department of Revenue i. Commissioner of Stamps and Registration ii. Director of Survey, Settlement and Land Records iii. Commissioner for Religions and Endowments
21.	Department of Transport i. Commissioner of Transport

(Contd.)

Table 2A5.1: List of Karnataka Departments and Directorates (Contd.)

22.	Department of Water Resources i. Chief Engineer North ii. Chief Engineer South iii. Chief Engineer — Projects iv. Chief Engineer WRDO
23.	Department of Health i. Commissioner of Health and Family Welfare ii. Director of HFW iii. Drug Controller iv. Director of Indian System of Medicine, Homeopathy and Unani v. Director, State Institute of Public Health and FW vi. Director of Medical Education
24.	Department of Information, Tourism and Youth Services i. Director of Information ii. Director of Tourism iii. Director of Youth Services
25.	Department of Minor Irrigation i. Chief Engineer, Minor Irrigation — South ii. Chief Engineer, North (M I)
26.	Department of Kannada and Culture i. Director of Kannada and Culture ii. Director of Tourism
27.	Department of Labour i. Commissioner of Labour ii. Director of Employment and Training iii. Chief Inspector of Factories and Boilers
28.	Department of Law i. Director of Prosecution

Annexure 6:

Karnataka Training Statistics Report

Table 2A6.1: 2004 Training Programs/Workshops

No.	Name of the Program	Date	Total No. of Participants	Training Hours
1	Program Budget	26 Jun 04	65	6
2	Procurement	10-11 Aug 04	35	12
3	Project Appraisal	30 Aug-4 Sept	32	36
4	Tax and Revenue Forecasting	6-11 Sept 04	35	36
5	Program Budget	27 Oct 04	90	6
6	Excel Training	5-6 Nov 04	36	12
7	Tax and Revenue Forecasting	8-10,17-20,22-25 Nov 04	35	66
8	Project Appraisal	22-27 Nov 04	26	36
9	Project Appraisal	3-4 Dec 04	19	12
	Nine (9) Workshops		**373**	**222**

Table 2A6.2: 2005 Training Programs/Workshops

No.	Name of the Program	Date	Total No. of Participants	Training Hours
1	Excel Training	18-19 Jan 05	27	12
2	II Module of Project Appraisal Training — "Economic and Stakeholder Analysis"	15-23 Apr 05	26	48
3	Program Budgeting — Health and Family Welfare Dept.	26 Apr 05	26	6
4	Program Budgeting — Police Department	29 Apr 05	20	6
5	Training Program on Macroeconomic Analysis and Modeling	24-28 May 05	20	30
6	Project Appraisal Case Studies Group Discussion	25-30 July 05	26	36
7	Project Appraisal — Practical Case Studies	17-24 Aug 05	26	42
8	Tax Policy Analysis Training Program	17-20 Aug 05	31	24
9	Debt Management	24-26 Aug 05	9	18
10	Debt Management "Concept and Tools"	17-19 Nov 05	5	18
11	Tax Policy Analysis	28-30 Nov 05	30	18
12	III Module of Project Appraisal Training Program "Risk Analysis"	28 Nov-8 Dec 05	26	60
13	Tax Policy Analysis — Practical Handholding	5-8 Dec 05	30	24
	Thirteen (13) Workshops		**302**	**342**

Table 2A6.3: 2006 Training Programs/Workshops

No.	Name of the Program	Date	Total No. of Participants	Training Hours
1	Training on Implementing a Performance-focused Approach to Budgeting	11 May 06	29	6
2	NCAER Presentation on Macroeconomic Database	15 Jun 06	55	6
3	Tax Analysis and Revenue Forecasting Refresher Workshop	27-30 Jun 06	20	24
4	Tax Analysis and Revenue Forecasting Refresher Workshop	3-4 Jul 06	25	12
5	Tax Analysis and Revenue Forecasting Refresher Workshop	10-13 Jul 06	25	24
6	Program Performance Budgets in Karnataka: Workshop on Data Analysis and Use — Health Department	26 Jul 06	23	6
7	Workshop on Developing Performance Indicators for the Education Department	9 Aug 06	44	6
8	Training Program on Integration of Project Appraisal with Capital Budgeting and Writing Specific Project Appraisal Manual	17-30 Aug 06	23	60
9	National Level Debt Management Training	31 Aug–2 Sept 06	5	18
10	State-level Workshop on Creditworthiness and Bond Issuances	26-27 Sept 06	43	12
	Ten (10) Workshops		**292**	**174**

Table 2A6.4: 2007 Training Programs/Workshops

No.	Name of the Program	Date	Total No. of Participants	Training Hours
1	Workshop on Data Analysis and Use-Education Sector	11 Jan 07	30	6
2	Project Appraisal Capacity-building Workshop	18-24 Jan 07	50	36
3	Input-output Analysis and Fundamentals of Matrix Algebra	22 Feb 07	26	6
4	Input-output Analysis and Fundamentals of Matrix Algebra	18 Apr 07	26	6
5	Project Appraisal Capacity-building Workshop	24-28 Apr 07	36	30
6	Tax Policy Analysis and Revenue Forecasting Training	17-22 Sept 07	25	36
7	Training Program on Project Finance and Debt Management	24-28 Sept 07	38	30
	Seven (7) Workshops		**231**	**150**

Table 2A6.5: 2008 Training Programs/Workshops

No.	Name of the Program	Date	Total No. of Participants	Training Hours
1	District-level PPB Gulbarga	7-8 Jan 08	33	12
2	District-level PPB Udupi	18-19 Feb 08	23	12
3	District-level PPB Mysore	28-29 Feb 08	27	12
4	District-level PPB Bijapur	22-23 Apr 08	40	12
	Four (4) Workshops		**123**	**48**

Annexure 7:
Karnataka PPB Rollout Report

Table 2A7.1: PPB Mentoring Sessions

S. No.	Dept. Name	Informal Task Force Groups Appointed (Date)	Training (Session Dates)	Manual Distribution (Date)	Schemes included (Plan / Nonplan)	Mentoring for 06-07/ 07 -08/ 08-09	Completion of PPB Document for 07-08	Comments	District-level PPB
1	Health and Family Welfare	2004	26 Jul 06, 11 May 06, 26 Apr 05, 27 Oct 04, 7-8 Jan 08 (Gulburga ZP), 18-19 Feb (Udupi ZP), 28-29 Feb (Mysore ZP), 22-23 April (Bijapur ZP)	Jun 06	Yes	Continuous Process	State-level document has been completed by Aug 2007. District level PPB for four districts will be completed by Jun 2008	Health PPB document has been submitted to the Finance Department and is getting translated into Kannada to be placed before the State Legislature	Repeated follow-up discussions have been carried out with the concerned officers of four districts to revise the document prepared by them
2	Higher Education	2004	11 Jan 07, 9 Aug 06, 27 Oct 04	Jun 06	Yes	Continuous Process	PPB document for FY 2007-08 has already been submitted to FD in Dec 2007	The PPB document for higher education has been submitted to FD, GoK	Nil
3	Primary and Secondary Education	2004	11 Jan 07, 9 Aug 06, 27 Oct 04, 7-8 Jan 08 (Gulburga ZP), 18-19 Feb (Udupi ZP), 28-29 Feb (Mysore ZP), 22-23 Apr (Bijapur ZP)	Jun 06	Yes	Continuous Process	PPB document for FY 2007-08 has already been submitted to FD in Dec 2007. District-level PPB for four districts will be completed by Jun 2008	The PPB document for the Primary and Secondary Education has been submitted to FD, GoK	Repeated follow-up discussions have been carried out with the concerned officers of four districts to revise the document prepared by them
4	Home	2004	29 Apr 05, 27 Oct 04	Jun 06	Yes	Continuous Process	PPB document for FY 2007-08 has already been submitted to FD in Dec 2007	The PPB document has been completed with information provided by the field Departments. Principal Secretary, Finance has	Nil

Table 2A7.1: PPB Mentoring Sessions (Contd.)

								been requested to have the gaps filled in by the Administrative Department concerned	
5	Transport	2004	27 Oct 04	Jun 06	Yes	Continuous Process	28-02-08	The document sent by the Transport dept is under revision	Nil
6	PWD	2004	27 Oct 04	Jun 06	Yes	Continuous Process	28.02.2008	Discussed with the Dept. officers for change of indicators	Nil
7	Irrigation	2004	27 Oct 04	Jun 06	Yes	Continuous Process	28.02.2008	Under Progress	Nil
8	Women and Child Development	2007	7-8 Jan 08 (Gulburga ZP), 18-19 Feb (Udupi ZP), 28-29 Feb (Mysore ZP), 22-23 Apr (Bijapur ZP)	Jan 08	Yes	Continuous Process	Jun 08	No state-level PPB document for this sector	Repeated follow-up discussions have been carried out with the concerned officers of four districts to revise the document prepared by them

Annexure 8:

Karnataka Public Procurement Papers

Table 2A8.1: List of Karnataka Public Procurement Papers

Report No.	Subject	Requested by	Start Date	Finish Date	Status
1.	Procurement of Perishables (Social Welfare Department)	Lata Krishna Rau, Chairperson, Procurement Reforms Committee	19 Apr 06	30 Apr 06	Final report submitted to Social Welfare Department-GoK on 26 Sept incorporating GoK inputs
2.	Procuring Training Services (Social Welfare Department)	Lata Krishna Rau, Chairperson, Procurement Reforms Committee	19 Apr 06	26 Sept 06	Report submitted to Social Welfare Department-GoK on 26 Sept
3.	Procuring Construction Materials (Social Welfare Department)	Lata Krishna Rau, Chairperson, Procurement Reforms Committee	19 Apr 06	26 Sept 06	Report submitted to Social Welfare Department-GoK on 26 Sept
4.	Bangalore Municipal Corporation — Procuring Civil Engineering Services	Lata Krishna Rau, Chairperson, Procurement Reforms Committee	19 Apr 06	13 Oct 06	Report submitted to Mr. Kamble, Expenditure Secretary and Chairperson, Procurement Reforms Committee
5.	Bangalore Municipal Corporation — Procuring Solid Waste Management Services	Lata Krishna Rau, Chairperson, Procurement Reforms Committee	19 Apr 06	13 Oct 06	Report submitted to Mr. Kamble, Expenditure Secretary and Chairperson, Procurement Reforms Committee
6.	Bangalore Municipal Corporation — Procuring City Road Maintenance Services	Lata Krishna Rau, Chairperson, Procurement Reforms Committee	19 Apr 06	13 Oct 06	Report submitted to Mr. Kamble, Expenditure Secretary and Chairperson, Procurement Reforms Committee
7.	Bangalore Municipal Corporation — Procuring of Electrical Equipment (Transmitters and Meters)	Lata Krishna Rau, Chairperson, Procurement Reforms Committee	19 Apr 06	By 30 Nov 06	Report to be submitted to Mr. Kamble, Expenditure Secretary and Chairperson, Procurement Reforms Committee

Annexure 9:

Karnataka FPAC and DIMC Studies

Sl No.	Title of Issue Paper	Officers Engaged	Department	Present Status	Government Action
1.	Integrated Check Post: The Karnataka Initiative — An Evaluation	• Dr. B.V. Muralikrishna • Mr. Hosamani. B	Commercial Tax Department	Yet to be Submitted	
2.	Congestion Tax — Feasibility and Alternatives	• Shri Vijay Vikram • Shri Hemanth Kumar	Transport Department/ FPAC	First Draft Submitted — Comments Received and Incorporated	Some of the Recommendations being Considered, likely to be Implemented shortly
3.	Conversion to Ad Valorem Excise Duty — Feasibility and Implications	• Shri Nishchith V.D. • Shri M.Chetan	FPAC/Excise	First Draft being Revised	Comments Given on the First Draft by the Finance Department
4.	Feasibility and Implications of Abolition of Sale of Arrack	• Shri Nishchith V.D. • Shri M.Chetan	FPAC/Excise	Final Report Submitted to the GoK	Action taken by the GoK as Mentioned in Budget 2007-08
5.	Year of VAT in Karnataka — Lessons Learnt	• Smt. Jijabai Manay • Shri Syed Ahmad Khan	Commercial Tax Department	First draft Submitted	No Action
6.	Extending VAT to Diesel, Petroleum Products and CAF — Impact Analysis	• Shri H.D.Arunkumar • Shri Jagadeesh Prasad • Smt. Zaibunnisa • Shri Siddegowda	Commercial Tax Department	Yet to be Submitted	
7.	Stamp and Registration — A Roadmap for Reform	• Shri P.H.L. Acharya • Shri Vasanth Rao	FPAC	First draft Submitted	Some of the Recommendations being Discussed for Consideration for Implementation
8.	Waiver of Short-term Cooperative Loans	• Shri Nishchith V.D. • Shri M.Chetan	FPAC	Final Report Submitted to the GoK	Action Taken by the GoK as Mentioned in Budget 2007-08
9.	Analysis of Potential Revenue from Mining Industry	• Shri Nishchith V.D. • Shri M.Chetan	FPAC	First Draft Submitted	Comments Provided by FD, Some of the Recommendations being Discussed
10.	Model Property Tax Assessment Framework	• Shri Vasanth Rao • Shri P.H.L. Acharya	FPAC/BMP	Final Report Submitted to the GoK	Recommendations being Implemented by BMP with Support from GoK
11.	Comparative Efficacy of Government schools and Government-aided Schools	• Smt Anita Nazare • Shri Vasanth Rao	FPAC/ Education Department	Final Report Submitted to the GoK	Some of the Recommendations being Discussed for Consideration for Implementation

Annexure 10:
Karnataka Testimonial Letter

Rajiv Gandhi Rural Housing Corporation Ltd.

Sub: USAID — GoK Training on "Project Appraisal" — Practical Utility.

"I attended the first stage of the training conducted by USAID & GoK on "Project Appraisal". It was indeed apt that the training started with practical sessions involving case studies through project appraisal analytical tools. The essence of the exercise was to find out whether the project under question was worth pursuing vis-a-vis other alternative projects. In this direction, the financial analysis was to compare the cash inflow and cash outflow on NPV basis adjusted to inflation indices, to arrive at the net gain of the project.

After the training, as GM (F&A), RGRHCL, I was able to put the financial analysis to the advantage of the Company resulting in a saving of INR 18,28,882 for the quarter January to March 2005. This is explained below:

The Company's outstanding loan in respect of major FIs, as on 01.01.2005 was of the order of INR 41648.12 lakhs and the quarterly repayment was of the order of INR 2321.61 lakhs comprising INR 1268.25 lakhs as principal and INR 1053.36 lakhs as interest. The quarterly repayment details as on 01.01.2005 was as follows:

(INR In Lakhs)

Institution	Repayment			Rate of Interest
	Principal	Interest	Total	
HUDCO	854.55	747.07	1601.62	7.5% & 8%
Corporation Bank	89 30	97.07	186.37	8%
Union Bank of India	127.97	93.46	221.43	7.5%
Indian Bank	8.93	9.27	18.19	7.5%
Oriental Bank of Commerce	187 50	106.49	293.99	7.25%
Total	**1268.25**	**1053.36**	**2321.6**	

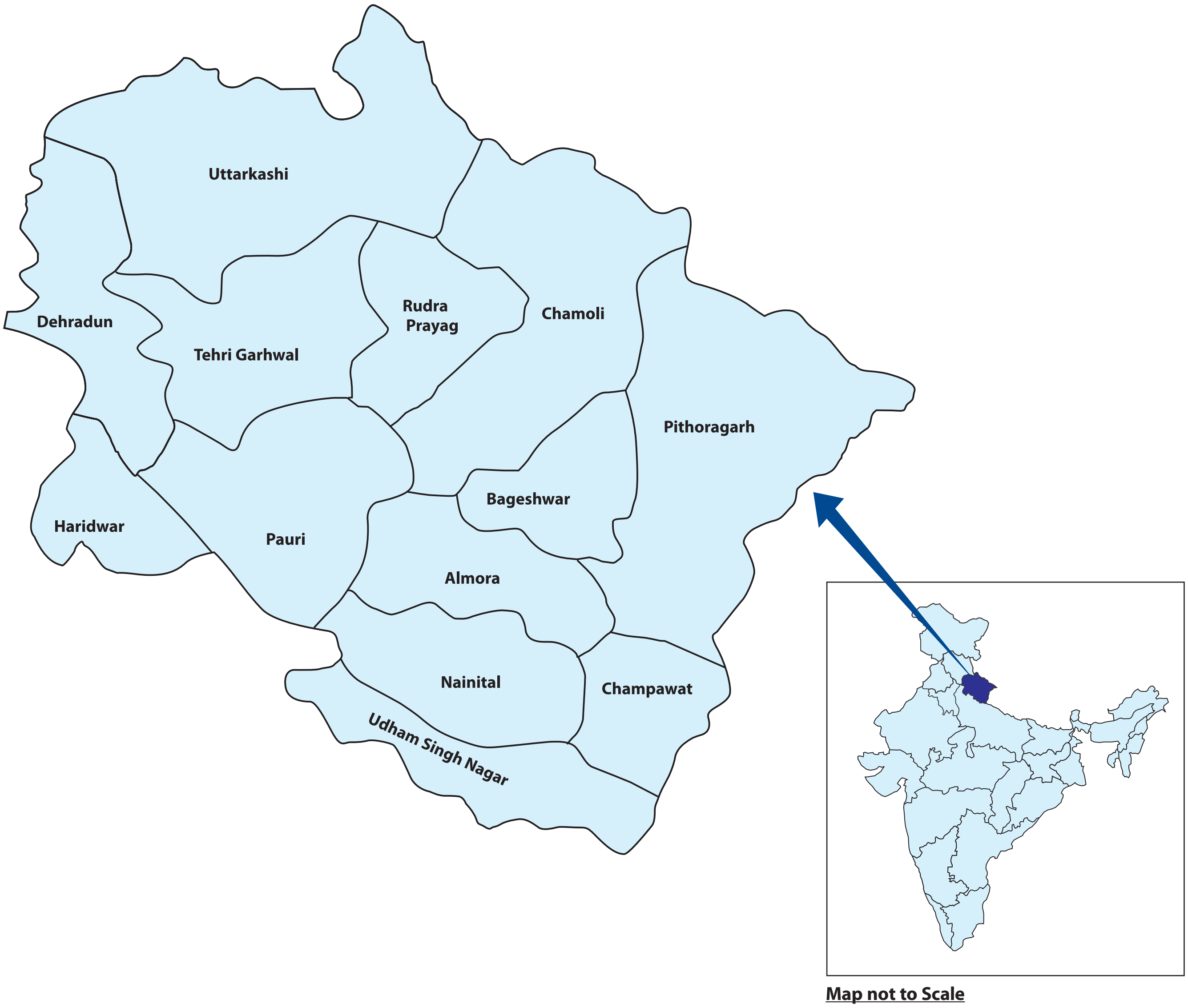
What we thought was that we can take short-term loan at a lower rate of interest, because short-term loans are available at lower rate of interest, and prepay partially to the FIs. In order to save the interest difference. The analysis for this purpose was made using the financial tool explained to us in the training and one important aspect that the tool threw out was that we should not prepay interest but we should only prepay principal. The analysis made in respect of one such loan is enclosed at Annexure A, wherein we were able to save INR 11,61,741 due to interest difference. This was done by obtaining a 90 days short-term loan of INR 25 crores from Karnataka Bank, at an interest rate of 5.75 percent, which was utilized for prepaying principal in respect of loans having interest rate ranging 7.25 percent to 8 percent.

In all, by such an exercise, we were able to save INR 18,28,882 for the quarter January-March 2005.

Anil B. Shedbal
Company Secretary and General Manager (F&A)

Uttarakhand State Case Study

India State Fiscal Management Reform Project (REFORM)



List of Abbreviations

BCR	Balance of Current Revenue
BE	Budget Estimate
CAG	Comptroller and Auditor General
CS	Commonwealth Secretariat
CSO	Central Statistical Organisation
DCID	Duke Center for International Development
DCRF	Debt Consolidation Relief Facility
DE	Development Expenditure
DG	Director General
DIMC	Debt and Investment Management Cell
DoF	Department of Finance
DRMS	Debt Recording and Management System
EFC	Eleventh Finance Commission
EXFC	Expenditure Finance Committee
FCP	Fiscal Correction Path
FD	Fiscal Deficit
FMIS	Financial Management Information System
FPAC	Fiscal Planning and Analysis Cell
FPC	Fiscal Policy Correction
FRMA	Fiscal Responsibility and Management Act
FY	Fiscal Year
GDP	Gross Domestic Product
GFD	Gross Fiscal Deficit
GSDP	Gross State Domestic Product
GO	Government Order
GoI	Government of India
GoU	Government of Uttarakhand
GRF	Guarantee Redemption Fund
GST	Goods and Services Tax
ICAI	Institute of Chartered Accountants of India
ICFAI	Institute of Chartered Financial Analysts of India
INR	Indian Rupees
IO	Input-Output
MIS	Management Information System
MoF	Ministry of Finance
MoU	Memorandum of Understanding
MS	Microsoft
MTFF	Medium Term Fiscal Framework
MTFP	Medium Term Fiscal Program
NABARD	National Bank for Agriculture and Rural Development
NCAER	National Council for Applied Economic Research
NGOs	Nongovernmental Organizations
NIC	National Information Center
NIFM	National Institute of Financial Management
NRHM	National Rural Health Mission
PA	Project Appraisal
PD	Primary Deficit
PFAD	Project Formulation and Appraisal Division
PMU	Program Management Unit
PPB	Program and Performance Budgeting
PPPs	Public-Private Partnerships
PRI	Panchayati Raj Institutions
PU	Project Unit
RBI	Reserve Bank of India
RD	Revenue Deficit
RE	Revised Estimate
REFORM	India State Fiscal Management Reform Project
RFP	Request for Proposal
RTI	Right to Information Act
SAG	State Accountant General
SARC	State Administrative Reforms Commission
SCS	Special Category State
SOE	State Owned Enterprise
SoW	Statement of Work
TA	Technical Assistance
TD	Tender Documents
TFC	Twelfth (XII) Finance Commission
ToR	Terms of Reference
UA	Uttarakhand/Uttaranchal
UAA	Uttarakhand Academy of Administration
UK	United Kingdom
UP	Uttar Pradesh
UPRA	Uttar Pradesh Reorganisation Act
USAID	United States Agency for International Development
UTC	Uttaranchal/Uttarakhand Transport Corporation
VAT	Value Added Tax

Box 3.1: Improved Capacity for Project Selection: Uttarakhand

For the first time, a systemic correction has been instituted in the Indian State of Uttarakhand for the appraisal and selection of large public capital projects. A State Government Circular issued in June 2007 mandates the application of a rigorous, comprehensive, and structured project appraisal methodology for all project valued at more than INR 5 crores before the projects can be considered by a high-level Expenditure Finance Committee (EFC) chaired by the Principal Finance Secretary.

In 2007-08, this enabled the Government of Uttarakhand to filter out 11 unviable projects valued at INR 25 crores from a total of 35 project proposals received (27 proposals in the area of power, roads, etc. for submission to the National Bank for Agriculture and Rural Development (NABARD) for financial assistance and eight related to irrigation projects).

One important contribution of the project appraisal methodology has been to insulate the project selection process from discretionary decision-making. Selection of projects based on a consistent and comprehensive economic, financial, and stakeholders risk analysis will make successful and timely completions within planned budgets more likely.

The Challenge

In November 2000, Uttarakhand became India's 27th state. Unfortunately, at the time of its separation from its mother state of Uttar Pradesh (UP) the Government of Uttarakhand (GoU) inherited its share of fiscal distress that was prevalent in UP.

Uttarakhand was further handicapped by scattered, sparsely populated settlements, a weak agricultural an industrial base and poor basic infrastructure. As a result, the state lacked employment opportunities, relative high levels of poverty, and poor social indicators. (See Annexure 1 *Uttarakhand State Socioeconomic Profile*.) Immediate, large investments were, therefore, required to build up the state's socioeconomic infrastructure base and revenue-generating capacity to promote economic growth and improve the quality of life of its citizens.

During fiscal years (FY) 2000-2005, the fiscal deficit grew from 4.6 percent of the Gross State Domestic Product (GSDP) to 8.1 percent. As a consequence, the debt burden of the state also went up from 29.6 percent to 50.84 percent of GSDP over this period. To determine the annual plan size of the state, first, the balance of current revenue (BCR)[19] is accounted for followed by the need for plan expenditure for the year. Therefore, overall plan resources for actual plan expenditure become disadvantaged if the BCR remains very high. Consequently, investments in development programs become adversely impacted creating a vicious cycle for non development. As a special category state, Uttarakhand had the advantage of higher Government of India (GoI) grants to address its developmental demands. However, practitioners of fiscal discipline may consider this to be a soft option and, consequently, a disincentive for state governments to usher in necessary fiscal reforms.

Uttarakhand State Development Report

The State Development Report (2006) clearly states "The budgets have systematically overestimated all the three measures of fiscal deficit since 2001-02."

From 2001-02, this soft option was exercised by the state government to be dependent upon central GoI grants.

State Fiscal Reform Initiatives

Table 3.1: Uttarakhand State Fiscal Reform Milestones

Year	Important Fiscal Legislations in Uttarakhand
2001	Fiscal Planning Budget and State Resources Cell
2004	Signing of a Memorandum of Understanding with the GoI introducing Medium Term Fiscal Program
2004	USAID REFORM Project Launched
2005	Fiscal Responsibility and Budget Management Act
2005	Value added Tax Introduced
2005	Computerization of State Treasury
2005	Administrative Reforms Commission

If this fiscal situation remained unaddressed, public investments would continue to be negatively impacted, affecting the GoU's ability to deliver the necessary services to its citizens as well as lowering the overall growth potential of the state. The inadequate capacity to address some of the emerging fiscal challenges required immediate attention.

(For more information on key indicators for the State of Uttarakhand, please see Annexure 2 for a series of tables and charts on key socioeconomic indicators for the *Uttarakhand State Socioeconomic Profile*; and, Annexure 3, 4 and 5

[19] Balance of current revenue is defined as being the nonplan revenue deficit as a percentage of total central transfers minus plan grants.

for the State of Uttarakhand for the period from FY 2001-02 to FY 2008-09 Budget Estimate (BE).

Uttarakhand was a latecomer in the field of subnational reforms. As a first step in correcting the legacy of fiscal malaise inherited from the mother state UP, in 2001 GoU established a Fiscal Planning Budget and State Resources Cell. The responsibility of this cell was to conduct both *a priori* and *ex post facto* analysis of the state resource mobilization and allocations for both investment and revenue expenditure. With the introduction of this cell, the GoU hoped that resource mobilization would be strengthened, quality of expenditure would be improved, and efficiency in allocation would be in place. Unfortunately, this did not happen. The cell was ineffective in removing dependence on soft options (*i.e.,* Government of India (GoI) grants) to move the state agenda forward.

The weakness of the cell was that its functions were not streamlined and job responsibilities were not well defined. Neither was there any expertise and database for proper estimations and analysis for prioritization of allocations and investments. There was also an absence of dialog between the individual spending/investing departments and the directorate for various financial decisions. One result of the lack of dialog was poor fiscal marksmanship as evidenced in the Comptroller Auditor General (CAG) Report on the State Accounts of 2006-07:

- The gross fiscal deficit (FD) was as high as 75 percent while the revenue deficit (RD) and primary deficit (PD) were also as high as 92 percent and 107 percent respectively in the initial BE;
- Excess capital expenditure of INR 935.92 crores occurred in five grants; and
- Excess revenue expenditure of INR 612.27 crores occurred in 12 cases.

On the lines of the recommendations made by the Eleventh Finance Commission (EFC) in 2000, a Memorandum of Understanding (MoU) was signed with the GoI introducing Medium Term Fiscal Reform Program (MTFRP) in February 2004. This late adoption of the MTFRP by the GoU was due to a lack of capacity to implement the recommendations. Although, at the instance of the EFC, the MoF constituted a state fiscal reforms facility to incentivize the states to draw up monitorable fiscal reforms programs, however, there were no attempts to build the capacity of the state to implement the EFC recommendations. As a result:

- The improvement in revenue deficit to total revenue receipts ratio during the award period of the EFC was only 10 percentage points as against the required improvement of 16 percentage points.
- The fiscal deficit to total revenue receipts ratio went up from about 4 percent to 10 percent during this period.
- The state was not able to draw its share of incentive fund from the GoI due to the lack of percentage performance in revenue deficit as a percentage of revenue receipts.

REFORM Interventions

In order to address the gaps identified above, and in response to a request from the GoI and the GoU, the United States Agency for International Development (USAID) began a series of dialogs at the state level to jointly identify international best practice solutions to be institutionalized within the state government machinery. The result was the design of the India State Fiscal Management Reform Project (REFORM).

Amongst the many fiscal reform options available, a conscious choice was made to select certain reform interventions/best practices, keeping in view the following: enabling and impeding factors present at that point of time; cost of the interventions/best practices proposed; time available to successfully implement the interventions; alternative resources available to the GoI; and, leverage existing resources within the state to be implement the proposed reform interventions.

Following the discussions, GoU decided to choose the following interventions for implementation by REFORM:

- Introduction of the Program and Performance Budgeting (PPB) to raise accountability for public fund management;
- Strengthening of both Revenue Forecasting methodologies and *ex post facto* analysis of tax administration effectiveness;
- Development and introduction of a rudimentary framework of a state input-output table to facilitate revenue analysis especially as it relates to value added tax (VAT) and future goods and services tax (GST);
- Introduction of a rigorous project appraisal methodology to ensure selection of socioeconomically viable projects;
- Development of guidelines to improve state creditworthiness;
- For the first time, introduction of software to track and manage public debt including contingent liabilities and guarantees at the subnational level;
- Development of guidelines for issuance of subnational guarantees;
- Development of state procurement rules to promote transparency and accountability in the purchase of goods and services;
- Introduction of a Fiscal Policy and Analysis Cell (FPAC) to provide a rational basis for better link revenue and expenditure analysis and to promote inter-departmental dialog for allocations and investments; and
- Development and introduction of a state macroeconomic database to serve as the information base for revenue mobilization and expenditure analysis.

Below, the rationale for the selection of these particular best practice tools and techniques as well as implementation methodology is presented.

Expenditure Management

Under expenditure management, the major intervention tool introduced by the REFORM project was the PPB methodology. The rationale for its selection was influenced by the lack of linkage between outlays, outputs, and outcomes. Not only does PPB provide this linkage but it also allows the state to move towards a three year medium-term budget horizon (instead of one-year), which, in turn, enables the state government to identify the policy framework necessary to achieve the proposed outcomes. From its outset, the REFORM project decided to incrementally implement the intervention with steady capacity building and cover at least 33 percent of the state budget with the PPB document.

GoU acceptance of the PPB methodology was facilitated by the fact that Uttarakhand, when it was a part of its mother state Uttar Pradesh, had a practice of preparing departmental PPB-like documents. However, not only were these budget-making skills lost over time but, even when it was under implementation, such documents were sporadic and skeletal in nature.

In sequential order, the specific interventions introduced by REFORM were as follows:

- The REFORM Project developed and issued a standardized PPB template that was common to all departments. This common template enabled inter-departmental/inter-temporal comparisons for performance. A conscious effort was made to bring in international and in-country expertise to help localize and inculcate the best practices in PPB.
- A practical guide for constructing PPB documents was developed and distributed to all departmental task forces. This was followed by a series of lectures explaining the principles of the PPB document. (See *Section IV* of the *REFORM Project Compendium and Toolkit* for the *Program and Performance Budgeting Implementation Guide*.)
- After completion of the initial training workshop, the departmental forces were mentored over a period of months in the preparation of actual PPB documents which incorporated the budget figures of the year along with planned outputs/outcomes and narratives on vision and mission, goals and objectives.
- The Finance Department also issued a budget circular every fiscal year in October with the PPB format along with a timetable requiring departmental submission of comprehensive information both on budget requirements and program targets by February of the ensuing fiscal year. The departments were also asked to prepare a budget program mapping circular to relate departmental programs to departmental budget heads. The PPB documents prepared by the departmental task forces then had to be approved by the concerned departmental secretaries thereby establishing ownership of the document. The departmental secretary was required to discuss the departmental PPB with the Principal Finance Secretary to secure the annual allocation.
- The investments proposed by the department (e.g., capital budget) in the PPB were correlated to Planning Department approvals and they had to be cleared by the Expenditure Finance Committee (EFC). (See the *Project Appraisal Section* below for further details.) The PPB approved by the departmental secretary and the Principal Finance Secretary was then required to be submitted to the state legislature for approval. In the initial years, PPB was prepared by secretariat-level departments. However, after gaining sufficient experience, PPB skills were scheduled for extension to the district level and subdistrict levels.
- Finally, departments were encouraged to upload their annual PPB documents onto the state government Web site for review by all stakeholders including the general public under the Right to Information Act (RTI).

In order to revive this budget-making practice and skills as well as to gain acceptability within the government, the REFORM project held a sensitization session for the seniormost officials from all twenty-five (25) secretariat departments. (See Annexure 5 for a complete list of GoU departments and directorates.)

As a second step, GoU departments were invited to form departmental task forces comprising four to six officers per department, vertically integrated who would participate in PPB training workshops.

The first group of training workshops conducted included all major spending departments such as education, health and family welfare, and investment departments like irrigation, power, and public works. In parallel, strong linkage between the Finance and Planning departments was established, at the secretariat (government) level, and similar linkage was established between program officers and finance officers at the departmental level. This networking was necessary to establish a strong connection between the various programs of the government and the approved budget; prior to this REFORM project intervention, the absence of any connection between programs and approved budget (*i.e.,* emphasis only on outlays) prevented official accountability in delivering intended results.

Revenue Management

REFORM used formal classroom training, handholding and case studies methodologies in

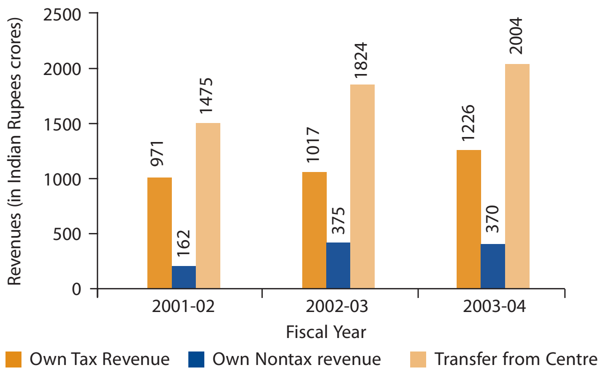
Box 3.2: ICAI High-level Committee on Outcome Budget

"….ad hoc and outlay focus continues despite three years of introduction of Outcome Budget, and more than 35 years of introduction of Performance Budget. There is no evidence to suggest that a serious thinking leave alone worthwhile initiative in that direction has taken place even as of now. In contrast, Program Performance Budget (PPB), having elements of outcome budget, under implementation in some of the states, such as Uttarakhand, Karnataka, and Jharkhand has followed more pragmatic approach. PPB initiative in Uttarakhand, though launched in August 2004 under a technical assistance program of USAID, is still in transition. [The first PPB was presented to the State Legislature during the 2008-09 budget sessions.] *The exercise was preceded by a thoughtful buy-in process, and involved a series of awareness and appreciation programmes; creation of a task force with change agents and nodal officer in each of the Departments; frequent reviews at the level of the Chief Secretary/ principal Secretary Finance; structured "top-down" and "bottom-up" participation and involvement; training and monitoring programs first at the department level and then at the programme/district/block level. The emphasis has been on bringing transformation by changing and building upon existing structures, and through selective and gradualism approach…"*

[From a report entitled "Discussion Report of the High Level Committee on Outcome Budget" by the Institute of Chartered Accountants of India (ICAI), which convened a panel of eminent public finance figures to review Outcome Budgeting in India introduced by Finance Minister Chidambaram in 2005.]

upgrading the skills of government officers to analyze the tax policies, forecasting revenues and assessing the efficiency of tax administration. Specific emphasis was given to the principles behind levy of VAT and exemptions granted. In addition, officials were exposed to issues pertaining to cost of tax collection and subsidies abolition. A few participants were also exposed to the principles behind the levy of "User Charges" as a source of revenue. Participants were selected from a cross-section of revenue-collecting departments. (For a review of Uttarakhand revenues by source since FY 2001-02 to 2003-04 see *Figure 3.1*.)

Figure 3.1: Uttarakhand State Revenue: 2001-04



Sources: 2001-2004

Project Appraisal Management

In 2000, with the formation of the state of Uttarakhand, the immediate and urgent need was to develop, within the shortest possible time span, a strong industrial base with basic infrastructure to take the nascent state forward. Unfortunately, the state did not have the luxury of a large resource base to immediately fund a large number of projects. Therefore, the state had to be extremely careful and strategic in the selection of its capital projects. By practice, at the state level in India, projects were not selected and accepted on comprehensive socioeconomic principles; the selection was largely influenced by political considerations without reference to cost, time and need factors.

Box 3.3: Value-added Tax Implementation in Uttarakhand

There was a lot of resistance to the 1 April 2005 introduction of value added tax (VAT) in Uttarakhand. Resistance to VAT was evident when trade unions called for the closure of businesses . To compound the situation, most state government tax officials had not received training on VAT and, therefore, did not know the intricacies of this new tax. As a result, the Government of Uttarakhand (GoU) needed to allay the concerns, fears, and misconceptions on the tax and its implication on commerce in the state. To ensure a smooth and publicly acceptable VAT introduction, the GoU requested REFORM to organize a series of one-day information seminars for the state business community, trade unions, general public, and tax collection departments.

REFORM assistance on VAT was strategically focused in two areas: demystifying VAT; and training officials to facilitate a smooth transition to VAT. The first focus was essential because not only the traders and consumers, but also many officials had misperceptions about VAT. The second focus was essential because the state intended to implement VAT in the near future but they did not know why VAT was needed, what it was, what appropriate VAT designs were, the compatibility of VAT with the Central Sales Tax, VAT transition issues, and VAT administration. In addition, REFORM provided its observations on the draft "State VAT Bill" and the necessary steps for VAT implementation in the state.

To allay public concerns about VAT, a one-day workshop on "VAT Introduction and Awareness" was conducted for 80 officials of the Finance and Sales Tax Departments, representatives of trade and industry, professional bodies (such as chartered accountants and advocates), and academicians.

For orienting and training GoU officials on VAT, a series of three workshops were conducted for more than 150 representatives from the Finance and Sales Tax Departments, the Fiscal Policy Analysis Cell (FPAC), and the Uttarakhand Academy of Administration (UAA). These workshops equipped the officials to launch VAT with full confidence.

As a result of these awareness-raising and skill transferal seminars and workshops, Uttarakhand successfully introduced VAT in the state by 1 October 2005. This new tax has helped the state to increase its revenues from INR 1444 crores in Fiscal Year (FY) 2004-05 (the year before the VAT introduction) to INR 3120 crores in its FY 2008-09 Revised Estimate, thus, enhancing the GoU's ability to fund its development programs using its own funds and, in the process, improving the quality of life of its citizenry.

Uttarakhand state had inherited the legacy of approving projects through the mechanism of an inter-departmental Expenditure Finance Committee (EFC), which consisted of senior representatives from the finance, planning and beneficiary departments from Uttar Pradesh. This practice was handicapped by; (i) absence of expertise for project selection and analysis based on socioeconomic criteria; primarily guided by political factors; (ii) absence of socioeconomic/ financial data and institutional memory to support informed decisions; (iii) the burden of analysis and selection rested with senior government officials. As a result, project reviews were postponed until the end of the fiscal year where time constraints compelled approval of a large number of projects without necessary rigorous analysis. This also resulted in rush of

Sequentially, the specific interventions introduced by REFORM to realize this capacity-building were as follows:

- A series of seminars on VAT were delivered at the initial stages of the project to help the GoU introduce VAT in the state. These seminars helped raise awareness amongst various stakeholders including academicians, businessmen, and traders in different parts of the state.
- The case studies used in this capacity-building effort were selected by the participants on the basis relevance of the case was to their daily work. The approach was designed to ensure that officials of the state excise, sales tax, registration, stamp duty, entertainment, and land revenue departments participated in the training process. Government officers from the Additional Secretary to Undersecretary level were exposed to the training and many were subsequently made members of the FPAC. Priority was given to training mid-level (undersecretaries) due to the stability and continuity of their official assignments beyond the normal 1-2 tenure for more senior officers.
- In total, more than 200 GoU officers were trained in various dimensions of revenue management over the four years of the REFORM project. The teaching methodology emphasized the case study approach over the traditional lecture method because this approach enabled participants to actually handle the problem-solving exercises on their own. Sequentially, training consisted of an explanation of the principles of taxation, an analysis of the Uttarakhand economy, and a review of state taxation policies. Sixteen case studies so analyzed by the participants were compiled into a compendium and presented to the GoU for review and use in deciding on the policies in the succeeding year. (Please see Annexure No. 2 for a list of these studies.)
- In addition to the above training, state taxation policy makers were also exposed to the importance of macroeconomic data and the use of input-output tables.
- Finally, a desktop reference guide on revenue management was developed for use by government officers to help them forecast revenues based on future tax reform initiatives. (See *Section IV* of the *REFORM Project Compendium and Toolkit* for the *Revenue Management Guide*.)

expenditure in the last months of the budget year with attendant risks

If unaddressed, continuation of this practice would have run the risk of funding a large number of unviable projects with the implication that none of the projects can be fully funded, resulting in time and cost overruns that would burden state expenditures for years to come. Therefore, this situation was contrary to the aspiration of the GoU, which wanted to develop the state economy in the shortest possible time to benefit the citizens.

In response to a specific GoU request to systematize the EFC procedures and practices, the challenge to REFORM was to build state capacity, especially at the junior official level, to identify, prioritize, select and implement projects based on a rigorous economic, financial, and social risk factors (see *Volume V: The Project Appraisal Practitioners' Guide* for the methodology introduced.)

Debt and Investment Management

The Uttar Pradesh Reorganisation (UPR) Act, 2000, laid down the criteria for distribution of revenues, authorization of expenditure and apportionment of assets and liabilities between Uttar Pradesh and Uttarakhand. Accordingly, the state was born with a total liability of INR 3185.91 crores, which included INR 1113.86 crores of internal debt, INR 1619.74 crores of loans and advances from Central Government of the Small Savings, and INR 432.31 crores from provident fund, etc. The debt as a percentage of GSDP worsened from around 29 percent in 2001-02, an acceptable percentage as per the Twelfth Finance Commission (TFC)

The interventions introduced to build this capacity-building were, in sequential order, as follows:

- A set of 32 officials from five major investing departments (e.g., Drinking Water, Power, Tourism, Transport, and Urban Development) who were charged with project formulation along with officials from the Planning and Finance departments who had the responsibility for project selections and approvals were selected for classroom training on the principles of project formulation and analysis.
- Officials were trained on the use of computers and particularly on the use of the software Crystal Ball for risk analysis.
- To introduce the case study method of training, these same officials were asked to select projects—either actual or planned for funding by their respective departments—for analysis and subsequent classroom presentation. Such presentations promoted appreciation of the inter-related socioeconomic factors as well as application of different parameters for different sectoral proposals.
- REFORM assisted in the redraft of the government order (GO) which required the application of a new set of parameters for appraisal of all projects valued at more than INR 5 crores. This order was issued in June 2007.
- The GO institutionalized this rigorous comprehensive review of project proposals by the junior officials and by the beneficiary departments. This, in turn, enabled quicker and more informed decision-making by the senior officials in the inter-departmental committee (EFC) without undue risk of projects being approved in the last months of the year with attendant rush of expenditure
- In response to a GoU request, REFORM assisted the trained officials of key investing departments to prepare the analysis for the EFC. These hand-holding sessions considered 35 proposals involving an investment of more than INR 100 crores and resulted in the elimination of 11 proposals with a cumulative value of more than INR 25 crores.
- At the request of the GoU, REFORM extended the project appraisal training to 25 newly recruited district statistical and planning officers.
- A comprehensive project appraisal manual (with 11 sector-specific guidelines) was developed as a desk reference guide to enable its users to appraise the projects. Further, to extend the process beyond project appraisal to project formulation, monitoring and evaluation, terms of reference (see *Volume V: The Project Appraisal Practitioners' Guide* for the methodology introduced.) was prepared for the establishment of a Project Appraisal and Formulation Division (PFAD) to be located in the Planning Department.

recommendations, to almost 39 percent in 2003-04, largely reflecting the demands of a new state for investments in social and physical infrastructure, which had a narrow revenue base.

There was no comprehensive debt data in a central location. Further, the responsibility for gathering, managing, and reporting information on debt was fragmented between GoU, RBI, and CAG. For example, most debt information was retained by the State Accountant General (SAG), the GoU Finance Department had some debt data but it was handwritten and not in digital form, and the RBI had a third set of data that it reported in its *Annual Report on State Finances*. Thus, at this point of time, GoU was neither particularly well-informed about the various tools available for debt management nor was there adequate expertise available within the state government staff.

Given its investment needs (*e.g.,* for industrial development and basic infrastructure requirements) along with its limited potential to generate its own revenues, incremental public borrowing was inevitable. At a minimum, the investment requirements were INR 9000 crores under the approved GoI-Planning Commission Five-Year Plan.[20]

[20] Speech of Shri Narayan Datt Tiwari, Chief Minister, Uttaranchal, 50th National Development Council Meeting on 21st December 2002 at New Delhi. Accessible at: http://planningcommission.nic.in/plans/planrel/pl50ndc/uttranchal.pdf

Sequentially, the REFORM approach to this debt and investment management capacity-building was as follows:

- Initiated discussions with the Finance Department officials on debt data availability and existing state management practices;
- Five (5) investing departments with large borrowing needs were targeted for capacity-building (e.g., education, health, irrigation, power and public works). The first step was to sensitize these 10 officials of the overall state debt situation and to promote the need for effective debt management.
- REFORM visited the Internal Debt Office of the RBI and the State Accountant General to obtain the current status of Uttarakhand state debt data;
- To promote synergy and inter-governmental cooperation, 3 national-level seminars were held for 41 select officials from the REFORM partner states. A spectrum of views and experiences from the RBI, Planning Commission and Ministry of Finance (MoF) (i.e., Aid Accounts) were presented. Also, these officials were trained on debt sustainability, new debt instruments, state creditworthiness, and international experiences and best practices.
- In tune with times to lessen the debt burden alternative techniques like Public-Private Partnership (PPP) were discussed by field experts with the participants.
- Next, to identify suitable software for effective debt management, REFORM identified the Commonwealth Secretariat (CS) Debt Recording and Management System (DRMS) software for introduction and implementation in all REFORM states. The CS-DRMS is currently being used by the RBI and the MoF (Department of Economic Affairs (DEA) for tracking and managing internal and external debt, respectively. REFORM initiated a dialog for CS-DRMS implementation for the first time at the subnational level for debt management and for modification of the software to track and manage contingent liabilities.
- REFORM approached the RBI and MoF to arrange in-country software training for three (3) persons from the GoU finance department.
- To achieve the objective:
  - Datasets were compiled and consolidated on all current state debt, guarantees and investments;
  - The officials were trained in migrating the data with MS Sequel Server;
  - These datasets were then migrated to the CS-DRMS Oracle database by the trained GoU officials; and
  - REFORM ensured that the SAG, who held the comprehensive data, was associated in populating the CS-DRMS database.
- In 2008, select officials were seconded to the Commonwealth Secretariat in the United Kingdom (UK) by the MoF for further hands-on training and a review workshop was held to ensure continued GoU ownership in maintaining and updating the data.
- A comprehensive toolkit was developed to assist practitioners with the monitoring and management of state government debt, investments, government guarantees and state creditworthiness.
- To sustain this debt reform effort and to promote continuous analysis, a Debt and Investment Management Cell (DIMC) was designed and proposed to the GoU.

The state government was not in total control of public debt management (*e.g.*, the GoU did not have a comprehensive dataset on its public debt). The responsibility was trifurcated between the borrowing departments, the RBI, and the State Accountant General (SAG). To correct this situation, the officials of the state government had to be educated on sustainable levels of debt, techniques of market borrowing, software for loan accounting, and timely servicing of the loans.

Thus, the interventions under the REFORM focused on strengthening the capacity of GoU officials to track and manage their public debt and investments with necessary knowledge, appropriate skills, reliable timely information and analytical capacity.

REFORM Achievements

The REFORM achievements have been evaluated in terms of *appropriate capacity* (*i.e.*, expertise of state officials and strength of fiscal infrastructure) and the *practices* (*i.e.,* consistent, transparent, and accountable processes) to perform relevant, economic and statistical analyses to make sound fiscal policies and implementation choices at the state level. The social science construct *Knowledge*, *Attitudes*, and *Practices* (KAP) was deployed for this purpose. Since it was important to capture the efficiencies and effectiveness that are beginning to accrue from the introduction of the new practices, *Impact* was added to the KAP construct. REFORM was therefore evaluated in terms of *K-A-P-I*—knowledge transferred, attitudes changed, practices introduced and their initial impact. KAPI may be defined as follows:

- **K**nowledge Transferred: Skill-sets enhanced through international best practices. This includes training provided, manuals developed, databases established, and reporting templates designed and introduced.
- **A**ttitudes Changed: This signals acceptance of the need for reform, understanding the changed methodology and a willingness to practice it. This includes cabinet decisions/ approvals, government orders and circulars issued, notifications released, curricula introduced and, funds, staff, and facility allocated by the respective state governments.
- **P**ractices Introduced: Actual application of the new practices introduced. This includes the commissioning of FPAC studies, project selection based on project appraisal methodology introduced under REFORM, international best practices introduced in annual curricula of state civil service training institutes, development of departmental PPB documents, report on debt using REFORM designed reporting templates, etc.
- **Initial I**mpacts Noted: Applications of new practices translating into efficiencies in the allocation and use of public funds. Examples include the savings accrued, poor projects filtered out, quality expenditures improved.

With respect to Uttarakhand, initial reports on the impact of the REFORM interventions on the state's fiscal management capacity are harbingers of what can happen if there is a serious and sustained effort to re-engineer fiscal management practices based on international best practice standards.

Achievements in Terms of Knowledge Transfers

Expenditure Planning and Management

- More than 150 GoU officials have been trained at all secretariat as well as district levels in PPB.[21] (See *Annexure 7* for the *PPB rollout* report.)
- A core group of 6 trainers and mentors developed.

[21] In addition to the above three departments whose PPB documents were approved by the state legislature, another nine GoU departments (Drinking Water, Homeopathy, Irrigation, Labor, Minor Irrigation, Planning, Power, Public Works, and Tourism) constituting another 30 percent of the state budget had also prepared PPB documents along with their regular budget documents. However, these draft documents could not be approved by the Finance Department in time for submission to the state legislature. Officials from another five departments (Finance, Rural Development, Scheduled Castes, Scheduled Tribes and Urban Development) have the capacity to prepare PPB documents for the FY 2009-10 having received training from REFORM bringing the total number of GoU departments to 17 out of 34 state departments comprising slightly more than 60% of the state budget.

Box 3.4: Uttarakhand Bus Acquisition Using New Project Appraisal Capacities

The Department of Transportation used their newly acquired skills in project appraisal analysis to purchase 300 new buses. The Uttarakhand Transport Corporation (UTC) needed to modernize and expand its bus fleet to meet public demand for better inter-city connections in the state. Due to a budget shortfall, the corporation could not purchase all of the required buses outright as it did not have INR 32.90 crores needed to complete the purchase.

The urgent UTC need was to determine if the proposed bus fleet purchase would be economically viable and financially feasible given the costs and debt to be incurred. Utilizing REFORM-provided training in using the Crystal Ball risk analysis software, the UTC finalized an economically viable procurement plan using INR 17.00 crores in debt as a five-year loan from financial institutions.

The Department of Transportation project appraisal team recommended that the project be implemented and this was subsequently sanctioned by the Expenditure Finance Committee of the state government. Today, the UTC is better servicing the public transportation needs of the state in a cost-effective manner, demonstrating its ability to make financial decisions based on modern project appraisal techniques.

- Sensitization of 85 GoU officials on the *UA Procurement Rules.* (See *Annexure 8* for a list of procurement papers.)
- *PPB Implementation Guide* and *Procurement Guide* developed and accepted by GoU.
- S/W database developed and presented to GoU for converting general budget data into program/scheme data.

Revenue Management

- More than 200 GoK officers have been trained in various tax and revenue management topics.
- A *Revenue Management Guide* has been developed for use by the GoU.

- An Input-Output Table along with a supporting macroeconomic database has been developed and presented to the GoU for its use.

Box 3.5: Impact of Project Appraisal Training

Trained GoU officials have started talking about the cost effectiveness of basic needs projects. For example, when appraising a drinking water project in which the pumping technology was used for a small population, one participant remarked "…*if half of the per capita cost is paid to the families, they will relocate to places where drinking water is available.*" As a result, this project alternative was actively pursued by the GoU officers concerned to the benefit of the local community.

Debt and Investment Management

- Implementation of the *CS-DRMS* software.
- Debt and investment reporting and tracking templates developed and presented.
- Six officers have been have been identified, trained and are available to serve as trainers/mentors.
- A *Debt Toolkit* and other manuals have been developed and accepted for use.

Project Appraisal

- More than 85 (60 secretariat and 25 district) officers have been trained in the Harberger project appraisal methodology.
- A core group of 18 officers have been identified, trained and are available to serve as trainers/mentors.
- More than 160 officers trained in *Crystal Ball* software.
- A *Project Appraisal Manual* with sector-specific guidelines is being provided for GoU reference and training at UAA.
- The ToR for a project formulation and appraisal division (PFAD) has been submitted for consideration by the GoU.

Institutionalization

- Training of FPAC resource persons in how to conduct good analysis has been conducted.

Achievements in Terms of Attitude Changes

Expenditure Planning and Management

- Uttarakhand Public Procurement Rules approved by the Cabinet and published in the state government May 2008 Gazette.
- The PPB methodology has been institutionalized through GoU issuance of three annual budget circulars since 2006.

Revenue Management

- Public acceptance of VAT and its subsequent introduction was facilitated by awareness-raising seminars conducted by REFORM.

Debt and Investment Management

- The GoU has accepted the need for structured analysis, comprehensive database, reporting structures for improved debt/contingent liabilities management to facilitate timely tracking.

Project Appraisal

- The GoU has accepted the need for a structured analysis of major capital projects as evidenced in the GoU June 2007 budget order mandating use of project appraisal process for all projects more than Indian rupees (INR) 50 million.

Achievements in Terms of Practices Introduced

Expenditure Planning and Management

- Submission of four departmental PPB documents to the state legislature for 2008-09 budget sessions.
- A total of 17 out of 27 GoU departments have PPB task forces and PPB documents comprising slightly more than 60 percent of the state budget.
- The PPB methodology has been institutionalized through GoU issuance of 3 annual budget circulars since 2006.
- GoU is using the *PPB Implementation Guide* as a desk reference for its PPB Task Forces.

Revenue Management

- Together, the GoU and REFORM completed eight tax policy issue papers that are being used as reference for tax department officials to administer tax policies enacted by the state government. (See *Annexure 9* for a list of tax policy papers.)

Debt and Investment Management

- DIMC personnel are using the *CS-DRMS* software for debt and guarantees reporting following the training and mentoring received in use of the CS-DRMS software.

Project Appraisal

- Based on 2007 GoU GO, 35 projects were appraised of which 11 were rejected for being financially unviable. Specifically, 27 project proposals were appraised, 24 revised, and three rejected before submission to the *National Bank for Agriculture and Rural Development (NABARD)*; and, eight irrigation proposals were rejected before submission to the GoU Expenditure Finance Committee (EFC). (See *Annexure 10* for a testimonial letter.)

Achievements in Terms of Initial Impact

Expenditure Planning and Management

- GoU state legislature has approved the PPB documents for four departments in the 2008-09 budget sessions.

Debt and Investment Management

- The GoU has consolidated all of its public debt data into one dataset and migrated it to the *CS-DRMS* database enabling it to better manage and report on the state public debt portfolio.

Box 3.6: Uttarakhand Procurement Modernization

The Government of Uttarakhand (GoU) is the first jurisdiction in India (including the Government of India (GoI)) to have a modern set of procurement rules that address new procurement modalities such as Public-Private Partnerships (PPPs) and eProcurement.

The REFORM-GoU team surveyed all of the various procurement documents available within India (both government and donor) and internationally to extract "best practices" for inclusion in the Uttarakhand Procurement Rules

The rules consolidate all state procurement into one robust system that will cover all pubic procurement regardless of funding source (e.g., GoI, GoU, or international donor).

Key resistance to the draft rules came from departments that saw the rules as an attempt to weaken their control over their departmental procurement process as well as from managerial-level government officials who feared that formal rules delegating authority to line staff could result in their being held legally liable for any deviation from the rules. However, this was overcome by a series of meetings with the concerned departments and officials designed to allay their concerns.

The Uttarakhand Procurement Rules were approved by the state cabinet and published in the GoU May 2008 Gazette. The rules enable Internet-based procurement, which increase the speed and transparency of the process, ensures a consistent approach, results in savings in public funds (All-India savings are estimated by the GoI to exceed INR 45,000 crores if eProcurement options are available), and provides legally admissible and unalterable documentation of state procurement activities.

Project Appraisal

- Since November 2007, the GoU has saved about INR 5 crores through use of the REFORM project appraisal process: three of 27 NABARD projects along with eight irrigation projects were rejected for being economically unviable before submission to the state EFC.
- The *Uttarakhand Transportation Corporation* has used the *Crystal Ball* risk analysis software to purchase new bus fleet using debt financing facility.

REFORM Under Achievements

REFORM was unable to complete its task in strengthening the institutional structures in the GoU, which would enable them to conduct on a continuous, regular basis, *a priori* and *ex post facto* analysis of the impact of policy, procedural, regulatory on state finances.

Although the task remains incomplete, the state officials who have already received training on fiscal analysis and forecasting have become a pool of experts who have begun to conduct analysis and produce topical papers on key

Box 3.7: Debt Management Modernization in Uttarakhand

The Government of Uttarakhand (GoU) needed to strengthen its legal framework for debt management, upgrade its staff capabilities to deal with debt management issues, and improve the information available for debt management tracking and reporting through new or expanded automation capabilities. In addition, the responsibilities for requesting, raising, recording, and reporting on debt were fragmented between the Department of Finance, State Accountant General (SAG), Reserve Bank of India (RBI), and central Ministry of Finance (MoF).

With the assistance of REFORM, state government officials assembled state government debt information in a single consolidated Microsoft (MS) Excel spreadsheet. State officials were trained on how to use the suggested templates for data collection. This was the first time the GoU had a consolidated dataset of its debt, contingent liabilities, and investments in once place. This dataset was accompanied with templates for reporting annual changes and trends, which state officials have used as guidelines for data collection.

However, given certain limitations on the format, search, storage, and reporting functions of this software as well as a desire to improve its overall debt recording and security, Uttarakhand requested Government of India (GoI) assistance to obtain the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) software. This software application uses a sophisticated Oracle database and is more robust in its formats for debt recording and reporting.

Training in the software took place in April 2007 and migration of the MS Excel dataset to the CS-DRMS database was completed in early 2008. To date, the GoU is using this software to generate reports on the status of its debt and contingent liability portfolios.

Today, the GoU has a consolidated debt management process that includes better coordination and data-sharing between the state government, SAG, RBI, and MoF. As a result, the government is better positioned to begin market borrowing, as recommended by the Twelfth Finance Commission, when this becomes a requirement in 2010 for all state governments.

fiscal-related issues (*e.g.*, tax policy issues papers). (See *Annexure 9* for a list of a report on all tax policy issue papers prepared by the GoU.)

While the GoU does not yet have the institutionalized structure to conduct similar analysis on debt, investment and project appraisal, it does have trained officers and a robust database, which will enable them to progress this agenda at an appropriate time.

REFORM was also unable to complete its task in strengthening GoU capacity in revenue management. However, the GoU now has possession of a rudimentary input-output table and an initial macroeconomic database to analyze the implications of tax policy options on the state economy, especially as it related to VAT and GST in the future

Finally, REFORM was unable to incorporate the training programs delivered during the course of the project into the curricula of the Uttarakhand Academy of Administration (UAA) in Nainital due to a variety of structural and systemic issues within the UAA itself (see *Lessons Learned* section below for more details). However, REFORM has provided all of its fiscal training course materials to the GoU and identified a good institution for providing these courses on a regular basis (see *Recommended: Immediate Next Steps* narrative on Page 127 for further details).

Lessons Learned

As a result of 4.5 years work in the state of Uttarakhand, the REFORM Project is able to provide a comprehensive list of lessons learned that can be leveraged by other state governments engaged in public fiscal reform. These lessons learned, which either facilitated or delayed implementation, adoption and sustained use of the tools and techniques introduced have been categorized in the following three broad categories:

- Prerequisite Factors;
- Ongoing Implementation Factors; and
- Future Sustainability Factors.

More specifically:

Prerequisite Factors

- After a joint agreement with the state government on the overall approach in the capacity-building program, in hindsight it was critical to have a *full-time Program Management Unit (PMU) to coordinate the REFORM interventions.*
- In absence of such a coordinator, there were delays in several project interventions. For example, a full-time state government appointed coordinator could have dialoged with the various state departments to provide timely identification of staff commitments. As a result, project progress was delayed (PPB implementation), confused (database and I-O Table ownership), or failed (FPAC and ATI) to achieve the intended results.
- *A detailed operational plan* in collaboration with state government to:
  - Demarcate responsibility within the state government of who would take ownership for each REFORM intervention. For example, project appraisal ownership between finance and planning was not clearly determined. This confusion, in turn, prevented establishment of the project unit (PU).
  - Clarify understanding by all experts (local and international) on systems and structures that are unique to the state that

Box 3.8: Networking for Fiscal Research in Uttarakhand

The Government of Uttarakhand (GoU) is in the process of establishing a fiscal research network to enhance its fiscal management processes. Following a REFORM recommendation, the GoU will utilize researchers from important academic institutions that are resident in the state: the Confederation of Indian Industries-Uttarakhand; the Forest Research Institute; the Institute of Certified Financial Analysts of India (ICFAI); the Petroleum University; the Indian Institute of Management-Roorkee, and the Reserve Bank of India-Uttarakhand office.

This network will augment the government's Fiscal Plan and Resources Directorate that was established in 2001. Originally, the purpose of this unit was to analyze fiscal year expenditures on an ex post facto basis. However, the GoU realized that the scope of this unit was too limited to meet its needs for current fiscal research and recommendation papers. In 2005, again under recommendation from REFORM, the GoU established a Fiscal Policy and Analysis Cell located in the Department of Finance and chaired by the Principal Finance Secretary.

Now, the GoU seeks to expand the expertise available to it by including nongovernment officials as FPAC Consultants/ Advisors. These researchers will receive consultancy fees, honoraria, and cost reimbursement for the completion of research projects.

To date, the FPAC is in the process of completing studies on: "Introduction of Entertainment Tax in Uttarakhand": and, "Introduction of Luxury Tax in Uttarakhand." These studies had been requested by the Principal Finance Secretary.

The long-term benefit of this research network will not only be a more widely represented pool of researchers available to the GoU but, the foregoing of a public-private partnership that can leverage academic faculty and research databases with government decision-makers/officials in order to improve the information needed for better fiscal decision-making. In the process, this network will help the government to accelerate implementation and realization of its development agenda.

need to be accounted for when designing detailed REFORM implementation plans. For example, the role and constituents of the EFC who could have been asked to identify appropriate officials for the first series of project appraisal trainees. As a result, the profile of the first training batch was flawed in terms of position, actual duties, and capability. Another example was the absence of early knowledge of a pre-existing structure that could have been redesigned to introduce the proposed FPAC.

– Obtain a definitive commitment in writing on the budget, staff, facilities, cost-sharing arrangements and any required logistical support to be made available in a timely manner by the state government for smooth implementation. For example, the numbers and the timely participation of officials especially for PPB was less than needed. In addition, actual responsibility to complete PPB documents and FPAC studies often fell upon REFORM personnel instead of the true responsible GoU staff. Mentoring sessions had to be conducted in the REFORM office often requiring the use of REFORM vehicles and funds for the activities the GoU should have been supporting on a cost-sharing basis.

 – Design an effective capacity-building methodology. For example, shorter duration and full-time training on each tool is more productive than longer duration and part-time training. The *CS-DRMS* training was very effective due to its off-site residential training arrangements; whereas state-based trainings were less well-attended on a consistent basis such as the project appraisal and PPB trainings. Whereas, the long duration of the first training cohort (24 months) resulted in a high attrition rate and as a result, only 25 percent of the trainees who started the course completed it.

Ongoing Implementation Factors

- Whenever there was *a demand-driven process* (readiness), the REFORM interventions had ownership, met with timely responses, enjoyed greater cost-sharing and, finally, resulted in institutionalization. As examples:
  - The recognized need for state procurement rules by the GoU facilitated REFORM to easily identify participants and hold well-attended sensitization sessions and training workshops without having to send reminders and convince officials on the value of such training;
  - The proposed amendments to the existing rules and formats also met with speedy approval by both senior officials and state cabinet;
  - Even without a request from REFORM, the state government, at its own cost, translated the procurement rules into Hindi for wider circulation within the GoU; whereas, in the case of PPB documents the above process was reversed; and,
  - In the case of the *CS-DRMS* software training and implementation, the demand from the Government of India (GoI) Ministry of Finance (MoF) played a key role in its acceptance and timely implementation at the state level.
- Wherever the REFORM project had *champions within the GoU,* government commitments of staff, resources, supporting infrastructure and logistical support were more forthcoming and helped to progress the project agenda. As examples, the procurement experience mentioned above, the preparation of PPB documents such as in the Education Department, and finally, the application of the project appraisal methodology. In sum, these reform champions served as both change agents and examples of the fact that such reforms were both possible and desirable.
- *A greater governmentwide approach possible* (both in terms of sectors covered and levels of governance) facilitated implementation of a sustainable reform program. Governmentwide approach may be defined in the following ways:
  - Selecting one department and then extending down to include all levels (vertical linkage). This helps everyone in that department in understanding the rationale, the implementation steps and their role in the reform process; and,
  - Selecting all nodal departments at a single governance level (horizontal linkage) so

that all interlinked can attain cost and time efficiencies through economies of scale and by leveraging interdepartmental comparative advantages (resources, skills, and infrastructure). The above did not happen in the case of Uttarakhand. For example, PPB was incrementally implemented with neither horizontal nor vertical coverage. As a result, district officials are not owners of the PPB prepared at the secretariat level. This, in turn, does not bind them to the deliverables.

- There was a need for supplemental *detailed quarterly rolling plans* in addition to annual work plans jointly developed with GoU to enable ongoing adjustments for smoother project implementation.

  For example, the actual use of the REFORM project appraisal methodology was only institutionalized after discussions with the Principal Finance Secretary on the need for the issuance of the necessary government order. Had there been stringent quarterly reviews, the need for issuance of such a GO would have realized sooner with the earlier institutionalization of the project appraisal methodology.

- While each time the REFORM project benefited from the *periodic reviews at the state and national levels*, it is apparent the number of reviews was not frequent enough to modify and adjust the implementation process. Further, in hindsight, it is also recognized that, if efforts had been made either by the state governments or the REFORM team, to establish a state level inter-donor committee, REFORM interventions could have leveraged other projects.

  For example, each time the three REFORM-assisted states met to review project progress at MoF and USAID-chaired respective project review meetings, the states learned from each other.

- *Periodic press coverage of state government fiscal reform efforts* may have helped to engender public and political interest in these reform efforts and, in turn, reinforce and compel the state government to continue down the reform path.

  For example, press coverage of the GoU decision to use it project appraisal GO for prospective NABARD-financed projects gave fillip to the acceptance of this methodology.

- There should have been *greater visible recognition for the officials participating in the state reform initiatives*.

  For example, officials completing particular training programs could be recognized through suitable mentions in their annual performance reports. In addition, such officials could be posted on deputation to the FPAC at a higher pay scale. Finally, officials used in a trainer/mentor capacity could receive both recognition and additional compensation. In Uttarakhand, officials did not receive either additional recognition or compensation. As a result, motivation was low to participate in the formation of FPAC.

- In a nascent state, fiscal practices are weak, technical skills of officials limited and available human capital is scarce—all posing additional challenges. Further, *frequent transfers of officials* at all levels, partly necessitated by an acute shortage of staff, *resulted in delaying the reform process*. Specifically:

  – Staff transfers led to induction of new persons who had to be convinced of the reform activity value and then be trained a new;

– Basic office skills among many of the government staff trained and mentored, such as computer literacy and English proficiency, were inadequate; and

– The interdisciplinary nature of REFORM assistance implied that additional training had to be provided to bring staff skills up to the required level in the areas of managerial and quantitative (*e.g.*, economic, finance, and statistics) skills.

Future Sustainability Factors

- Experience on the ground indicates that unless the *state government formally institutes the practices* introduced under REFORM interventions (*e.g.*, GOs and circulars), the sustainability of the effort is imperiled. Similarly, this implies that unless the manuals under REFORM are published and disseminated by the state government, if necessary, through GOs and circulars, their use will remain limited.

- *Early and full involvement of state training institutions are needed* to incorporate the fiscal reform tools, techniques and training courses into their mainstream curricula. In Uttarakhand, the project was not able to take advantage of the Uttarakhand Academy of Administration (UAA) in Nainital due to its distance from Dehradun and insufficient faculty.

- *Existing legal frameworks* strengthen the adoption of REFORM proposals. For example, passage of the *Fiscal Responsibility and Budget Management (FRBM) Act* provided the legal and operational context within which fiscal reform interventions could take place. Specifically, the *FRBM Act* required state governments to have consolidated debt data that could be used to generate reports and enable proactive debt management. At times, these existing legal frameworks may have to be modified to accommodate the adoption of the REFORM proposals such as the Budget manual to incorporate the PPB methodology and submission.

Recommended: Immediate Next Steps

In order to maintain the momentum and sustain the fiscal reform initiatives generated by the REFORM Project, the Uttarakhand project team recommends the following immediate next steps by the GoU:

Expenditure Management

- Ensure a clear requirement for the submission of PPB to the state legislature along with budget documents through necessary amendments in the Budget Manual;

- Ensure submission of PPB documents of all departments (including departments not yet covered) to the state legislature during the 2009-10 budget session;

- Upgrade the PPB database to ensure all departments are covered to facilitate the formulation of PPB documents;

- Appoint Expenditure Budget Analyst in the restructured FPAC dedicated to studying budget execution trends and preparation of PPB documents at different governance levels across key sectors (*e.g.*, Agriculture, Education, Health, and Power) to improve the quality of expenditure management; and

- Continue with sensitization seminars and training on a regular basis to orient departmental officials on the new *Uttarakhand Procurement Rules* for ensuring compliance.

Revenue Management

- Appoint revenue analysts in the restructured FPAC dedicated to undertake regular studies on improving state government revenues (both tax and nontax); and
- Secure CSO support to use, update, and maintain the macroeconomic database and state input-output table.

Debt and Investment Management

- Appoint debt experts in the restructured FPAC dedicated to undertake studies on debt management and its implications; and
- Ensure continuous monitoring and maintenance and upgrading of debt data in *CS-DRMS* format and subsequent reconciliation with database of the State Accountant General.

Project Appraisal

- Continue adherence to use of the project appraisal guidelines mandated by the June 2007 GoU Government Order;
- Initiate establishment of a Project Formulation and Appraisal Division (PFAD) in the Department of Planning as recommended by the REFORM project to undertake project formulation, analysis, selection, and monitoring; and
- Initiate project units in conjunction with the PFAD in all major investing departments such as Education, Health and Family Welfare, Irrigation, Power, and Public Works so that proposed projects are adequately analyzed before submission to the Planning Department.

Institutionalization

- Build upon the 2001 *GoU Fiscal Policy State Resources Cell* to restructure and operationalize the FPAC as suggested by the REFORM Project;
- Appoint a dedicated Director General of the Uttarakhand Academy of Administration (UAA) to institutionalization REFORM training courses into the annual training calendar;
- Identify appropriate sections of REFORM manuals and issue necessary GOs and circulars to operationalize the fiscal reform processes (*e.g.*, the standardized PPB format); and
- Bring *Institute of Chartered Financial Analysts of India (ICFAI)* on board to serve as the Dehradun branch of the UAA for training GoU officials by signing a memorandum of understanding (MoU).

Conclusion

The fiscal numbers of Uttarakhand registered considerable improvement during the last four years (*e.g.*, since fiscal year 2004-05 to fiscal year 2008-09 BE). This is largely due to the revenue buoyancy in the overall Indian economy as a result of sustained high rates of growth over the same time period. Due to this buoyancy in revenues, the role of expenditure management has become less pressing in fiscal consolidation.[22]

However, trends clearly indicate that the revenue buoyancy may considerable dampen in the not-too-distant future, due to several external factors (*e.g.*, increases in the global price of oil and food items), which have already impacted inflation rates. Against the backdrop of this scenario, the

[22] Fiscal consolidation is defined as a stage in which a balance exists between the expenditure and income of the state coupled with debt sustainability (*i.e.*, possessing a debt level that can be serviced by the state government within the limits of its expected revenue base) without creating an adverse impact between expenditure and income.

Table 3.2: State Finances of Uttarakhand: Summary Growth Indicators

Summary Indicators	2001/02-2008/09	2001/02-2004/05	2004/05-2008/09
GSDP Trend Growth Rate	12.78%	12 27%	13.41%
Expenditure Trend Growth Rate			
· Total Expenditure Trend Growth Rate	20 54%	24.85%	17.64%
· Revenue Expenditure Trend Growth Rate	3.33%	6.51%	2.02%
· Capital Outlay Trend Growth Rate	30.23%	55.09%	10.21%
Own Tax Revenue (OTR) Trend Growth Rate	20.63%	14.77%	22.40%
Central GoI Transfer Trend Growth Rate	10.44%	-0.12%	16.86%
Buoyancy[23] OTR	1.61	1 20	1.67

(Source: Finance Accounts and Budget Document—GoU)

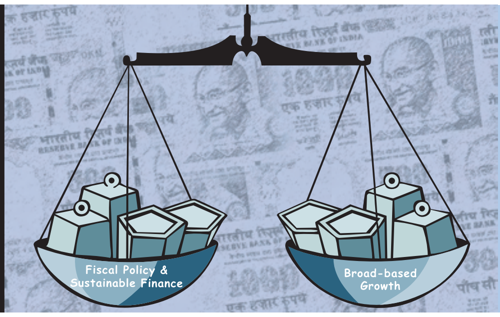
sustainability of the revenue buoyancy becomes highly uncertain. Similarly, high inflation rates are bound to put pressure on expenditure management. With the cost of capital further expected to rise, the dilemma for the states to choose between fiscal prudence and development becomes a challenge.

Systems, tools, and techniques that enable fiscal managers to make informed fiscal choices are critical to follow an appropriate development strategy to improve the lives of its citizens. Therefore, continued effort to introduce and institutionalize relevant fiscal management tools and techniques are critical for the sustainable development of any and all sectors of the state economy.

In closing, it is hoped that the REFORM project experience in assisting the GoU in fiscal reform efforts, was rewarding and educational to all concerned. Many operational lessons in how to conceptualize, implement, and institutionalize fiscal reform initiatives have been learnt and shared with the policy makers and practitioners. It is an earnest hope that individual and institutional memories have been enriched to weather future challenges. Lastly, it is common knowledge that "reform" is a dynamic refrain and not a static destination. The GoU had risen to the challenges of initiating and putting through an ambitious reform process. REFORM Project only responded to the GoU request for assistance. It is fervently hoped that greater awareness has been created in the GoU on the merits and need for fiscal reform to continue their journey even after the closure of the Uttarakhand State REFORM Project.

Lastly, for more information on the fiscal reform project tools implementation experiences implemented by the REFORM project (*please see the various tool reports, which are located in the following Volumes—II, IV and V of the REFORM Project Compendium with Practitioners' Guide*.

[23] Buoyancy is defined as the ratio of the growth of own tax revenue and growth of state gross domestic product.



Annexures

Annexure 1:

Uttarakhand State Socioeconomic Profile

Table 3A1.1: Uttarakhand State Social Indicators[6]

Indicator	Uttarakhand	All-India
Total Geographical Area	54,483 sq. kms.	3287263 sq. kms.
Percentage of Arable Land	12,61,915 hectares	
Percentage of Forest Cover	64.60%	23.38%
Percentage of Hilly Terrain	93%	
Major Water Resources	Yamuna, Bhagirathi, Ganga, Ramganga and Sharda	Rivers
Major Energy Base (Hydro, Coal, Oil, Gas, Wind…)	Hydroelectric projects on the rivers of Yamuna, Bhagirathi, Ganga, Ramganga and Sharda generating electricity	
No. of Districts	13	593
Total No. of Villages	16,826	638588
No. of Villages connected by roads: Both National and State Highways	45%	
Number of State Elections since 2001	Two: 2004 and 2007	
Population 2001 Census	84,79,562	1026443540
Major Religions (As a Percentage of Overall State Population)	Hindu-68 57%, Muslim-13.85% Christian-4.06%	Hindu-84.9%, Muslim-11.9% Christian-.31%, Sikh-2.4% Buddhist-.015%, Jain-.01%
Percentage of Indigenous Population	3.01%	8.1%
Percentage of Population Below Poverty Line: Official Estimate	Total=39.6%, Rural=40.8%, Urban=36.5%	Total=27.5%, Rural=28.3%, Urban=25.7%
Literacy Rate 6 years and above	72.28%	65%
Unemployment Rate: 20-24 Years		13%
25-29 Years		6.4
Number of Health Centers	232	22,400
Infant Mortality Rate 2005-06	43 per 1,000 births	57 per 1,000 births
Electrification: No. of Villages Electrified	78.6%	NA
No. of Villages Connected by Roads Both National and State Highways	45%	
Drinking Water Clean Water Sources	15,547	1,628,269 units

Sources:
- Economic Survey 2007-08 GoI
- Economic Survey 2007-08 Uttarakhand

[6] Information taken from official Government of Uttarakhand web site and is accessible at: http://gov.ua.nic.in/uaglance/

Annexure 2:

Uttarakhand State Finances

Table 3A2.1: Finances of Uttarakhand

Fiscal Parameters	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 RE	2008-09 BE
Gross Fiscal Deficit	613	890	1405	2180	1878	886	1607	1155
As % of GSDP	3.8286178	4.7657296	6.7979485	9 5761037	7.2858473	2.9650949	4.801785176	3.081419392
Revenue Deficit	330	459	760	950	74	-896	-1107	-1794
As % of GSDP	2.061083	2.4578313	3.6771821	4.1730727	0 2870888	-2.998561	-3.307763653	-4.786204666
Primary Rev Deficit	-177	-94	163	135	-734	-1861	-2294	-3043
As % of GSDP	-1.10549	-0.503347	0.7886588	0 5930156	-2.84761	-6.228038	-6.85457075	-8.118406243
Debt and Liabilities	4634	6003	8030	9909	11714	13034	14430	15482
As % of GSDP	28.942602	32.144578	38.852332	43.527345	45.445376	43.619691	43.11746117	41 30435933
Revenue Expenditure as % of Revenue Receipts	112.65337	114.27239	121.11111	123 25012	101.33646	94.651469	88.04793781	82.84402792
Capital Outlay	208	339	533	1136	1705	1699	2607	2802
As % of GSDP	1 2991069	1.815261	2.5788659	4.9901164	6.6146803	5.6858874	7.789828223	7.475443409

(Source: Finance Accounts and Budget Document—GoU).

Annexure 3:

Uttarakhand State Fiscal Trend Data

Table 3A3.1: Expenditure Trends in Uttarakhand

Sectors	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 BE	2008-09 BE
Education, Sports and Culture Expenditure	697	970	1094	1172	1319	1522	1830	
As % of GSDP	4.35	5.19	5.29	5.15	5.12	5.09	5.47	
Health Expenditure	146	403	209	249	352	418	535	
As % of GSDP	0.91	2.16	1.01	1.09	1.37	1.40	1.60	
Water and Sanitation	169	145	156	319	277	285	381	
As % of GSDP	1.06	0.78	0.75	1.40	1.07	0.95	1.14	
Roads Expenditure	181	168	211	345	535	683	891	
As % of GSDP	1.13	0.90	1.02	1.52	2.08	2.29	2.66	

(Source: RBI Report on State Finances).

Table 3A3.2: Investments and Return on Investments: Trends in Uttarakhand

Fiscal Parameters	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 RE	2008-09 BE
Interest Payments	507	553	597	816	808	964	1187	1249
As % of GSDP	3.17	2.96	2.89	3.58	3.13	3.23	3.55	3.33
Investment at Year-end								
INR crores	5	28	40	333	669	762		
Return on Investment								
INR crores	0.02	0.04	0.04	0.26	0.07	0.16		
Return on Investment								
Return in %	0.4	0.14	0.1	0.08	0.01	0.02		

(Source: Finance Accounts and Budget Document—GoU).

Table 3A3.3: Sources of State Revenue in Uttarakhand

Fiscal Parameters	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 RE	2008-09 BE
Own Tax Revenue	971	1017	1226	1444	1785	2514	2887	3120
As % of GSDP	6.06	5.45	5.93	6 34	6.93	8.41	8.63	8 32
Own Nontax Revenue	851.88	162	375	370	548	650	647	892
As % of GSDP	1.01	2.01	1.79	2.41	2.52	2.17	2.67	2 39
Transfer from Centre	2057.66	1475	1824	2004	2094	3102	4213	5482
As % of GSDP	9 21	9.77	9.70	9 20	12.03	14.10	16.38	17.18
Total Rev Receipt	2608	3216	3600	4086	5537	6843	9262	10457
As % of GSDP	16.29	17.22	17.42	17.95	21.481223	22.90084	27.6752547	27.89818406

(Source: Finance Accounts and Budget Document—GoU) In Indian Rupees crores.

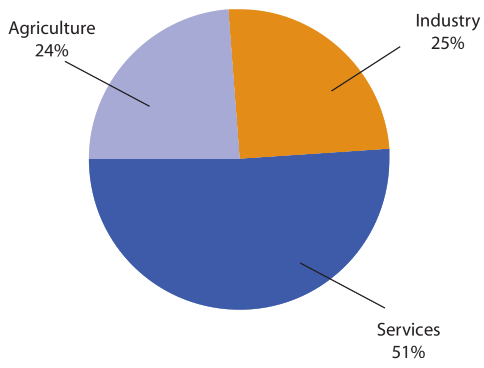
Annexure 4:

Uttarakhand Gross State Domestic Product Data

Table 3A4.1: Share in GSDP by Sector (2003-04)[7]

Sector	Share in GSDP
Agriculture	27%
Industry	29%
Service	44%

Figure 3A4.1: % Share in State GSDP



[7] NCAER Uttarakhand Development Report accessible at: http://aboututtarakhand.blogspot.com/2008/01/income-and-poverty-in-uttarakhand.html

Annexure 5:

Government of Uttarakhand Departments and Directorates

Table 3A5.1: List of Uttarakhand Departments and Directorates

1.	Department of Vidhan Sabha
2.	Department of Governor
3.	Department of Minister's Cabinet
4.	Department of Judicial Administration
5.	Department of Selection Committee
6.	Department of General Administration
7.	Department of Finance
	i. Department of Tax
8.	Department of Planning
9.	Department of Secretariat and Other Services
10.	Department of Excise
11.	Department of Lok Seva
12.	Department of Police and Jail
13.	Department of Education
	i. Directorate of Primary Education
	ii. Directorate of Middle Education
	iii. Directorate of Higher Education
	iv. Directorate of Technical Education
	v. Department of Sports
	vi. Department of Youth Welfare
	vii. Department of Culture
14.	Department of Health
	i. Directorate of Health and Family Welfare
	ii. Directorate of Homeopathy
	iii. Directorate of Ayurveda and Unani
15.	Department of Drinking Water
	i. Directorate of Jal Sansthan
	ii. Directorate of Jal Nigam
	iii. SWAJAL
16.	Department of Urban Development
17.	Department of Information
18.	Department of Social Welfare
19.	Department of Labour and Employment
	i. Directorate of Labour
	ii. Directorate of Employment
20.	Department of Agriculture and Allied Services
	i. Department of Horticulture
21.	Department of Co-operatives
22.	Department of Rural Development
	i. Directorate of Rural Development
	ii. Directorate of Panchayati Raj
23.	Department of Irrigation and Flood Control
	i. Directorate of Minor Irrigation
	ii. Directorate of Major Irrigation and Flood Control
24.	Department of Power
25.	Department of Public Works
26.	Department of Industries
27.	Department of Transport
28.	Department of Food and Civil Supplies
29.	Department of Tourism
30.	Department of Forest
31.	Department of Animal Husbandry and Fisheries
32.	Department of Schedule Tribes
33.	Department of Schedule Castes

Annexure 6:

Uttarakhand Training Statistics Report

Table 3A6.1: Uttarakhand Training Statistics Report

No.	Name of Training Event	Duration	No. of Participants	Training Hours
1	Performance Budgeting (Major Departments)	6-7 Aug 04	32	12
2	Performance Budgeting (Pilot Projects)	15 Oct 04	14	6
3	Performance Budgeting (Education Department)	10 Nov 04	12	6
4	Performance Budgeting (Health and Rural Dev. Departments)	15 Feb 05	29	6
5	Performance Budgeting (Education Dept.)	16 Feb 05	21	6
6	Performance Budgeting (PWD and Irrigation Departments)	19 May 05	24	6
7	Performance Budgeting (Drinking Water and Urban Development Departments)	19 May 05	19	6
8	Performance Budgeting (Health & Family Welfare Departments)	28 Jun 05	25	6
9	Performance Budgeting (Education Departments)	1 Jul 05	19	6
10	Performance Budgeting (Major Departments)	30 Nov-01 Dec 05	24	12
11	Performance Budgeting (Education Department)	9 Dec 05	10	6
12	Performance Budgeting (Health Department)	10 Dec 05	12	6
13	Performance Budgeting (Health and Education Department)	10 Jan 06	19	6
14	Performance Budgeting (Health and Education Department)	30-31 May 06	26	12
15	Performance Budgeting (PWD and Irrigation Department)	19-20 Jun 06	10	12
16	Performance Budgeting (Drinking Water Department)	22 Jun 06	2	6
17	Performance Budgeting (Rural, Planning and Forest Department)	26-27 Jun 06	8	12
18	Performance Budgeting (Power and Forest Department)	28-29 Jun 06	6	12
19	Performance Budgeting (Planning, Urban Dev. and Finance Department)	17-18 Jul 06	8	12
20	Performance Budgeting (Power Department)	19-20 Jul 06	3	12
21	Performance Budgeting (Minor Irrigation, Forest and Finance Department)	24-25 Jul 06	5	12
22	Performance Budgeting (Irrigation, PWD, Drinking Water, Planning and Forest Department)	26-27 Jul 06	7	12
23	Program and Performance Budgeting	21 Dec 2006	20	6
24	Program and Performance Budgeting	12 Jan 2007	37	6
25	Program and Performance Budgeting	19 Apr 2007	21	6
26	Program and Performance Budgeting Mentoring Sessions	2006-2008	210	280
	Total	**25 Workshops**	**623**	**490**

Table 3A6.1: Uttarakhand Training Statistics Report (Contd.)

No.	Name of Training Event	Date	No. of Trainees	Training Hours
1	Financial Controllers' Workshop on Financial Management	9-10 Feb 05	22	12
2	Value Added Tax (VAT)	16 Oct 04	70	6
3	VAT Policy and Administration	7-12 Feb 05	21	36
4	VAT Policy and Administration	18-24 Oct 05	12	42
5	Tax Analysis and Revenue Forecasting	4-10 Nov 04	31	42
6	Tax Analysis and Revenue Forecasting	23-27 Nov 04	17	30
7	Tax Analysis and Revenue Forecasting (Practical)	13-20 Dec 04	15	42
8	Tax Analysis and Revenue Forecasting (Peer Review Workshop)	20-21 Jan 06 *	12	12
9	Tax Analysis and Revenue Forecasting (Hand-holding Sessions)	3-7 Jan, 16-20 Jan, 14-18 Feb, 1-5 May, 5-9 Jun, 25-29 Jun, 24-28 Jul, 21-25 Aug, 18-22 Sept, 28 Oct-3 Nov 2006	19	330
10	Tax Analysis and Revenue Forecasting	12-17 Mar 2007	6	36
11	Tax Analysis and Revenue Forecasting	14-25 May 2007	1	60
12	Tax Analysis and Revenue Forecasting	16-31 July 2007	8	60
	Total	**22 Activities**	**234**	**696**
No.	**Name of Training Event**	**Date**	**No. of Trainees**	**Training Hours**
1	Project Appraisal	16-21 Aug 04	30	36
2	Project Appraisal	22-25 Sep 04	30	24
3	Project Appraisal	4-8 Oct 04	30	30
4	Project Appraisal	12-15 Oct 04	30	24
5	Project Appraisal Presentation	9-10 Dec 04	28	12
6	Project Appraisal	31 Jan-11Feb 05	23	60
7	Project Appraisal	19-30 Sep 05	15	60
8	Project Appraisal (Hand-holding Session)	7-12 Nov 05	6	36
9	Project Appraisal	10-20 April 2007	17	60
10	Project Appraisal (Module I)	29 Jan-3 Feb 2007	39	36
11	Project Appraisal (Practical Session)	12-13 Feb 2007	19	12
12	Project Appraisal (Module II)	9-14 April 2007	26	36
13	Project Appraisal Implementation and Formulation	20 Aug 2007	44	6
14	Project Management and Project Selection	1-5 May 2007	80	13
	Total	**14 Workshops**	**417**	**446**

Table 3A6.1: Uttarakhand Training Statistics Report (Contd.)

No.	Name of Training Event	Date	No. of Trainees	Training Hours
1	Macroeconomic Issues	7-11 Jun 05	20	36
2	Macroeconomic Issues (Peer Review Workshop)	29-30 Dec 05	13	12
3	Macroeconomic Analysis (Hand-holding Sessions)	23-25 Jan, 20-24 Feb, 8-12 May, 28 Aug-1Sept, 25-29 Sept, 2006	18	138
4	Procurement (Major Depts.)	3 Jan 06	20	6
5	NCAER Presentation on Macroeconomic Database	13-14 Feb 2006	20	12
6	NCAER Presentation on Macroeconomic Database	19 Dec 2006	33	6
	Total	**11 Workshops**	**124**	**210**
	72 Training Activities		**1398**	**1842**

Annexure 7:

Uttarakhand PPB Rollout Report

Table 3A7.1: Uttarakhand PPB Rollout Report

S. No.	Department Name	Task Force Appointed	Trainings held (Session Dates)	Mentoring Sessions held for the Period 2006-08	Completion of PPB Documents		Comments
					2007-08	2008-09	
1	Health	–	30 Nov-01 Dec 2005 10 Jan 2006 30-31 May 06	09/08/2006 10/09/2006 /15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 09/08/2007 17/01/2008	Yes	Yes	Completed
2	Education	–	30 Nov-01 Dec 2005 10 Jan 2006 30-31 May 06	11/10/2006 19/10/2006 06/11/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 10/08/2007 17/01/2008	Yes	By Feb end	Work under Progress
3	Forest	22-Sep-06	26-27 Jun 06 28-29 Jun 06 24-25 Jul 06	30/08/2006 13/09/2006 28/09/2006 12/10/2006 16/10/2006 08/11/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 17/01/2008	Yes	By Feb end	Work under Progress
4	Rural Development	3-Nov-06	26-27 Jun 06 17-18 Jul 06	24/08/2006 28/09/2006 04/10/2006 01/11/2006 03/11/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 30/07/2007 17/01/2008	Yes	By Feb end	Work under Progress
5	Minor Irrigation	3-Nov-06	19-20 Jun 06 24-25 Jul 06	23/08/2006 26/09/2006 06/10/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 31/07/2007 17.01.2008	Yes	Yes	Completed
6	Drinking Water	18-Oct-06	21 May 05 30 Nov-01 Dec 2005 21-22 Jun 06 26-27 Jul 06	22/08/2006 25/09/2006 01/11/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 17/01/2008	Yes	Yes	Completed
7	Labor	31-Oct-07	05-08 Nov 07	03/12/2007 23/01/2008	-	By Feb end	Work under Progress
8	Urban Development	–	21 May 05 17-18 Jul 06	07/09/2006 27/09/2006 14/10/2006 08/11/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 17/01/2008	Yes	By Feb end	Work under Progress
9	Planning	21-Sep-06	26-27 Jun 06 17-18 Jul 06	04/09/2006 17/10/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 17/01/2008	No	No	Partly completed
10	Public Works	12-Oct-06	19 May 2005 30 Nov-01 Dec 2005 19-20 Jun 06 26-27 Jul 06	28/09/2006 05/10/2006 02/11/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 10/08/2007 17/01/2008	No	No	Partly completed. Official appointed has been transferred

Table 3A7.1: Uttarakhand PPB Rollout Report (Contd.)

S. No.	Department Name	Task Force Appointed	Trainings held (Session Dates)	Mentoring Sessions held for the Period 2006-08	Completion of PPB Documents		Comments
					2007-08	2008-09	
11	Irrigation	19-Sep-06	19 May 2005 30 Nov-01 Dec 2005 19-20 Jun 06, 26-27 Jul 06 24 Jan 2007, 26-27 Jan 07	21/08/2006 29/09/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 17/01/2008	No	By Feb end	Partly completed
12	Finance	23-Aug-06	19-20 Jun 06, 24-25 Jul 06	29/09/2006 06/09/2006 27/09/2006 04/10/2006 17/10/2006 01/11/2006 07/11/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007 17/01/2008	No	No	Partly completed
13	Power	10-Oct-06	28-29 Jun 06 19-20 Jul 06	10/08/2006 27/09/2006 09/10/2006 15/11/2006 13/12/2006 21/12/2006 12/01/2007 19/04/2007	No	No	Partly completed
14	Animal Husbandry	–	17-Jan-08	17/01/2008	-	By Feb end	Work under Progress

Annexure 8:

Uttarakhand Public Procurement Papers

Table 3A8.1: Uttarakhand Public Procurement Papers

Report No.	Subject	Requested By	Start Date	Finish Date	Status
1	Report on Procurement System Capacity Assessment and Recommendations on System Improvement	Mr. T. N. Singh Additional Secretary—Finance	January 2006	4 Mar 2006	Report Submitted to the GoU on March 9
2	Procurement Capacity-building for the Government of Uttaranchal: A Brief Review and Suggested Procurement Rules	Mr. T. N. Singh Additional Secretary—Finance	January 2006	1 May 2006	Report Submitted to the GoU on May 9

Annexure 9:

Uttarakhand Tax Policy Issue Papers

Table 3A9.1: Uttarakhand Tax Policy Issue Papers

S. No	Subject	Officials/Resource Persons Working on the Case Study	Final	Draft	Current Status	Focus of the Study
1	Revenue Implications of Alternative Thresholds under Trade Tax of Uttaranchal	Mr. I S Brijwal (Dy. Commissioner, Commercial Tax) Mr. T. P. Nautiyal (Dy. Commissioner, Commercial Tax) Mr. B M Pant (Asst. Commissioner, Commercial Tax, Rishikesh)	June 2006	Feb. 2006	Completed	Focuses on the revenue implications of alternative thresholds of INR 1 lakh, INR 0 2 lakh, INR 0.5 lakh and INR 10 lakh
2	Forecasting Trade Tax Revenue of Uttaranchal	Mr. U. S. Bisht (Jt. Commissioner, Commercial Tax, Haridwar) Mr. B. B. Mathpal (Dy. Commissioner, Commercial Tax, Haridwar)	June 2006	Feb. 2006	Completed	Illustrates use of alternative techniques for estimating trade tax revenue
3	Forecasting Trade Tax for Srinagar	Mr. S. S. Negi (Asst. Commissioner, Commercial Tax, Srinagar)	June 2006	Feb. 2006	Completed	Illustrates pitfalls in forecasting revenue for the state based on a small sample region
4	Implications of Reduction in CST Rate for Uttaranchal	Mr. N. S. Pangtey (Dy. Commissioner, Commercial Tax) Mr. N. C. Joshi (Dy. Commissioner, Commercial Tax) Dr. Trilochan Tripathy (Faculty, ICFAI Business School)	Aug. 2006	Feb. 2006	Completed	Focuses on the revenue implications of concessions allowed in CST at present, and further reduction in CST
5	Tax Expenditure: Estimation and Implications	Mr. U. S. Bisht (Joint Commissioner, Commercial Tax) Mr. Pradeep Srivastava (Joint Commissioner, Commercial Tax) Dr. Trilochan Tripathy (Faculty, ICFAI Business School)	Aug. 2006		Completed	Focuses on the concept, preparation, and interpretation of tax expenditure budget in respect of tax concessions given in Uttaranchal
6	Analysis of Subsidies for Water Supply	Dr. P. K. Pande (Chief Engineer, Planning Commission, GoU) Mr. G. K. Pant (Add. Secretary)	Aut. 2006		Completed	Attempts to suggest measures for improving the cost structure and minimizing the element of subsidy involved
7	Forecasting State Excise of Uttaranchal	Mr. Suresh Prakash (Additional Commissioner, Commercial Tax) Mr. Pyush Kumar (Dy. Commissioner, Commercial Tax, Rudrapur) Mr. Harsh Vardhan Chaturvedi (Deputy Excise Commissioner) Mr. T. P. Singh (Deputy Excise Commissioner)		Dec. 2007	Preliminary Draft Ready	Focuses on forecasting State Excise of Uttaranchal by using alternative forecasting techniques

Table 3A9.1: Uttarakhand Tax Policy Issue Papers (Contd.)

S. No	Subject	Officials/Resource Persons Working on the Case Study	Final	Draft	Current Status	Focus of the Study
8	Analysis of Subsidies in Irrigation Sector	Mr. Arvind Singh Hayanki (Add. Secretary, Irrigation) Mr. Devendra Paliwal (Under Secretary, Finance Department)		Dec. 2007	Preliminary draft ready	Attempts to suggest measures for improving the cost structure and minimizing the element of subsidy involved
9	Analysis of Structure of Uttaranchal's Economy	Dr. R C Mishra (Deptt. Of Commerce, Kumaon University, Nainital) Mr. P S Rana, (Dy. Commissioner, Commercial Tax, Haldwani)			In Progress	Focuses on sectoral contribution to and potential for the growth of the economy
10	Regional Disparities: Trends and Issues	Dr Manoj Pant, (Deputy Director, Economics and Statistics, Planning) Mr S N Tripathi, Mr L N Pant (Budget Officer, Finance) Mr Pankaj Kumar (Lecturer(Ecso), Higher Education)		Dec. 2007	Preliminary draft ready	Focuses on the trends in regional disparities in Uttaranchal and possible remedial measures
11	Management of Pension Liabilities	Mr Surendra Singh Rawat (Add. Secretary, Personnel) Mr R C Sharma (Joint Secretary, Finance) Dr Trilochan Tripathy (Faculty, ICFAI Business School)			In Progress	Focuses on a suitable design of contributory pension scheme for Uttaranchal
12	Tackling Unemployment in Uttaranchal	Mr P S Jangpangi (Rural Development) Dr Manoj Pant, (Deputy Director, Economics and Statistics, Planning) Mr Chatur Singh Tulera (Research Officer, Planning)		Dec. 2007	Preliminary draft ready	Aims at identifying levels of unemployment in Uttaranchal and suggesting means for mitigating unemployment
13	Analysis of Transfers to Local Bodies	Mr Amit Verma, (Research Officer, Finance Department) Mr Naveen Chandra Joshi (Assistant Commissioner, Trade Tax), Mr R P Pasbola (Financial Controller, PWD)			In Progress	Focuses on the extent of decentralization of functions and criteria for revenue transfers to local bodies
14	Forecasting Nontax Revenue of Uttaranchal	Mr. Amit Varma (Research Officer, Finance Department) Mr. L N Pant, (Budget Officer, Finance Department) Mr. R C Sharma, (Dy. Secretary, Finance Department)			In Progress	Focuses on forecasting nontax revenue of Uttaranchal by broad categories
15	Analysis of Subsidies in Sugar Sector	Mr. Vinod Sharma (Add. Secretary, Cane and Sugar Development) Mr. Devendra Paliwal (Under Secretary, Finance Department)			In Progress	Attempts to suggest measures for (i) minimizing the element of subsidy involved; and (ii) exercising control on use of molasses

Notes:
1. Studies on TARF were identified by the senior officials of GoU who participated in our six-day workshops on Tax Analysis and Revenue Forecasting.
2. Studies on macroeconomic issues were identified by the senior officials of GoU (including Mr L M Pant) who participated in our six-day workshop on Macroeconomic Analysis and Policy.

Annexure 10:
Uttarakhand Testimonial Letter

"I attended the two phases of Project Appraisal Training Program in January-February and April 2007, which was conducted by REFORM Project, USAID/India. I was interested in this program as it was related to my work in the State Planning Commission. It helped me a lot in appraising projects in a more objective way.

This training program was far superior to the existing training programs available on PA in India as it was application based.

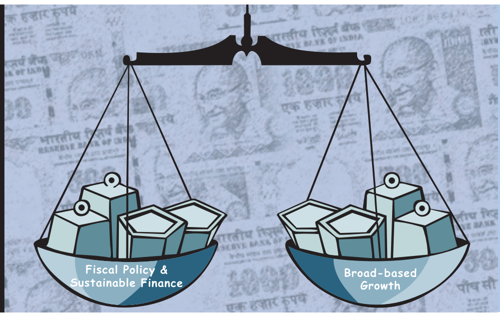
Before coming to Uttarakh and, I was doing EFC proposals in the State of UP. There I could not do economic analysis and was unable to adjudge the financial viability of the projects. In UP I, like many others in the PFA Division, just looked at the cost-estimates along with other methodologies developed regarding feasibility of a particular type of project.

After the aforesaid training, I did the economic analysis of 27 proposals for submission to NABARD and pertaining to Power and Roads were reviewed. Out of these projects, three projects were found to be economically unviable and these were rejected. In addition, another eight irrigation projects that were going to be submitted to the Expenditure Finance Committee were rejected as we found that they were economically unviable. Previously, these projects may have been funded and later failed.

Lastly, this training has provided us with an advanced decision making tools in financial risk analysis to assess the financial and economic viability of the project. Had this training been provided to me earlier, I could have used it in my previous posting in UP, where there is an established division for this purpose. This training will be of great help in UP also.

I do think that two weeks training on Project Appraisal is not sufficient in dealing with the projects that we receive for appraisal.

Devesh Kumar Sharma
Research Officer, State Planning Commission, Uttarakhand,



Section III

Annexures

Annexure 1:

Performance Indicator Status Report

Table A1.1: Performance Indicator No. 1 – Expenditure Planning and Management

Item	Description
End of Project Result to be achieved	Program Performance Budget (PPB) Introduced & Capacity Built in its Construction, Application and Reporting
Gaps to be addressed in current expenditure management	Current budget preparations focuses on expenditure controls, physical targets, short-term (one year) time horizon and fails to adequately insulate against discretionary decision-making
The tools, techniques and systems introduced will enhance state government capacity to:	• Implement budgets based on longer-term achievements of objectives/goals • Prioritize fund allocation based on greater quantitative and qualitative performance and not just on disbursement rates • Better budget monitoring thru greater interactions and ties between the budget making (finance) and budget requesting (e.g. health) departments • Improve transparency and accountability
Achievements of project results to date & current operational issues	State Government now has 670 trained officers in PPB; manuals to help develop PPB; Over 50% of budget covered by PPB in each state; FPAC needs to operationalize PPB analysis.

No.	Indicator: Steps Required to Achieve Desired Result	JH	KA	UA	Verification Document
1	REFORM PPB implementation proposal accepted by state gov't	1	1	1	REFORM Inception report
2	Staff to be trained identified by state gov't	1	1	1	Gov't Order with list of participants
3	Training of pilot departmental (dept) staff initiated	1	1	1	Training program design/ training material
4	Initial outcome and output indicators identified by pilot depts	1	1	1	Outcome/output indicators for pilot depts
5	PPB Training manual developed & submitted to state gov'ts	1	1	1	PPB training manual
6	Draft PPB prepared by pilot depts	1	1	1	Draft PPB pages for pilot depts
7	Institutionalization of PPB thru issuance of annual state budget circulars instructing depts to prepare PPBs, starting in FY 2006-07	1	0	1	Budget circular
8	At least 2 pilot departs in each state prepare PPB budget for 2006-07 and submit to Legislative Assembly (LA).	1	1	1	Minutes of the meeting of state gov't
9	PPB extended to additional state depts to ensure that at least 33% of the 2007-08 state expenditure is covered by PPB	1	1	1	Final departmental PPBs covering 33%+ of budgeted expenditure for 2007-08
10	PPB in use	1	1	1	FPAC conducted analysis using PPB doc
11	PPB extended to district level?	1	1	0	District-level PPB documents
	Out of a total score of 11, REFORM achieved "X"to date	**11**	**10**	**10**	**31/33 indicators met or 94% completion**

Table A1.2: Performance Indicator No. 2 – Revenue Management

Item	Description
End of Project Result to be achieved	Macroeconomic and Revenue Analysis Capacity Strengthened and Utilized
Gaps to be addressed in current expenditure management	Inaccurate forecasting of state's own revenue; incremental approach to set revenue targets and bargaining with departments; little capacity to simulate alternative policy scenarios.
The tools, techniques and systems introduced will enhance state government capacity to:	• Improve tax and non-tax forecasting; • Increase understanding of tax reform (VAT); • Improve cost recovery; • Utilize the state macroeconomic database and input-output table to build fiscal policy scenarios; and, • Institutionalize it new 'International Best Practice' revenue capacity through FPAC research and policy paper work.
Achievements of project results to date & current operational issues	• State Government now has 450 trained officers in tax analysis and revenue forecasting; manuals developed; Input-output table with supporting macro-economic database developed; Issues papers commissioned to FPAC. • Input-output table with supporting macro-economic database to be operationalized.

No.	Indicator: Steps Required to Achieve Desired Result	JH	KA	UA	Verification Document
1	REFORM macro-economic analysis and revenue forecasting tools and techniques proposal accepted by state governments.	1	1	1	REFORM Inception report
2	Staff to be trained identified by state governments.	1	1	1	Government Order with list of participants
3	Training of FPAC members and resource persons initiated.	1	1	1	Training program design/ training material
4	Macroeconomic database developed to help states analyze the implications of tax policy changes on state budgets.	1	1	1	Macro-economic Database
5	Training Manuals developed and submitted to state governments.	1	1	1	Training manual
6	Input-output Tables developed to help in revenue (VAT) analysis.	1	1	1	Input-output Table
7	Forecasting models in use.	1	1	0	Issues Papers
8	Input-output tables in use.	0	0	0	Issues Papers
9	Macro-economic Database in use.	0	0	0	Issues Papers
10	FPAC Conducting tax analysis and revenue forecasting studies.	1	1	0	Issues Papers/Policy Decisions
	Out of a total score of 10, REFORM achieved "X"to date	**8**	**8**	**6**	**22/24 indicators met or 91% completion**

Table A1.3: Performance Indicator No. 3 – Project Appraisal

Item	Description
End of Project Result to be achieved	Project Appraisal Capacity Improved and Utilized
Gaps to be addressed in current expenditure management	Projects selected based on financials; poor capital programming and budgeting techniques affect returns on public investments.
The tools, techniques and systems introduced will enhance state government capacity to:	• Develop a cadre of officials versed in modern project appraisal techniques; • Introduce "international best practice" Project Appraisal manual; • Institutionalize project appraisal, monitoring, and evaluation activities through Project Units (PUs) in all partner states; • Codify project appraisal protocol through either Executive Order or state legislation requiring a formal project appraisal, monitoring, and evaluation process for projects above a certain fund level; • Develop sectoral tie-ins with technical departments (e.g ,Water, Health, Education); and, • Develop a Centre of Excellence in a non-REFORM state using a PPP approach.
Achievements of project results to date & current operational issues	• State Government now has 255 trained officers in PA; manuals to help develop PA; Risk management software Crystal Ball provided.; Government Order issued (GOU), in-process (GOJ and GOK); Project Unit establishment in-process (GOJ).; • Project Unit decision and ownership pending (GOK and GOU)

No.	Indicator: Steps Required to Achieve Desired Result	JH	KA	UA	Verification Document
1	REFORM Project Appraisal techniques/proposal accepted by state governments.	1	1	1	REFORM Inception report
2	Staff to be trained identified by accepted by state governments.	1	1	1	Government Order with list of participants
3	Project Appraisal Training Completed.	1	1	1	Training program design/ training material
4	Sector-specific Feasibility Report template developed to help states make good project selection.	1	1	1	Sector-specific Feasibility Report template.
5	PA Training Manuals developed and accepted by states.	1	1	1	PA training manual
6	Capital Budgeting and Project Prioritisation training completed.	1	1	1	Training program design/ training material
7	State government notification to institutionalize use of methodology/Manual for high-value capital projects.	0	0	1	Government notifications.
8	Establishment of a project unit (PU) in each state.	0	0	0	Government order.
9	Project Appraisal methodology introduced is in use.	0	0	1	Project selection minutes.
	Out of a total score of 9, REFORM achieved "X"to date	**6**	**6**	**8**	**20/24 indicators met or 83% completion**

Table A1.4: Performance Indicator No. 4 – Debt and Investment Management

Item	Description
End of Project Result to be achieved	Debt and Investment Management Cell Established and Functional
Gaps to be addressed in current expenditure management	Absence of debt/contingent liability/investment documenting, tracking, simulating, reporting structure; focus on short-term analysis; poor awareness and capacity to improve state creditworthiness.
The tools, techniques and systems introduced will enhance state government capacity to:	• Establish specialized, full-time, dedicated DIMCs; • Staff-up with trained, competent analysts; • Develop and maintain up-to-date data sets through 'International Best Practice' reporting structures; • Introduce appropriate software; • Migrate state debt, investment and contingent liability datasets to Oracle-based databases; and, • Develop a User's Guide to help improve state creditworthiness and access to financial markets.
Achievements of project results to date & current operational issues	• State Government now has 73 trained officers in debt and investment; manuals on debt, contingent liabilities/guarantees, investment, and guidelines on creditworthiness; CS-DRMS software provided; Issues papers on debt in process (GOJ); DIMC incorporated into FPAC (GOJ and GOK) • DIMC formation in process (GOU)

No.	Indicator: Steps Required to Achieve Desired Result	JH	KA	UA	Verification Document
1	Proposal to establish DIMC accepted by state governments.	1	1	1	REFORM Inception report
2	Job description of key personnel submitted.	1	1	1	REFORM Inception report
3	State governments issue notification establishing and funding DIMC.	1	1	1	Government notification
4	Training of DIMC officials initiated.	1	1	1	Training program design/ training material
5	Debt datasets developed on EXCEL.	1	1	1	Debt datasets
6	Manuals on Debt, Contingent Liabilities & Investments submitted.	1	1	1	Manuals
7	Debt software of the Commonwealth Secretariat (CS-DRMS) presented to and accepted by 3 states	1	1	1	CS-DRMS Software
8	State Creditworthiness and Debt Issuance Toolkit developed and accepted to enable states to access financial markets on their own	1	1	1	Toolkit
9	Reporting Templates developed to help state governments to track, review, monitor and report on the debt and investment position	1	1	1	Reporting Templates
10	CS-DRMS in use? (Impact?)	1	0	0	DIMC Studies and reports
	Out of a total score of 10, REFORM achieved "X"to date	**10**	**9**	**9**	**28/30 indicators met or 93% completion**

Annexure 2:

Knowledge, Attitudes, Practices, and Impact (KAPI) Report

Table 2A.1: Knowledge Transfers to Reform Partner States (By Fiscal Sector)

Fiscal Sector	Jharkhand	Karnataka	Uttarakhand	Government]of India
Expenditure Planning and Management	• More than 300 GOJ officials trained at all levels in PPB. • A core group of 6 trainers and mentors developed; A total of 39 out of the 42 GOJ ministerial departments have PPB task forces. • PPB Implementation Guide developed and accepted by GOJ. • S/W database developed and presented to GOJ for converting general budget data into program/ scheme data.	• More than 220 GOK officials trained at all secretariat and district levels in PPB. • A total of 8 out of 28 departments have PPB task forces. • Training of 35 GOK officials on public procurement management issues. • *PPB Implementation Guide* developed for use by *Fiscal Policy Institute.* • Procurement guidelines developed for 'Social Welfare Department', 'Bengaluru Mhanagara Palike' and 'Gulbarga Electricity Supply Company'.	• More than 150 GOU officials trained at all levels in PPB. • A core group of 6 trainers and mentors developed; a total of 17 out of 27 GOU departments have PPB task forces. • Sensitization of 85 GOU officials on the *UA Procurement Rules.* • *PPB Implementation Guide* and *Procurement Guide* developed and accepted by GOU. • S/W database developed and presented to GOU for converting general budget data into program/ scheme data.	Training courses in PPB for: IAS trainees at LBS-NAA; CAG officers at NAAA; and 30 ATI trainers from 12 states at RBI College of Agriculture-Pune.
Revenue Management	• More than 200 GOJ officers trained in various tax and revenue management topics. • *A Revenue Management Guide* has been developed for use by the GOJ. • Input-Output Table and a supporting macro-economic database has been developed and presented to the GOJ.	• More than 250 GOK officers trained in various tax and revenue management topics. • A *Revenue Management Guide* has been developed for use by the GOK. • Input-Output Table and a supporting macro-economic database has been developed and presented to the GOK.	• More than 200 GOU officers trained in various tax and revenue management topics. • A *Revenue Management Guide* has been developed for use by the GOU. • Input-Output Table and a supporting macro-economic database has been developed and presented to the GOU.	
Debt and Investment Management	• Implementation of the CS-DRMS software. • Debt and investment reporting and tracking templates developed and presented. • Six officers have been trained to serve as trainers and mentors. • A *Debt Toolkit* and other manuals accepted for use. • More than 70 officers trained in project appraisal. • A core group of 10 officers available as trainers/mentors.	• Implementation of the *CS-DRMS* software; • Debt and investment reporting and tracking templates developed and presented. • Six officers have been trained to serve as trainers and mentors. • A *Debt Toolkit* and other manuals accepted for use. • More than 100 officers trained in project appraisal. • A core group of 25 officers available as trainers/mentors.	• Implementation of the CS-DRMS software; • Debt and investment reporting and tracking templates developed and presented. • Six officers have been trained to serve as trainers and mentors. • A *Debt Toolkit* and other manuals accepted for use. • More than 85 (60 secretariat and 25 district) officers have been trained in project appraisal techniques. • A core group of 18 officers available as trainers/mentors.	
Project Appraisal	• More than 70 officers trained in Crystal Ball software. • A *Project Appraisal Manual* with sector-specific guidelines is being provided for GOJ reference and training. • TOR for a project formulation and appraisal division (PFAD) submitted.	• More than 100 officers trained in *Crystal Ball* software. • A *Project Appraisal Manual* with sector-specific guidelines is being provided for GOK reference and training at FPI. • TOR for a project formulation and appraisal division (PFAD) submitted.	• More than 60 officers trained in *Crystal Ball* software. • A *Project Appraisal Manual* with sector-specific guidelines is being provided for GOU reference and training at UAA. • TOR for a project formulation and appraisal division (PFAD) submitted.	Training courses in PA for: IAS trainees at LBS-NAA; and, CAG officers at NAAA.
Institutionalization	Training of FPAC resource persons in how to conduct good analysis.	Training of FPAC resource persons in how to conduct good analysis.	Training of FPAC resource persons in how to conduct good analysis.	

Table 2A.2: Attitudinal Change in Reform Partner States (By Fiscal Sector)

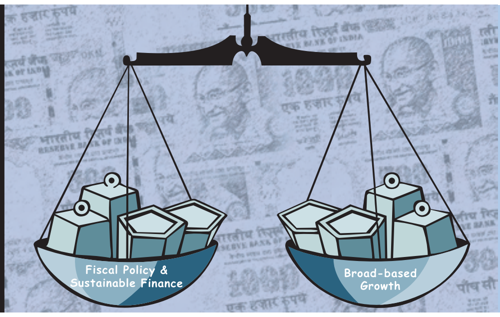
Fiscal Sector	Jharkhand	Karnataka	Uttarakhand	Government of India
Expenditure Planning and Management	• PPB methodology institutionalized through issuance of 3 annual budget circulars. • PPB methodology is being extended to all 24 state district health resource centers.	• State Legislature Estimates Committee decided on January 10, 2007 that PPB documents should be extended through-out the government - final legislation is awaited. • PPB implementation for district Education, Health and Family Welfare, And Women and Child development officers in Bijapur, Gulbarga, Mysore, and Udupi districts.	• Uttarakhand Public Procurement Rules approved by the cabinet and published in the state government May 2008 Gazette. • PPB methodology institutionalized through issuance of 3 annual budget circulars.	The *Institute of Chartered Accountants of India (ICAI) High Level Committee on Outcome Budget Report* to the Minister of Finance recommended the Uttarakhand PPB experience.
Revenue Management	• Structured analysis of revenue management issues is being commissioned. • Public acceptance of VAT and its subsequent introduction facilitate by awareness-raising seminars.	Structured analysis of revenue management issues is being commissioned.	Public acceptance of VAT and its subsequent introduction facilitate by awareness-raising seminars.	
Debt and Investment Management	• Acceptance of the need for structured analysis, comprehensive database, reporting structures for improved debt/contingent liabilities management to facilitate timely tracking. • Responding to worsening revenue deficit, the GOJ is considering shifting its short-term investments to fixed-deposit bonds marketed by *HDFC Bank* to increase its annual yield to INR 57 crores from the current INR 5 crores.	• Creation of a *Department of Investment Tracking and Monitoring* to better its state investment portfolio. • Acceptance of the need for structured analysis, comprehensive database, reporting structures for improved debt/contingent liabilities management to facilitate timely tracking.	Acceptance of the need for structured analysis, comprehensive database, reporting structures for improved debt/contingent liabilities management to facilitate timely tracking.	
Project Appraisal	Acceptance of need for a structured analysis of major capital projects has led to GOJ considering establishment of an Empowered Committee (EC) chaired by Chief Secretary/ Development Commissioner to review and approve project proposals before submission to the state cabinet.	GOK considering issuance of a GO to mandate a structured project appraisal process all capital projects costing more than INR 100 million in infrastructure and INR 20 million in social sector projects, starting with fiscal year 2009-10.	Acceptance of need for a structured analysis of major capital projects has resulted in a GOU June 2007 budget order mandating use of project appraisal process for all projects more than Indian rupees (INR) 50 million.	
Institutionalization	• A 16-member FPAC/DIMC established with supporting staff, budget, facility and web site. • High Power Committee established with Development Commissioner as Chair along with Finance and Planning secretaries to review FPAC policy papers. • SKIPA has allocated its own budget funds to conduct courses in PPB and project appraisal techniques as part of its annual training programme.	• A fully-dedicated 8-member FPAC/ DIMC established with supporting staff, budget and facility. • Fiscal Policy Institute (FPI) established in January 2007 to serve as GOK fiscal reform nodal agency, research and training to start in 2009.		

Table 2A.3: Practices Introduced By Reform Partner States (By Fiscal Sector)

Fiscal Sector	Jharkhand	Karnataka	Uttarakhand	Government of India
Expenditure Planning and Management	• More than 95% of the state budget covered by PPB documents. • GOJ is using the *PPB Implementation Guide* as a training tool at the SKIPA and SIRD.	• More than 50% of the state budget covered by PPB documents. • PPB documents developed for the Education, Health and Family Welfare, and Women and Child Development officers in Bijapur, Gulbarga, Mysore, and Udupi districts. • GOK is using the *PPB Implementation Guide* as a reference.	• Submission of 4 departmental PPB documents to the state legislature for 2008-09 budget sessions. • More than 60% of the state budget covered by PPB documents. • PPB methodology institutionalized through issuance of 3 annual budget circulars. • GOU is using the PPB *Implementation Guide* as a reference.	
Revenue Management	Structured analysis of revenue management issues are being undertaken by the Centre for Fiscal Studies.	FPAC studies being used in revenue policy formulation as announced in budget speeches.	GOU-REFORM joint completion of 8 tax policy issue papers.	
Debt and Investment Management	Consolidation of the GOJ public debt data into one dataset and migration to the *CS-DRMS* database for GOJ DIMC/ FPAC use.	• *Department of Investment Tracking and Monitoring* is actively managing its state investment portfolio. • DIMC personnel are using the *CS-DRMS* software for debt and guarantees reporting.	Consolidation of the GOU public debt data into one dataset and migration to the CS-DRMS database and use by DIMC personnel for debt and guarantees reporting.	
Project Appraisal	GOJ is using the *Project Appraisal Manual and Guidelines* as training tools at the SKIPA and SIRD.		Based on 2007 GOU GO, 35 projects were appraised of which 11 were rejected for being financially unviable. Specifically 27 project proposals were appraised, 24 revised, and 3 rejected before submission to the *National Bank for Agriculture And Rural Development (NABARD)*; and, 8 irrigation proposals were rejected before submission to the GOU Expenditure Finance Committee (EFC).	
Institutionalization	• FPAC has completed 7 out 15 studies and 5 have been published in a compendium for circulation throughout the state government. • SKIPA PPB and project appraisal courses are being led by GOJ officials trained by REFORM. • GOJ publishing an annual state "Economic Survey Report" on the state government website.	To date, 9 of 11 commissioned studies have been completed by the FPAC.		

Table 2A.4: Impacts Experienced by Reform Partner States (By Fiscal Sector)

Fiscal Sector	Jharkhand	Karnataka	Uttarakhand	Government of India
Expenditure Planning and Management	The Water Resources Department has used the PPB methodology to: complete long-delayed and cost-overrun irrigation projects; discover inefficiencies, (e.g., spending almost 10 times more on Irrigation Revenue Directorate salary than actual water charges). GOJ now considering closure of directorate and transferring its responsibilities to the Water Users Association.		• GOU state legislature has approved the PPB documents for 4 departments in the 2008-09 budget sessions.	
Revenue Management	• An FPAC study on the GOJ Excise Tax Policy uncovered an estimated loss of more than INR 80 crores in the first two years of the policy due to poor implementation. This led to the formation of a High Level Committee under Chair of Member Board of Revenue for further review. • VAT training contributed to the GOJ increasing its own tax revenues from 4.99% of GSDP (INR 1986.22 crores) in 2003-04 to 8.03% of GSDP (INR 5535.65 crores) in 2008-09 BE.			
Debt and Investment Management		*Department of Investment Tracking and Monitoring* is using a comprehensive public investment database and has helped the GOK to raise more than INR 124 crores as dividend and guarantee commission.		
Project Appraisal		The company Secretary and General Manager (F&A) of the *Rajiv Gandhi Rural Housing Corporation Ltd* was able to put the financial analysis to the advantage of the company, saving INR 18,28,882 (INR 1.8 million) for the quarter ending March 2005.	• Since November 2007, the GOU has saved about INR 5 crores through use of the REFORM project appraisal process: 3 of 27 NABARD projects along with 8 irrigation projects were rejected for being economically unviable before submission to the state EFC. • *Uttarakhand Transportation Corporation* use of risk analysis software to purchase new bus fleet using debt financing facility.	
Institutionalization	Establishment of the *Centre for Fiscal Studies* and the FPAC to lead fiscal policy initiatives and research.	• Creation of *Fiscal Policy Institute* as a result of the catalytical effect of the REFORM Project. • *Department of Investment Tracking and Monitoring* established due to recommendations of REFORM Project.		Establishment of a fiscal management virtual resource centre "Fiscal Watch" by REFORM Project.



Annexure 3

Competency Development (Training) Report

September 2008

List of Abbreviations

DIMC	Debt and Investment Management Cell
FPAC	Fiscal Planning and Analysis Cell
GO	Government Order
GoI	Government of India
INR	Indian Rupees
MoF	Ministry of Finance
MS	Microsoft
PPB	Program and Performance Budgeting
REFORM	India State Fiscal Management Reform Project
TA	Technical Assistance
USAID	United States Agency for International Development
VAT	Value Added Tax

Author:
Robert Voetsch, BearingPoint

Part 1: Background

The focus of this paper is to examine the fiscal management competency development dimension of United States Agency for International Development (USAID) India State Fiscal Management Reform Project (REFORM) with specific reference to: its implementation approach; its discrete achievements; the lessons learned that can benefit similar projects in the future; and, finally, the immediate next steps that its partner states need to pursue in order to maintain and progress the new competencies provided to them by REFORM.

The first and most critical step of any competency development must be the training of the targeted population. Training alone cannot achieve the end purpose in of itself as there are a number of other factors that contribute to overall competency development. These factors include: official mandates, information systems, management processes, support personnel and other organizational infrastructure. However, without the initial skill-set development of the targeted population, none of these additional factors will provide the desired operational results.

REFORM: Skill Enhancement Achievements

In the knowledge transfer capacity-building dimension, REFORM succeeded in providing its partner states with:

- More than 670 state government officials (300 in Jharkhand, 220 in Karnataka and 150 in Uttarakhand) at different levels (from secretaries to undersecretaries) now have the expertise to not only develop but also to help mentor the preparation of PPB documents throughout the state government. These officials were trained in 83 structured workshops and over 100 informal mentoring sessions.
- A pool of 20 officials (six in Jharkhand, eight in Karnataka and six in Uttarakhand) are serving as PPB mentors, resource persons, and trainers.
- More than 650 officers (200 in Jharkhand, 250 in Karnataka and 200 in Uttarakhand) have skills in VAT administration, revenue forecasting, macroeconomic policy issues, use of the input-output table and macroeconomic database, tax policy formulation, and in how to use Microsoft (MS) Excel to improve their tax policy analysis and revenue forecasting skills, especially as regards revenue and expenditure trend analysis and reporting. These officials were trained in 33 TARF workshops and 13 macroeconomic workshops.
- More than 255 government officials (70 in Jharkhand, 100 in Karnataka and 85 in Uttarakhand) at different levels (from secretaries to assistants) who have now been trained in the project appraisal methodology and use of the risk management software (e.g., Crystal Ball) to improve their appraisal, and of project proposals along with their reporting on the status of ongoing projects. These officials were trained in 42 formal workshops.
- A pool of 53 officials (10 in Jharkhand, 25 in Karnataka and 18 in Uttarakhand) to serve as mentors, resource persons, and who will extend the project appraisal methodology to the district and city government levels or teach at the state civil servant training institutes such as the SKIPA, SIRD.
- A total of 73 government officials (six in Jharkhand, 57 in Karnataka and 10 in Uttarakhand) who can serve as trainers and mentors throughout the state government on issues ranging from debt, contingent liabilities/ guarantees, investment and state creditworthiness practices as well as use of the CS-DRMS software to generate regular reports and monitor state debt sustainability. These officials were trained in 12 formal workshops.
- Training for 35 GoK and 85 GoU officials on public procurement management issues. These officials were trained in three formal workshops.

Therefore, one of the first steps of the REFORM Project was the joint development of comprehensive competency development programs with each partner state government as well as the strengthening of the state civil service training institutions.

As a demand-driven project, the specific technical competencies transferred to each partner state varied depending on the fiscal management priorities and initial conditions of each state. As an overview, the prioritization of the training efforts for each state are as follows:

- In Jharkhand, the state government articulated an urgent interest in preparing the state revenue department personnel, along with concerned citizens' groups such as labor unions and merchants, on the key issues related to value added tax introduction in the state. In parallel, the Government of Jharkhand (GoJ) required assistance in developing its Fiscal Policy and Analysis Cell (FPAC) so that it could undertake meaningful scientific research on important fiscal issues. Later, the GoJ displayed a keen interest in the development of Program and Performance Budgeting (PPB) task forces in its ministerial departments. Thus, the competency development program shifted over the course of the REFORM project period from Revenue Management to Expenditure Planning and Management skill transferal.
- In Karnataka, the state government was more interested in developing the expenditure planning and management skills of its highest budgeted departments such as Education and Health. To meet this Government of Karnataka (GoK) request, REFORM launched a focused program to improve the PPB skills of the concerned departmental budget officers. At the same time, the GoK established an FPAC with the aim of improving the revenue forecasting skills of its revenue officials. REFORM imparted training in various quantitative areas to meet this request.
- Lastly, in Uttarakhand, the state government expressed an interest in both VAT preparation for its revenue officers as well as skills in modern procurement management and project appraisal. Later, REFORM competency development focused on PPB in response to a Government of Uttarakhand (GoU) request.

In all of its partner state competency development activities, REFORM trained departmental secretaries and their immediate deputies in a concerted top-down, bottom-up effort. This dualistic approach ensured political buy-in and state ownership, while ensuring creation of practitioners to apply the new skills on a daily basis. Finally, in most of the intervention areas, REFORM ensured that training was imparted to state government officials across state departments and from senior to junior functional levels. In all three partner states, the competency development effort was extended to selected district-level personnel.

Part 2: Implementation Phases

The REFORM strategy for implementing its competency development programs is described below. As discussed below, priority was placed on identifying trainees who would be able to immediately apply the skills imparted. Training sessions emphasized a practical, hands-on approach using either the case study or live exercise methodology. This meant maintaining as low a trainer-trainee ratio as possible. Finally, attention was paid to cultivate a peerage relationship between the trainers and trainees in order to facilitate the long-term interaction required to institutionalize the new fiscal management techniques and develop trainees who could assume the role of trainer/change agent in their respective offices.

Actual implementation of the REFORM fiscal management competency development program can be divided into three overlapping, yet distinct, phases:

- Awareness-building
- Skill(s) transferal
- Trainer/mentor development

A more detailed description of these implementation phases follows:

Awareness-building

There were two dimensions to the awareness-building activities of the REFORM Project:

- Sensitization Seminars
- Orientation Workshops

Sensitization Seminars were provided for key government decision makers and administrators (*e.g.*, department secretaries) to report on the outcome of the preliminary discussions and present the fiscal management competency development plan and schedule and inform the officers of what was required from them to make the program successful. These seminars were organized for all priority project interventions such as FPAC development, expenditure planning (PPB), revenue forecasting, input-output table/macroeconomic database usage, public procurement, project appraisal, and debt and investment management. In most cases, international experts delivered the seminar sessions. However, in a few cases, the sessions were delivered by a combined state team lead advisor-technical expert delivery. For example, in the input-output table/macroeconomic database usage seminars, the REFORM team advisors explained the rationale for the tools and the technical consultants discussed the actual use of the tools. In the debt and investment seminars, a

The Awareness-building activities of REFORM actually began when the project Assessment Report was being prepared in early 2004. During this time, REFORM experts visited each partner state, interviewed government officials on their perceived needs and prepared a detailed operational plan for project capacity-building. The approach was demand-driven in so far as partner government articulated their fiscal reform priorities and REFORM, in turn, incorporated these into the project Inception Report. Thus, specific REFORM awareness-building activities consisted of:

- Interviews and discussions with government officials;
- Presentations on the fiscal reform scope, goals and objectives of REFORM;
- Presentations on the specific international best practices that would be made available to partner governments, especially in the areas of Expenditure Planning and Analysis, Debt Management, Public Procurement, and Project Appraisal;
- Providing the blueprint for establishing an FPAC, which included detailed description of the expertise required and possible mandate; and
- Seminars (with some practical training) on program and performance budgeting, public procurement, use of a macroeconomic database and input-output table, and issues on debt management and project appraisal.

combined team of international and national experts delivered a series of talks on key debt, investment, and state creditworthiness issues.

The second and final stage of awareness-building was the holding of *Orientation Workshops* for trainees. As mentioned above, this phase represented the transition activity from awareness-building to actual skill transferal. In these orientation training workshops, trainees were identified by their state governments on the basis of their ability to immediately apply the new tools, techniques, and technologies being introduced to demonstrate the benefits from the new fiscal methodologies. These training workshops consisted of one to two formal classroom lectures accompanied by some high-level problem-solving exercises.

Skills Transferal

The second phase of the REFORM fiscal management competency development program concerned the transfer of actual skills in fiscal management. These skills were either the use of specific tools (*e.g.*, PPB budgeting forms, project appraisal analytical methods, revenue forecasting models) or the acquisition of new software application knowledge such as the *CS-DRMS* for debt management, *Microsoft (MS) Excel* for revenue forecasting, or the *Crystal Ball* risk analysis software for project appraisal.

There were three dimensions to the skills transferal activities of the REFORM Project:

- Training Workshops
- Case study and live-time Exercises
- Trainee Mentoring

In the *Training Workshops* stage, REFORM introduced and tutored trainees in the application of new fiscal management tools. The trainees were identified by their departments on the basis of their ability to immediately apply the new tools, techniques, and technologies being

The skills transferal activities of REFORM overlapped with the awareness-building phase in the form of the seminars (with some practical training) on program and performance budgeting, public procurement, use of a macroeconomic database and input-output table, and issues on debt management and project appraisal. In addition to these activities, the REFORM skill transferal program included the following:

- Identification and induction of part-time resource persons in the FPAC along with full-time GoJ officials.
- Working with FPAC researchers in Jharkhand and Karnataka to provide the analytical framework needed to begin the required analyses.
- Conducting training courses and mentoring sessions for partner state government officials in the following fiscal reform areas: tax policy analysis, revenue forecasting, program and performance budgeting, debt and investment management, public procurement, project appraisal, and performance indicator development.
- Developing and submitting to each partner state government a rudimentary input-output table with supporting macroeconomic database and a socioeconomic database to use when preparing PPB documents.
- Preparing and submitting to each partner state government the following desktop reference guides: *Fiscal Planning and Policy Analysis Cell Implementation Guide, Program and Performance Budgeting Implementation Guide, Revenue Management Guide, Debt Toolkit, Manual, Effective Monitoring of Guarantees and Contingent Liabilities—A General Review and Instruction Manual, and State Creditworthiness and Debt Issuance Reference Manual,* Public Procurement templates, *Project Appraisal Manual and Guidelines.*

introduced. The training workshops consisted of formal classroom lectures, problem-solving exercises, use of case studies to identify issues and apply tools and techniques. Further, during these workshops, actual ongoing state government projects and work assignments were given to the trainees to complete using the new tools and techniques.

The critical element of these workshops was this immediate application of new tools by the trainees during the course of the workshop. Once the formal training workshop was completed, the trainees were asked to produce discrete deliverables (*e.g.*, PPB documents, revenue forecasts, project appraisal analyses, or migration of debt data) within a predetermined time period.

The *Case study and live-time Exercises* stage comprised a major and critical part of the skill transferal workshops conducted in all project interventions but, especially in the program and performance budgeting and project appraisal workshops. In these workshops, participants were required to apply theoretical concepts and formulas to produce actual documents required of them in their daily work. For example, in the PPB workshops, *the departmental PPB task forces were required to prepare a PPB document for their department including the actual narrative pages, program summary and subprogram summary pages and to populate these sectors with actual information and data from their current budget documents.* The result at the end of the workshops was the classroom presentation of the draft PPB document and the fielding of comments and suggestions from the rest of the training class. This approach greatly facilitated the acquisition of the new budget planning tool (PPB) as it had to be applied to a real-life document needed by the trainees.

In the case of the project appraisal workshops, trainees were asked to bring in a real project proposal that was being considered for funding by their state government. This proposal was then subjected to the various economic, financial risks, and stakeholder analyses covered in classroom lectures. The result of this practical and immediate application of theoretical knowledge was the preparation of comprehensive analyses on the viability of an actual project proposal. *This, in turn, led to the proposal being ready for submission to senior departmental officers for final review.*

In the case of tax policy analysis training, actual case studies of taxation policy issues, application, and administration were reviewed, analyzed, and discussed. These training sessions took place over an extended period of time (one to two weeks) for a few hours a day. Trainees were asked to perform homework analysis before the next session. At that session, a review and critique

As mentioned above, the trainer/mentor development activities of REFORM reflect both the Attitudes change and Practices introduced dimensions of the KAP construct. These were reflected in the following key government activities that were either recommended by REFORM or supported by REFORM:

- Conducting a series of public seminars on VAT in Jharkhand and Uttarakhand to allay the concerns of the public, labor unions, merchants, and revenue officials.
- Introducing REFORM advised training programs in the Jharkhand civil service training institution curricula to upgrade capacity of FPAC staff on a continuous basis.

took place. Over time, the trainees learned to carefully and systematically think through the practical application and administration of new tax policies or the modification of existing policies. *The aim was to ensure that new tax circulars of legislation would be well-written to accommodate the many practical dimensions and enforcement issues involved.*

Finally, the last stage of actual skill transferal consisted of *trainee mentoring*. During trainee mentoring, trainee shadowing and reverse-shadowing served as the modality for skill transferal. As mentioned above, the shadowing and reverse-shadowing (as described below) actually began during the skill transferal (workshop) phase of the project as described above. However, there was rarely enough formal classroom time available to properly and fully complete the process. As a result, formal and informal mentoring sessions were held under REFORM supervision for the PPB and project appraisal trainees. These sessions were usually held in REFORM offices to minimize disruptions due to daily work. However, on occasion the mentoring was provided on-site (*i.e.*, in the trainee offices) to minimize the inconvenience to the concerned government officers.

There were two phases to trainee mentoring: shadowing and reverse-shadowing. During the shadowing phase, trainees observed the use of the reform tool or technique in a classroom setting. Then, during the reverse-shadowing phase, the trainee(s) performed the work under the supervision and guidance of the trainer. These approaches were used for the PPB and project appraisal work as described above. They were also employed in the revenue forecasting, tax policy analysis, and debt software training and mentoring sessions.

In summary, the skills transferal methodology employed by REFORM was efficient in that real departmental work was being completed during training time and, more importantly, the trainees were able to immediately apply new concepts and tools under the supervision of their trainers. In the process, ensuring completion of important quality documents in a time-efficient manner.

Trainer/Mentor Development

The third and final stage of the REFORM fiscal management competency development program concerned *trainer-mentor development* for each of the newly introduced fiscal management tools. The objective was to ensure that the specific tools (*e.g.*, PPB budgeting forms, project appraisal analytical methods, revenue forecasting models) would be properly used by departmental personnel under the oversight of the mentor. In addition, these REFORM-trained mentors would be available for delivery of structured trainings in the tool or technique at the state civil service training institute as adjunct trainers and faculty.

There were two dimensions to the trainer/mentor development activities of the REFORM Project:

- Skill Routinization
- Trainee development as trainers/mentors

The function of *Skill Routinization* stage is to enable and habituate daily use of the newly acquired skills. The trainers/mentors play a critical role in this process as they are responsible for ensuring their colleagues consistently and properly apply the new practices on the job. For example, the leads in the PPB task forces and the project appraisal teams were asked to guide their colleagues in the completion of the required deliverable (*e.g.*, PPB document, project appraisal report).

Trainee development as trainers/mentors

Trainers were identified on the basis of a combination of the following factors: their official position, their personal interest and their performance in the training programs. Although REFORM did not implement any formal training-of-trainers sessions, informal sessions (*i.e.*, mentoring sessions supervised by REFORM technical experts) took place regularly.

Further, some of the trainees were asked to deliver classroom lectures or tutorials in state civil service training institutes. For example, on the use of fiscal methodologies such as PPB document development or software applications such as *Crystal Ball* or the *CS-DRMS* software. However, only in Jharkhand did this occur for that was the only REFORM state that was able to incorporate REFORM training courses into its annual training calendars and curricula.

Part 3: Impact Analysis

The following analysis examines some key dichotomies the REFORM project faced during its five year competency development program:

- Internal *versus* external-driven training;
- Institution-building *versus* individual development; and
- Time-bound *versus laissez-faire* knowledge transfers.

Internal *versus* external driven training

Although the work priorities of each REFORM partner state were articulated by them during the project assessment phase, changes in the incumbency of government officials often meant that earlier requests for technical assistance (TA) were no longer operative.

For example, in one partner state, the initial request for a robust and widely covered PPB implementation approach, led by international experts, was replaced with one which only focused on two departments. As a result, there was significant implementation of PPB at the state level.

The reverse situation occurred in another partner state where initial attempts to implement PPB training were postponed as low priority. However, with a change in administration, a robust and vigorous PPB implementation was launched taking the state to cover nearly 100 percent of its budget with the PPB methodology by the end of the REFORM project.

Therefore, the REFORM experience demonstrates the criticality of upfront government buy-in for fiscal reform activities.

Institution-building *versus* individual development

In hindsight, the REFORM project experience clearly indicates the importance of identifying officials from institutions responsible for implementing new fiscal practices as against merely selecting the requisite number of officials needed to fulfill the training output requirement.

For instance, the first project appraisal training cohort was more a collection of government officers from diverse departments than from the relevant practicing institutions. As a result, there was much attrition in the first project appraisal cohort and the impact of that fiscal management competency development effort was minimal. Unfortunately, this resulted in the inability to develop the sector-specific project appraisal guidelines since the appropriate officers had not been involved in the training activity.

Therefore, the REFORM experience demonstrates the criticality of developing institutions as opposed to just individuals.

Time-bound *versus Laissez-faire* knowledge transfers

REFORM needed to translate the skill transferal to actual practice in the shortest period of time, both to demonstrate the usefulness of the new skills to partner governments as well as to assess the impact of the new techniques on fiscal management results.

Another critical lesson learned is to ensure definitive time-bound completion of competency development efforts. For example, in the absence of such an approach, there is the danger of failing to complete the desired level of training outputs as occurred in the tax policy training efforts in one partner state. In this example, *laissez-faire* approach resulted in the completion of approximately 50 percent of the case studies that were meant to be completed.

Learning from the above experience, the project required a one-to-one link between training program completion with the delivery of actual state government work deliverables within a specified time frame. For instance, all the PPB task forces were required by finance department circulars to produce a PPB document for the next fiscal year beginning on 1 April. Thus, there was a clear and unmovable date that served as the parameter for completion of the training course— *i.e.*, delivery of the course output—a PPB document.

Therefore, the REFORM experience demonstrates that when training courses and their deliverables are linked to work and that work has a definite time frame for completion, the competency development effort will be successful and useful.

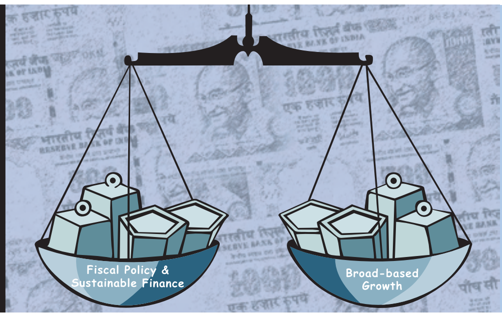
Part 4: Conclusion

In conclusion, REFORM was tasked with introducing international best practice tools and techniques to promote informed fiscal decision-making. In this respect, the project succeeded in introducing and transferring new fiscal management competencies to all of its partner state governments.

Firstly, establishment of a robust FPAC with both dedicated and part-time resource officers in Jharkhand and dedicated officers in Karnataka that are able to prepare fiscal research papers to support the fiscal decision makers of the state.

Secondly, coverage of more than 50 percent of each partner state budget with the PPB methodology along with a formal commitment by each state government to extend this expenditure planning and management methodology to all their districts that will, in time, lead to better expenditure quality and public service delivery in the state. (This has already started in Jharkhand and Karnataka.)

Finally, the REFORM experience in state fiscal management competency development serves as a baseline example of how such programs can be implemented and, more importantly, can reasonably-expect to achieve results within a 60-month (five year) time frame. In the process, the lessons learned from the REFORM experience (such as approaches, resistance encountered and its management, achievements, and institutionalization) are relevant guides for similar projects to strengthen their competency development efforts. In the end, competency development—regardless of the sector in which it is attempted—is a long-term process with many inherent challenges and conflicts. However, these various obstacles can be overcome and, when they are, the result is greater momentum and traction in the pursuit of better equipped public officials who are able to practice informed decision-making for the betterment of their citizens.



Annexure 4

About the Center for Fiscal Policy (Moscow, Russia)

September 2008

Author:
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Editor's Note

This paper was part of the USAID/India REFORM Project, prepared in 2005. The objective was to provide information on how other federally-structured countries have established FPAC-like structures (in this case the example of the Fiscal Policy Centre in Moscow, Russia). The paper is a translation from the original Russian version and, therefore, may contain mistranslation of some terms and phrases.

The Center for Fiscal Policy

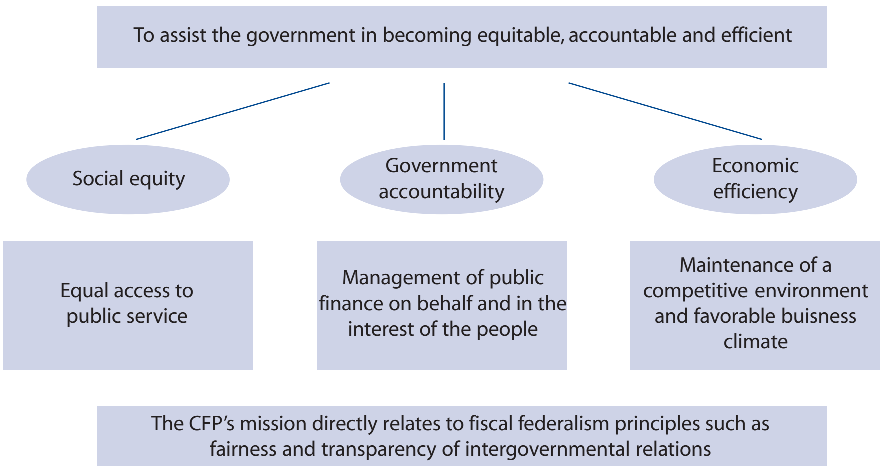
The Center for Fiscal Policy was registered on February 7, 2000 as a non-for-profit partnership founded by physical entities. It was the USAID Moscow office that initiated the establishment of the Center.

The CFP core are Russian local experts that in the 90s participated in the technical assistance program provided by the USAID to Russian authorities in the field of fiscal reform implementation. During the eight years the CFP staff has grown up from 14 to 35 people. They are graduates of Moscow State University, the Russian Higher School of Economics, the Russian New Economic School, and US universities. The CFP experts specialize in public finance, economic modeling, economic geography and public law.

Until early 2000s, Public Finance as a subject was not taught in Russian universities. We were grasping the nuts and bolts of that complicated and very important science during our training in US universities such as Harvard University, Stanford University, Georgia State University, Duke University and working side by side with internationally known US experts. Those contacts with foreign colleagues enabled our staff to look at the state of Russia's budget system in the light of international experience and realize that Russian problems were not unique. That helped us describe differently the reasons for, and come up with what in those days was not quite common recipes of how to eliminate, disruptions in Russia's budget policy mechanisms.

From the very beginning the major line of CFP activities was intergovernmental fiscal relations. The Center was given a real start in life when the Russian Ministry of Finance approved a formalized methodology of equalization grants distribution to Russian regions, and guidance for regional authorities on building of intergovernmental fiscal relations with municipalities that had been developed with our contribution. The next stage was practical testing of the guidelines. In the beginning it was

CFP Mission



difficult to find regions that would need our assistance even free of charge. But as chief financial officers were learning more about our successes in dealing with the Federal Ministry of Finance they were increasingly involving us in cooperation.

The year 2000 also saw the establishment of a tradition to provide workshops for regional financial authorities. The first workshop was held in the RF Ministry of Finance Computer Classroom. The workshop was attended by representatives of 20 regions for each of which we had developed beforehand a simplified computer model of distribution of transfers to local governments. Besides, at the workshop we had to explain the federal grants distribution methodology that had just come into effect and at first was Greek to many people. Since then our workshops have become an annual event, the number of participants going up to over 100 (note that participants pay for their participation the market price). For us those workshops have become an indicator of the level of demand for what we do. The workshop format is designed to allow attendees in the first place to ask questions directly to representatives of Federal Ministries invited as lecturers, and in the second – to hear from our experts about how new federal legislative initiatives may impact regional and local governments, or what is the best way to implement those initiatives at the regional and local levels and which uncertainties in the legislation regional authorities shall fight against. And finally, it is no less important that during round-table discussions and networking breaks workshop participants can share work experience, which under the decentralized financial system is not a frequent, and hence, especially valuable, opportunity.

CFP Areas of Competence

- Intergovernmental fiscal relations
- Public finance management
- Public services
- Regional development

CFP Services

- Policy advice
- Technical assistance
- Legal expertise
- Training
- Research

At workshops and in the process of consultations we helped regional authorities to develop their finances in line with toughened requirements of the federal legislation. Concurrently, our regional experience enabled us to make proposals at the federal level about ways of improvement of the Russian budget system. That's why we were first invited for drafting of the Federal Government Strategy for Budget Federalism Reform and later – to the Presidential Commission dealing with the Reform in the field of assignment of powers to different levels of government.

Our overriding goal at that time (in 2002-2003) was to demonstrate to politicians that public power is based on public finances and therefore intergovernmental relations should be built on the basis of relations concerning finance management. To make out a strong case for budget federalism as opposed to the then domineering centralization philosophy we had to provide to the Commission analysis of current situation in Russia and references to international experience.

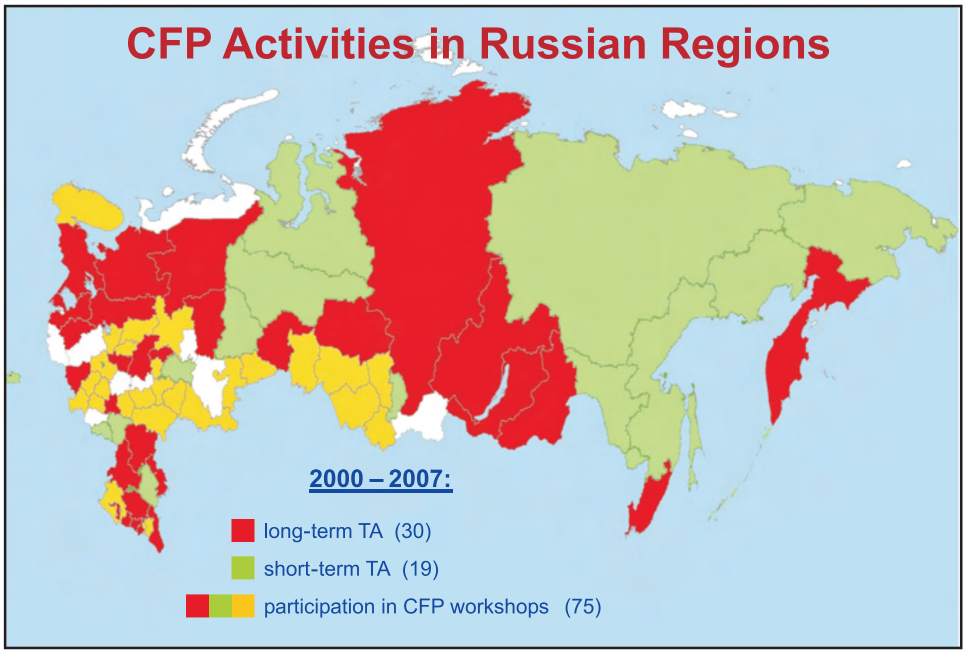
It stands to reason that those who are pleased with how matters currently stand are few and far between. However, people have short memories of their past. But looking back and comparing the current situation with our recent past one realizes

CFP Activity Outputs	CFP Activity Outcomes
• Amendments to federal laws • Regional laws and regulations • Methodologies • Public expenditure reviews • Equalization grants allocation formulae • Training of government officials and training of trainers • Round table discussions • Research papers • Analytical reports	**Intergovernmental reform:** • Assignment of responsibilities • Away with unfunded mandates • Transparency of equalization grants **Public finance reform on federal, regional and municipal level:** • Improved transparency and efficiency of public spending • Multi-year budgets **Social sector reforms:** • Improved quality of public services

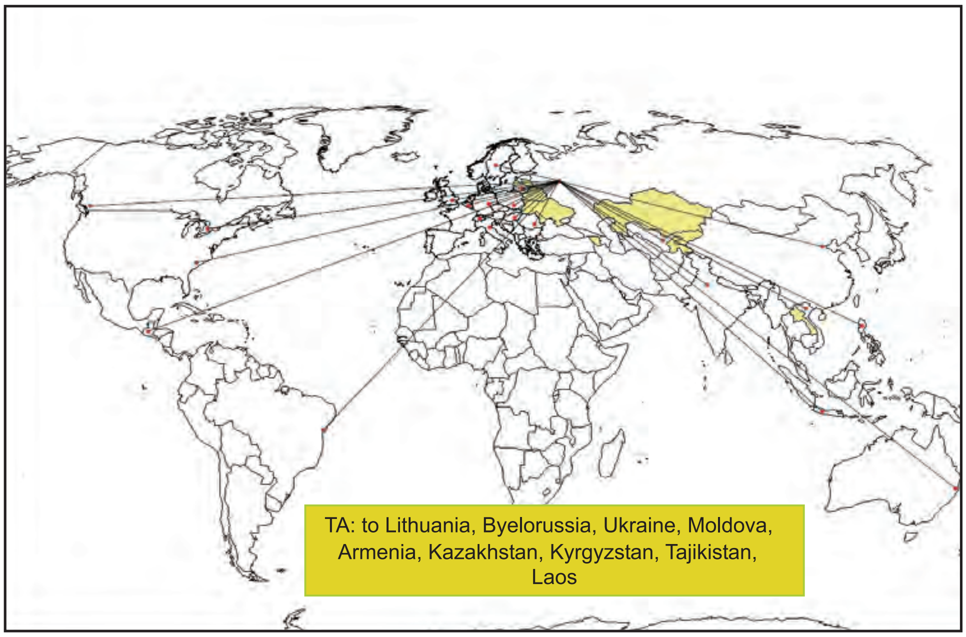
that a lot of ground has been covered in recent years, a few cases in point being abolishment of unfunded mandates, establishment of transparent intergovernmental fiscal relations, formula-based distribution of intergovernmental transfers, adoption of a three-year budget law, introduction of performance based budgeting principles, initial transition from infrastructure funding to funding of public services.

In early 2000s, parallel to intergovernmental fiscal relations improvement process, the RF Ministry of Finance together with the Center had to come to grips with a new challenge – performance budgeting - that was new not only to us but to the country at large. At stage one we made an attempt at MoF request to determine the efficiency of federal public spending in a number of fields. Stage two was devoted to thorough studies of international experience in the field of budgeting oriented at effective results. At stage three we explained to federal ministries and departments how they should stop regarding payment of salaries to employees as a major objective of their activities; how they should position their ministry or department vis-à-vis nation-wide priorities; how they can realize which strategic and socially important goals each federal ministry or department is facilitating and which tactical objectives they shall reach to that end. Finally, at stage four we started to provide assistance to regional and local governments in implementation of the centrally initiated budget reform, which turned out to be the most interesting part.

The Federal Government that initiated the budget reform at the central level offered that regional authorities follow suit, although not for free. The Federal Ministry of Finance chose to "buy" regional reforms by giving grants to those regions that would announce and satisfactorily implement reform programs. That gave rise to a competition in the field of development and implementation of regional (later followed by municipal) finance reform programs. As neither



CFP Activities outside Russia



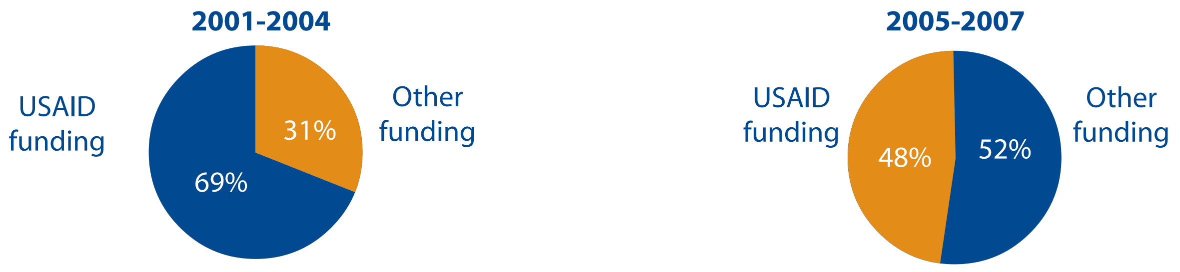
the Federal Government nor textbooks provided recipes describing how exactly a particular reform area should be tackled, both processes were heavily reliant on creativity. That is when regions were desperate for assistance!

CFP like many other brain trusts ventured to provide the sought assistance. To do so one indeed had to pluck up courage because until then we had been dealing with bare theory while now we had to apply it to the "live organism" of regional financial systems. Moreover, it was not just financial systems that were targeted. The public sector funding reform will inevitably raise the issue of assessment of efficiency of organization and functioning of all social sectors.

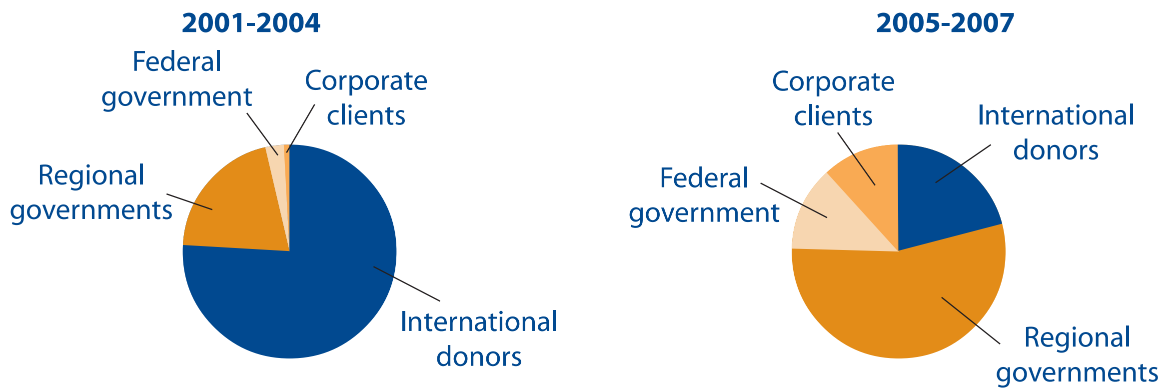
The story about the CFP history will not be complete if we fail to mention one more category of our service consumers. These are private companies that in their home cities are the only or major employers. This is where business takes a keen interest firstly in rationale behind the amount of transfers allocated to the municipal budget from higher level governments, and secondly in the efficiency of public spending on maintenance of their employees' habitat. That job brought us to the other side of the barricade. It's true that business community interests more often than not are at conflict with government's interests, but in their turn, the interests pursued by one government level may be contrary to the interests of another. However, our partners are federal, regional and local governments and businesses. We have a right to believe that this is due to our reputation of an objective and unbiased expert.

Center's vast experience with the development of

CFP Funding



Diversification of Other than USAID Funding



fundamental principles and implementation of budget reforms in Russia has in recent years come to the attention of governments of other countries in transition, especially FSU countries. In countries such as Kazakhstan, Kyrgyzstan, Tajikistan and Moldova our experts are favored over western consultants. Whatever one may say, practical implementation of reforms becomes much more efficient after western experience has been 'digested' and adapted to post-Soviet realities in other FSU countries. From our work with Ministries of Finance in the above mentioned countries (the Ministry of Economy and Budget Planning in Kazakhstan) we have seen a great deal of interest for the reforms undertaken in Russia. Our work in each of the counties started with a detailed overview of Russian experience. It may give one the impression that reforms in CIS countries are just a copy of Russian ones. However, this is a wrong impression. To the contrary, our partners are very careful not to allow us to thrust Russian experience on them and see to it that we analyze it from a positive and negative experience standpoint.

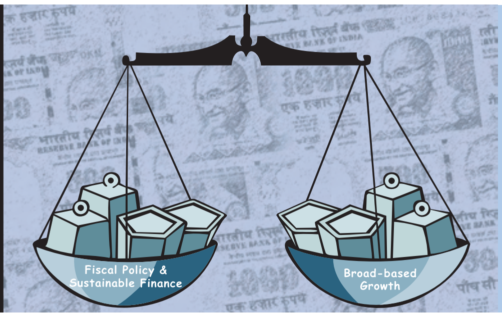
Apart from FSU countries our assistance was sought by Laos Peoples Democratic Republic, where we went twice to give a series of lectures in Vientiane in the theory and best practice in public finance management. Furthermore, our experts visited no less interesting countries such as USA, Canada, Great Britain, the Netherlands, Australia, Indonesia, Philippines, India, Vietnam, China, Brazil and even Guatemala, to give lectures and make presentations there.

The competence of the Center's experts is confirmed by the fact that they are invited to become members of a number of expert's councils such as:

- the World Bank (Russia) Consultative Group;
- the Forum of Federations Experts' Committee;
- the Russian President's Commission on Federative Relations and Local Governance;
- the Public Council on Local Self Governance under the Chairman of the Russian Parliament (State Duma);
- the Experts' Council with the RF Accounting Chamber;
- the Experts' Council with the RF Parliament Committee on Federative Affairs and Regional Development.

It is important also to mention the CFP financial matters. During the first stage of the CFP existence (2000-2003) USAID would not go into direct agreement with the CFP due to its lack of financial history. The CFP acted as a subcontractor to Deloitte Touch Tohmatsu Emerging Markets, the well known international consulting company. Deloitte assisted the CFP with corporate financial management and corporate development strategy. Starting end of 2003 USAID went into direct Cooperative Agreement with the CFP.

Diversification of clients and services permitted CFP twice to increase the total yearly turnover and to become less dependent on USAID funding.



Annexure 5

Fiscal Policy Analysis Cell Implementation Guidebook

September 2008

Table of Contents

Author's Note

Why develop this Guidebook?

The purpose of this Guidebook is to help an Indian State Government to establish and operationalize Fiscal Policy Analysis Cells (FPAC) with the aim of improving informed fiscal decision-making.

What is the Guidebook?

The purpose of this implementation guidebook is to discuss international best practices, to identify the key elements of the FPAC, and to suggest practical organizational strategies that will help states organize their own financial policy analysis capacity.

When to use the Guidebook?

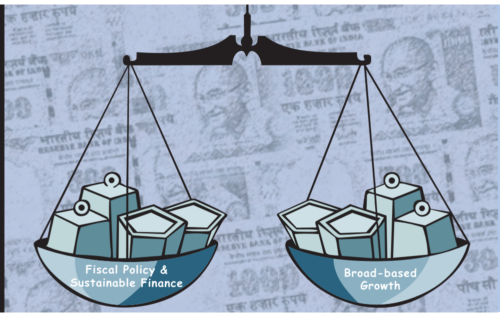
Once a state government has decided to establish an FPAC, the state can use the guidebook as an introduction to the organization, composition, and scope of work for an FPAC.

Who should use the Guidebook?

The Guidebook is helpful to: those who will be learning how to prepare budgets using the PPB methodology, department of finance officials who will review and approve the PPB documents, and other state decision-makers who will be considering the PPB documents for the first time.

How to use the Guidebook?

The Guidebook is most effective when combined with employing a competent consultant who can advise the state government on the establishment, staffing, and operationalizing a FPAC. Accordingly, it is best used in conjunction with a formal implementation plan organization development program. Employing specialists who have had experience with the approach would significantly augment setting-up an FPAC. There are other techniques recommended in this implementation guide that will assign responsibility and accountability so that officials can monitor and manage the FPAC. Finally, there is a step-by-step guide and an implementation timeline that can help assure that the process remains on track.



Section I

Institutionalizing Fiscal Policy Analysis for Informed Decision-making

Introduction to Institutionalizing Fiscal Policy Analysis

State and national governments throughout the world tend to have a central analytical unit or agency that advises the government on the overall conduct of its fiscal planning and management. These analytical units commonly have the capability to conduct macroeconomic studies, revenue estimates, tax policy analysis, debt management, budget planning, and even program evaluation.

A fiscal analysis unit can become a focal point in state government's ongoing efforts to improve its fiscal management practices. It can also be the cornerstone organization for implementing fiscal management changes and good fiscal governance (*i.e.,* simplification of procedures and increased transparency).

In Australia, Canada, New Zealand, and the United States, central governments have been active in strengthening their fiscal analysis capability. This approach has also filtered down to their state and other subnational governments.

In most instances, these units tend to be located in or near the locus of decision-making on fiscal issues. They operate commonly as an organizational component within a Ministry of Finance, a Finance Department, a Budget Department, a Department of Administration, or even as a special division in the Office of the Chief Executive. Yet, many leading national and state level governments organize their analytical units differently. In fact, it would be unlikely to find two governments that have identical structures. However, in all cases, these analysis groups collectively provide objective, analytical, and informed fiscal policy advice to decision makers.

Table 5A1.1, depicts the organizational structures in some of the governments in developed countries. While organizations with various titles can house the analytical functions, the governments have assigned responsibility for most of the basic core functions of fiscal management. Most of these organizations have other responsibilities beyond the core areas

Table 5A1.1: Analytical Units in a Sample of Developed Systems Around the World

		Core Functions			
Government	**Relevant Organizational Unit**	**Macroeconomic Studies/ Reports**	**Revenue Estimation**	**Expenditure Budget Development**	**Debt Management**
New South Wales, Australia	Treasury - Office of Financial Management	✓	✓	✓	✓
Ontario, Canada	Dept. of Finance	✓	✓	✓	✓
New Zealand	Treasury Ministry	✓	✓	✓	✓
Scottish Executive	Finance & Central Services Dept.	✓	✓	✓	✓
California, USA	Dept. of Finance	✓	✓	✓	X
Minnesota, USA	Dept. of Finance	✓	✓	✓	✓
Wisconsin, USA	Dept. of Admin. & Dept. of Revenue	✓	✓	✓	✓

shown here such as management or oversight of information technology, internal audit coordination, Federal/State fiscal relations, accounting and treasury functions and many others.

Annexure 1 of this implementation Guidebook contains additional detailed information on the structure and functional duties of select units in other countries. For example, the depiction of the New South Wales Office of Financial Management's responsibilities offers an example of the extensive scope that could reside in an analytical cell. The depiction of the annual planning and budgeting process in New Zealand offers examples of how a Fiscal Policy Analysis Cell (hereafter referred to as the FPAC) could integrate economic and policy studies with a rigorous budget planning process, linking policy with resources through a comprehensive annual process. The other government examples illustrate the features that are common in well-developed analytical units.

Essential Terms of Reference for an FPAC

Overview

International experience indicates that in its initial stages of operation, states should organize the FPAC around five core functions:

1 Macroeconomic Studies/Reports.

2 Tax Policy Analysis.

3 Resource Forecasting.

4 Expenditure Planning and Analysis.

5 Debt Management.

Organizing the FPAC around these five components might initially require approximately 16-21 highly qualified analysts. These analysts could come from numerous organizational sources, bringing together current staff from units both inside and outside the Finance Department.

Linkages developed with academic institutions or other policy-level analytical sources could significantly enhance the effectiveness of the cell. These outside resources should also have a formalized reporting and accountability relationship to the FPAC leadership. (See Annexure 2 for more information on the importance of FPACs.)

Macroeconomic Studies/ Reports and Tax Policy Analysis

Governments all over the world use tax laws for many purposes besides raising revenue. Tax policy can have significant effects on the economy; changes in the tax laws may stimulate the economy or may have the opposite effect. All governments must continually improve their ability to predict the effects of proposed changes in tax policy. Understanding the dynamics of the economy is essential to predicting the effects of changes in tax policy reliably.

Tax policy issues can range from considering the potential effects of changes in tax rates as well as the introduction or elimination of specific taxes. Developing an understanding the factors affecting the revenue streams is a vital step towards improving the financial condition of a state.

Initially, this unit should focus on developing a degree of analytical ability in macroeconomics and tax analysis. Later enhancements would include advanced tax policy analysis and revenue forecasting.

Since changing tax policy can create significant changes in revenue, this component of the FPAC should have a close relationship with the Revenue Forecasting component.

Revenue Forecasting

The importance of understanding the dynamics of revenue streams is of paramount importance to developing reliable forecasts of revenue. Policy makers and budget decision-makers also need confidence that financial forecasts are of high quality. The key to reliable financial forecasts lies in the ability to use modern modeling techniques that use available data to forecast revenue levels with a higher degree of confidence.

This component of the FPAC will begin building forecasting models by analyzing macroeconomic indicators and relating them to revenue trends. It will track revenue collections and analyze tax policy to determine the impact on future collections. Finally, it will eventually develop models that will provide credible revenue estimates that, combined with improved expenditure estimates, will enhance the state's fiscal planning and management.

The USAID/REFORM project has developed training materials and has successfully conducted training for the FPACs and other concerned officials in the three partner states (See Annexure 3 for details on REFORM state experiences and Annexure 4 for details on the training program.) in Macroeconomic Analysis. In addition, the project has developed a Macroeconomic Database as a first step in creating a model of the state's economy. The project is also developing user manuals covering Macroeconomic Analysis, Tax and Revenue Forecasting, and Macroeconomic Database. State FPACs are beginning to use this new capacity to produce analyses covering a range of topics relating to macroeconomic analysis and tax policy alternatives.

The FPAC should have a group of analysts assigned the responsibility for providing budget decision-makers with analyses of alternatives to current budget allocations. This unit would support budget formulation through its analytical work in recommending baseline spending estimates, expenditure prioritization, and fiscal impacts of policy changes.

Expenditure Planning and Analysis

Constituents of governments all over the world ask for better understanding of what their government is doing for them. In fact, recently, the Government of India has introduced the concept of "outcome budgeting" at the central level. The central government is beginning to shift the focus of the budget discussion from outlays to outcomes. It recognizes that the budget discussion must include scrutiny of both the plan and the nonplan expenditure components. As a result, the central government actively encourages state governments to implement similar improvements in their budgeting. Clearly, the introduction of the modern budget preparation models is important to Indian government.

In the wake of an interest expressed by partner state governments to respond to these pressures, the USAID/REFORM team developed a methodology for an advanced form of modern budgeting, called Program and Performance Budgeting (PPB). The team adapted the methodology to work in Indian states by making it compatible with other state government fiscal reforms in India. It is also compatible with the Indian budget classification system.

State governments selected pilot spending departments to begin the implementation. Officials in these departments received training in the new approach to budgeting. In addition, the project team developed an implementation guidebook describing PPB. With on-site training and technical assistance provided by project experts through on-site collaboration and mentoring sessions, these officials prepared their first budget requests in the new format.

Experience in many countries has shown that the introduction of a new approach to budgeting takes time. Teaching state officials how to prepare their budget request using a new methodology is an important step. However, equally important and more difficult is to develop the capacity of budget decision-makers to use the new budget documentation. The FPAC is the logical place to help develop that capacity.

Evaluation of programs, schemes, and expenditure policies by FPAC analysts is different from the scope of the program evaluation function found in some planning departments. The FPACs scope should focus on ongoing programs. It should address questions relating to the efficiency of allocating money to various programs.

The FPAC should have a group of analysts assigned the responsibility for providing budget decision-makers with analyses of alternatives to current budget allocations. This unit would support budget formulation through its analytical work in recommending baseline spending estimates, expenditure prioritization, and fiscal impacts of policy changes.

By working with spending agencies, the analysts would understand department issues and program trends. They would be able to relate these trends to medium-term expenditure planning. In addition, working with planning officials they could help spending departments prepare their requests and help integrate approved new initiatives and capital projects into the medium-term fiscal plan.

While planning departments usually coordinate the five-year and annual plan documents funding allocations require consideration of the finance department. The FPAC, working with spending departments can help improve the documentation required for new ideas.

The USAID Project team has developed an effective methodology that improves the documentation needed to determine if proposed projects are worthwhile. This methodology, called Project Appraisal, should be prepared by spending department officials. However, one or two FPAC analysts should also have the expertise to assist departments as needed. The project team has developed several manuals that can help departments prepare proper appraisal documentation.

The analysts assigned to this component of the FPAC should conduct evaluations of programs, schemes, or other expenditure policies to weigh their costs against their effectiveness. Decision-makers would have access to the analytical reports and be able to consider them in their budget decisions.

These analysts should have the ability to use the information that is contained in new budget documentation to formulate recommendations for more effective and more efficient budget allocations. For instance, expenditure analysts could develop recommendations to help fine-tune state programs or policies to enhance their usefulness. In addition, decision-makers could receive assurances that programs are continuing to provide the desired outcomes or to help the government redirect resources from uses that are less productive to uses that are more productive. Finally, these analyses could help the finance department curtail unproductive programs in favor of other more worthy efforts.

Evaluation of programs, schemes, and expenditure policies by FPAC analysts is different from the scope of the program evaluation function found in some planning departments. The FPACs scope should focus on ongoing programs. It should address questions relating to the efficiency of allocating money to various programs. In effect, the FPAC should determine if the programs are effective in meeting the needs that the program designers originally intended to address. In addition, analysts should determine if the programs address the state's current priorities. Routinely evaluating programs that have been in existence for many years is essential to ensure that the state continues to allocate money in response to the highest priority public needs.

As capacity building at the spending department level is necessary, using the information provided by this approach is a new experience for decision-makers. The project team recommends developing the capacity in the FPAC to provide analytical support to decision-makers. An effective implementation strategy is to have FPAC expenditure analysts work with spending department officials in developing their PPB documentation. Such a strategy can be helpful to analysts as they learn the intricacies of the various departments and programs. Working with department officials, FPAC analysts will develop the necessary skills needed to prepare effective analysis of budget documents.

For many state officials and FPAC analysts, demonstrating how their programs make real impacts on the people they serve is a new concept that takes time to develop. Accordingly, the project team suggests that states seriously consider the approach outlined above.

Debt Management

Debt management operations are most effective when consolidated in one primary location and organized along functional lines. When establishing a fiscal policy analysis function, the finance department officials should, however, consider organizing the debt management operations within the FPAC. While states may consider organizing a Debt and Investment Management Cell (DIMC) within the FPAC, it is not an essential component.

Annexure 5 of this implementation guidebook presents an excerpt from the Debt Management Manual and highlights technical recommendations for the establishment of a comprehensive Debt Management Cell independent of the FPAC.

The goal is to achieve a seamless integration between fiscal policy analysis capability and effective debt management regardless of whether the DIMC is a component of the FPAC. Accordingly, the staff of the debt management unit must be able to:

- Establish a cost and risk management strategy or framework for the State government's debt portfolio;
- Monitor compliance with the State's portfolio and risk management policies;
- Produce effective cash flow projections regarding debt service; and

- Develop an effective database of all State budget and off-budget obligations.

The debt management unit should develop a set of portfolio management policies and present them to the decision-makers in the department of finance. The unit will need to identify the key portfolio-related risks including the refinancing and budgetary implications associated with having large amounts of short-term debt that has to be rolled over on a frequent basis. The debt management officials need to discuss these policies with appropriate decision-makers and obtain official approval.

The debt management unit should also perform a mixture of research, analysis, and due diligence with respect to the State's debt management portfolio position. Using the state's cost and risk preferences, the unit must monitor compliance of the state's portfolio with the State's debt management policies. The debt management unit's responsibility must also cover broad monitoring of obligations on the government's balance sheet including but not limited to guarantees and other contingent liabilities.

A key factor in building an effective debt management capacity is to correctly estimate the resources needed to service outstanding debt on a timely basis. The debt management unit should be responsible for producing accurate debt management cash flow projections. These projections should cover all outstanding debt instruments so that expenditure planning can cover all future financial outlays. Accordingly, relating the work of the debt management unit to the overall work of the FPAC can ensure that revenue and expenditure planning frameworks include debt management fiscal considerations.

Building a sound institutional structure that provides useful and relevant information must include skilled staff and modern information systems. Effective debt management systems can provide the technical capability to perform a complete analysis of a state's outstanding debt. These systems can help analysts in tracking, managing, and planning for the government's debts, loans, guarantees, payment schedules, and contingent liabilities. In addition, these systems provide scenario analysis that aids the decision-making process when considering future financing options.

Building a successful debt management capacity for building this capacity takes time and requires skilled staff. The linkages between this unit and the FPAC, especially the Expenditure Planning and Analysis unit, will be critically important to the success of the government's fiscal management capacity building efforts.

Prerequisites for an Effective FPAC

Overview

An effective FPAC requires the following:

- A clear mandate with Political Buy-in;
- Unambiguous roles and responsibilities;
- Qualified expert staff with access to best practice tools and techniques;
- Integrated Systems and Information Networks; and
- Access to continuous upgrading of expertise (*e.g.*, training, mentorship, professional networks/societies).

A Clear Mandate with Political Buy-in

Lessons learned internationally show that successfully implementing fiscal improvements requires understanding and support of many decision-makers and officials throughout the government. It is not just a matter of concern for senior level decision-makers and finance professionals.

Finance officials admit that the failure of many reforms attempted in the past has been the lack of an "ownership" feeling by many line agencies. Therefore, essential to developing a state's analytical capacity is involvement of line agencies. This not only includes briefings of high-level officials in the agencies regarding the need for change but also through inclusion of their staff in training.

Involving a greater number of state officials in establishing an analysis unit has many benefits. Sharing in the training can help department officials understand some of the new analytical techniques. In addition, many of the recommendations coming out of the unit will have significant effects on line departments. Further, as the management skills in these departments rise, significant responsibilities and accountabilities will devolve to them. This is especially important, as some reforms will involve more flexibility and responsibility for them. Accordingly, international experience suggests that line departments need to understand the changes as they have a stake in the outcome of many of the recommendations.

Insulation from Unfair Influence

Government policy and programs are important to many people in the state. Improvements in the financial capacity of states, including implementing an FPAC, are important steps that can help maintain the citizen's confidence in state government. International best practice is that the state's analytical capacity should have the appearance of independence and objectivity.

The FPAC analysts should be free from the daily tasks of expenditure controls, budget execution, tax administration, or public borrowing. On the other hand, the FPAC analysts should have the organizational stature to have full and unimpeded access to financial data, line agency rationales for allocation decisions, and line agency administration and implementation policies.

Accordingly, the Department of Finance should ensure that FPAC analysts have the ability to provide analytical guidance and recommendations to decision-makers in an unimpeded, straightforward manner. While their analyses and inputs should be mindful of the political realities of governance, their work products and conclusions should be fair and honest.

Unambiguous Roles and Responsibilities

The FPAC must operate with a comprehensive view of government and it should be equipped to advise decision makers on any issue that may arise related to the management of government finances. Functional assignments within the cell should cover all the elements of government.

All FPAC members must have clear job descriptions inclusive of reporting relationships and research scope—*i.e.*, responsible sectors.

Finally, any research overlap with other FPAC members must be accompanied with a protocol for completing and finalizing research findings and suggestions—*i.e.*, a dispute resolution process.

Qualified Expert Staff with Access to Best Practice Tools and Techniques

The expertise available on the FPAC will be determined by the operational and research scope of the FPAC. Ideally, an FPAC should have experts in the following fiscal sectors: Revenue Management, Expenditure Management, Debt Management, Treasury Operations, Project Appraisal Management, Capital Budgeting and Programming, etc…

In closing,

Integrated Systems and Information Networks

Information is essential to effective fiscal policy analysis. Systems support should provide access to a variety of sources of information. For instance, access to current treasury information is essential for cash flow projections. In addition, expenditure analysis depends on not only expenditure plans but also budget execution. As mentioned in relation to debt management, analytical systems are indispensable. Finally, the systems support should provide access to macroeconomic and socioeconomic databases.

FPAC analysts should also have access to ongoing training opportunities through state, regional, and national facilities. In addition, they should have access to the Internet and be expected to research international best practices and developments in their areas of expertise.

The state Information Technology (IT) unit—usually the National Information Center (NIC)—should support all components of the FPAC. It should provide information support and functional integration within the cell and in connection with other units in the Finance Department. They should integrate automated systems for the cell and provide functional inputs into the development of new budget formulation systems. The unit should also serve as liaison with the treasury on automation linkages and conduct special studies in support of the cell's mission.

Establishing an information support component that is associated with the FPAC is a key strategy for success.

Access to Information

With the above IT support environment in mind. The analysts in the FPAC should have access to the following information sources:

- Internet connectivity with access to international Web sites;
- Intranet access to all state and central government Web sites that may be of assistance in conducting research studies;
- Virtually all financial and program information of any type in the government; and
- All state financial information including: economic data, revenue receipts, expenditure figures, state debt information, financial liabilities, contingent liabilities, and programmatic performance information.

Finally, it should be mentioned that FPAC analysts need to exercise appropriate discretion when handling sensitive information that could jeopardize state criminal investigations, state security, or national security. (See Annexure No. 6 for details on virtual links FPACs can access for information.)

Linkages to other Units within the Department

In connection with the goal of having access to all information, the analytical cell should have direct, immediate, online, and comprehensive access to all information available within the finance department. The FPAC analysts should be free from the daily tasks of expenditure controls, budget execution, tax administration, or public borrowing. On the other hand, the FPAC analysts should have the organizational stature to have full and unimpeded access to financial data, line agency rationales for allocation decisions, and line agency administration and implementation policies.

Access to continuous upgrading of expertise (e.g., training, mentorship, professional networks/societies)

Internationally, fiscal analysis units require appropriate training, tools, and databases to equip them to deal with the full range of fiscal issues. In revenue forecasting units, analysts usually develop sophisticated models of the economy and apply econometric techniques to macroeconomic data to understand the overall economy. They also use tax analysis databases, including information drawn from actual tax returns and tax-specific revenue estimating models to provide more accurate revenue forecasts.

In the expenditure area, analysts may use detailed economic, demographic and expenditure data and models designed to project baseline (or current services) budgets. These models often have the capability to incorporate alternative economic and policy parameters, such as different interest rates to estimate debt service, various rates of inflation, changes in salaries, change in the target population of specific programs (e.g., number of students, number of beneficiaries of target spending programs).

While the spending units also develop detailed spending requests, these models project aggregate revenues and expenditures. In time, some of these models can help estimate monthly revenue and expenditures in order to assist in cash flow analysis and financing needs of the government.

Accordingly, adequate access to training and data is essential to the success of the analysis units. (See Annexure No. 3 for more information on training FPAC members.)

Internal Guidance and Mentoring

Senior analysts in the cell should serve in a mentoring role to junior staff both in the cell and in the finance department. A good mentoring strategy could inspire other finance employees to upgrade their skills and performance. For example, the work of the FPAC staff could tend to upgrade the overall quality of work in the finance department by encouraging other officials to upgrade their skills in order to cope with the changing environment.

FPAC analysts should also have access to ongoing training opportunities through state, regional, and national facilities. In addition, they should have access to the Internet and be expected to research international best practices and developments in their areas of expertise.

It may not be feasible for any state to initiate an FPAC with all of these features in place, but the information and insights gleaned from the past two years of experience with the REFORM project should allow the state to employ many of the basic features up front, and then work to institute other features in future years.

Organizational Issues

General Considerations

International experience illustrates that a fiscal analysis unit should have full-time dedicated staff of qualified and trained personnel. Annexure A of this implementation guidebook describes a variety of effective structures in a number of countries and US state governments. The size of the unit depends on resource and staffing constraints faced by the Department of Finance.

The ideal FPAC organization should be part of the Department of Finance. A central unit may provide superior analysis of the functioning of the current and alternative fiscal policies. Such a unit can also bring discipline to the budget formulation process. This approach can also strengthen the Finance Department's ability to present fiscal projections based on solid analysis of current events. Collaboration between analytical units in several departments can also be effective.

In states where there are limitations on resources, there may be less specialization so that the same staff may deal with both revenue and expenditure analysis.

Budget Analysts as Generalists

International best practices suggest that budget analysts should be a cadre of well-trained critical thinkers who do not necessarily have any particular functional specialty. The analysts are generally qualified and educated as "generalists," with specific functional expertise only as a secondary concern. These individuals should have the ability to adequately articulate an issue, analyze the appropriate factors involved, and develop practical recommendations for decision-making. Good generalist analysts with relevant background and experience in an FPAC will be able to provide critical thinking and credible analytical support to virtually any function or program of government.

While expenditure budget analysts should be generalists, personnel with functional expertise in certain areas such as tax policy, revenue forecasting, macroeconomic analysis, and information technology is a sound strategy.

Reporting and Accountability

The cell should have direct reporting and accountability to the officers who can advise the government's decision makers—those who have influence on the planning, allocation, and direction of government resources. Normally, this is the secretary level. In any state, an FPAC with overall guidance and direction of the Principal Finance Secretary/ Secretary Finance and direct supervision by a special/ additional/ deputy secretary would satisfy this attribute.

Full-time Appointments

As stated elsewhere, the appointment of FPAC personnel should be on a full time basis. Accordingly, the analysts should have few ongoing responsibilities other than to perform their core analytical tasks. Individuals assigned to the FPAC should have a minimum tenure of three years; a more desirable tenure would be four to five years.

Elevating state fiscal analysis capability to international standards of inquiry and critical thought requires careful selection of personnel. Identifying sources of an effective human resource pool is a first step in establishing an FPAC. Economists and analysts in the planning, tax, and finance departments are logical choices for the new organization. However, states should also consider senior officials in departmental budget offices and highly qualified individuals from outside state government. Many of these new employees will need significant training and mentoring in the new techniques.

International experience indicated that people perceive that these units are a highly desirable posting, particularly for government officers early in their careers who aspire to top management. It should be one of the most desirable postings for employees internally, who could see it as a great way to boost their careers to greater heights.

Filling Staff Vacancies

There should be an institutional method for backfilling vacant positions routinely with officers who are just as capable as their predecessors. This allows the cell to fulfill its critical function to the Government without fail day-in and day-out, regardless of the specific individuals who may be engaged in the cell at any point of time. This may require the cell to have special dispensation for filling vacancies, whether as contractors, or outside the normal civil service channels, or through systematized links that allows deputing from well-respected research or educational institutions, as well as State or Central enterprises or institutions.

Staffing Requirements

With experience gained from the REFORM team's involvement in providing technical assistance in the three states, the insights gained from training dozens of officers and staff, and the team's knowledge of the relative financial importance of the various organizations, the team recommends that the cell be structured as shown in Table 5A1.2.

Consistent with the basic features outlined above, the REFORM team recommends that the state government constitute the FPAC in the following manner:

- It should be organizationally housed in the Finance Department to serve as the primary analytical capability of the Department—providing analytical support and objective, informed analytical advice to decision makers;
- It should operate under the overall guidance and control of the Finance Secretary, and it

Table 5A1.2

Organizational Composition of FPAC				
Unit:	**Tax Policy and Resource Forecasting**	**Expenditure Planning and Analysis**	**Debt Management**	**Information Systems Support**
# of Staff:	5-6	6-8	2-3	3-4
Staff Drawn From:				
	Commercial Taxes Dept.	Finance Department Undersecretaries from Budget	Finance Department	Finance Department Undersecretaries from Expend
	Stamp and Registration Dept.	Finance Department Controllers	Research Institutes	Research Institutes
	Excise Dept.	Social Sector Depts. (Ed/Health)	RBI	Open Market
	Transport Dept.	Infrastructure Sector	Open Market	
	Finance Dept.	SFC, SIIDC or PC		
	Economic. Research Inst.	IDFC or CRISIL or ILFS (or IIM Grads)		
		Planning Department		
		Open Market		

should work under the direct supervision of an additional secretary;

- The officers who are drawn from other departments or deputed or assigned from PSUs, or outside institutes or the private sector should be fully engaged in the cell, and completely relieved of their previous duties during their tenure with the FPAC;
- The cell should have the ability to engage its key staff on a contractual basis if necessary for the sake of expediency, quality recruitment, and retention; and
- There should be flexibility in salary and other compensation in order to meet the goals of maintaining high quality in recruitment and retention.

With the four functional units described above, the FPAC should have between 17 and 22 persons including the director. As illustrated, they can come from numerous organizational sources, bringing together current staff from units inside and outside the Finance Department.

The Department of Finance should consider many options for appointments, as other good candidates may emerge. As an example, good individual candidates for the Expenditure Planning and Analysis unit might emerge from the within the ranks of the Department of Finance itself or from other outside organizations not cited above.

Suggested Job Descriptions

The USAID/REFORM team recommends the following job descriptions and position requirements. The descriptions depict what would be expected of new staff being recruited for high-level analytical work in any complex government. The descriptions should be used as a general guidepost as the Department embarks upon the process of identifying the proper persons for the cell, and not necessarily a perfect prescription for each posting. In recognition of the fact that the state will likely fill most of the positions from the complement of known staff and officers within the government, as contrasted with launching a broad-based open recruitment effort for the majority of the posts, it may be difficult to find the perfect "fit" in many cases. The trade-off will consist of striving for perfection in matching up people with job descriptions, against the desire to move as expediently as possible. If filling most of the jobs from inside Government is the desired method, it may be possible to compromise on the some of the job requirements, and still compose a strong FPAC cell.

The FPAC Director's job description is an illustration of what would be required with an open competition. However, if a state assigns this task to a current additional secretary, posting this job description would be unnecessary.

Director of FPAC

Job Description

- Advising the senior leadership (or others) on macroeconomic issues, tax policy, revenue mobilization and estimation, and related economic issues;
- Overseeing development of models and analytic materials;
- Managing day to day operations of the staff; and establishing programs for staff development (training, materials, etc.);
- Overseeing the development of annual and multiyear fiscal plans, including medium-term

expenditure plans, and advising senior leadership on strategies for the government to attain and sustain a fiscally balanced position; and

- Advise senior leadership on the impacts of tax policy and expenditure policy changes, along with the annual and long-term impacts of proposed tax and expenditure initiatives.

Desired background

- Familiarity with the priorities of the Government;
- Experience within the Finance Department, including knowledge of the general operations;
- Knowledge of economics and economic analysis;
- Knowledge of the techniques of public policy analysis;
- Knowledge of the State's tax laws;
- Knowledge of the State's budget process, and familiarity with the development of Plan and Nonplan budgets;
- Demonstrated management skill; and
- Experience in public policy or related fields.

Macroeconomic Analysts

Job Description

- Remain conversant with the structure and content of macroeconomic statistics, including GDP, GSDP and income statistics;
- Work with all providers of statistics, the RBI and other government agencies to obtain and update data;
- Write periodic reports on the evolution of the main macroeconomic indicators, the extent to which they differ from forecasts used by other models, and provide possible explanations for this divergence;
- Provide timely information to the Director of the FPAC on the economy;
- Monitor monetary, interest rate, and other macroeconomic indicators, and their likely impact on tax collections in the state; and
- Interact with all other functions to determine and provide needed data.

Desired background

- At least a Masters degree in Economics or Public Policy (with a good background in macroeconomics);
- Basic computer skills;
- Experience with economic and/or mathematical modeling; and
- Ability to communicate complex economic issues to nontechnicians.

Revenue Analysts

Job Description

- Monitor revenue collections, analyze revenue and macroeconomic indicators, trends and tax expenditures;
- Prepare complex analyses for use in planning and decision making;
- Ensure that results are integrated with outputs from other models;
- Produce final reports; and
- Present analyses and final reports to decision makers and nontechnical audiences.

Desired background

- A graduate, and preferably with a masters level degree;

- Skill, experience or special training in applied mathematics, mathematics, statistics, economics, finance, or accounting;
- Basic computer skills;
- Experience with economic and/or mathematical modeling;
- Knowledge of the derivation of the input data that is used in analyses;
- Knowledge of relevant tax laws and analytic techniques that are applicable to fiscal policy issues; and;
- Ability to communicate on tax issues to nontechnicians.

Expenditure Analysts

Job Description

- Develop a detailed understanding of programmatic and fiscal operations;
- Conduct independent analyses and work closely with departmental staff, frequently on location to identify areas for management or fiscal improvement;
- Examine and analyze departmental budgets, financial structures, expenditure trends and budget estimates;
- Perform fiscal, statistical, and other studies and analyses of key aspects of departmental budgets;
- Analyze the sources and uses of various State and central funds;
- Make informed recommendations and provide technical assistance on budget estimates for departments and programs, taking into account government priorities, availability of resources, and impact on programs; and
- Identify issues that affect departments' ability to stay within budget allocations and assist in the development of corrective action plans.

Desired Background

- Academic training and/or experience in: working with the concepts and procedures used in preparing and analyzing a governmental budget and governmental legislation;
- Academic training and/or experience analyzing complex public policy issues;
- Skill in designing, implementing, and working with advanced data collection methods—utilizing personal computer-based spreadsheet applications (e.g., Excel) for the compilation, qualitative evaluation, and presentation of data;
- Ability to apply reasoning skills effectively to complex problems and to work independently towards defensible solutions or recommendations;
- Ability to summarize and analyze complex data, to spot trends, and to present quantitative and/or qualitative information in a clear, concise fashion;
- Ability to work well independently or in team settings and to adapt effectively to rapidly shifting priorities and high-pressure situations; and
- Ability to communicate effectively both orally and in writing.

Information Technology Analysts

Job Description

- Work with other analysts to develop models or to improve existing models;

- Work with all other functions in the FPAC to enhance efficiency by automating the data gathering, data entry, and data analysis processes;
- Work jointly with data providers to secure regular receipt of basic data needed for the models and to recommend better methods of data provision;
- Make recommendations for additional software to enhance FPAC operations;
- Serve as technical advisor on computer-related issues to the FPAC Director; and
- Oversee the maintenance and upgrade of FPAC computers and software.

Desired background

- Minimum of Bachelors degree in computer science or programming;
- Thorough knowledge of all basic computer-related skills;
- Experience with computer programming and/or systems design; and
- Basic knowledge of econometrics and forecasting techniques.

Head of Debt Management Unit to Advise Budget Manager

It is essential that close links between the debt manager, the budget office and the treasury be enhanced. This will enable the debt manager to assess current and future total borrowing needs and the budget manager to be apprised of the financial flows relating to debt operations. Accordingly, the Head of the Debt Management Unit should also have the capacity and status to fully participate in the planning stage of the budgetary process because the size of the debt and consequent interest payments are a key factor on the size of the budget deficit. The debt management unit itself can make a unique contribution to the budget process by: i) Calculating the medium and long-term consequences for total State debt, liabilities and interest payments if current fiscal policy were to continue; and ii) Calculate different scenarios and consequences for debt sustainability under different fiscal policy stances.

The head of the unit would supervise other staff members and would be capable of providing help with any of the functions (data base development, analysis, risk analysis, and interfaces with the fiscal policy and treasury operations). In brief, the Head of the Debt Unit would:

- Advise the senior leadership within the DoF on debt policy and other related economic issues;
- Oversee the development of debt/risk management models and analytical materials;
- Manage day to day operations of the staff; and
- Assist in establishing programs for staff development training (training, materials, etc.,).

Background: The desired background includes:

- Familiarity with the priorities of the Government;
- Experience with the Department of Finance, including knowledge of general operations;
- Knowledge of economics and economic analysis;
- Knowledge of the techniques of public policy and familiarity with debt management issues;
- Demonstrated management skills; and
- Experience in public policy, finance or related fields.

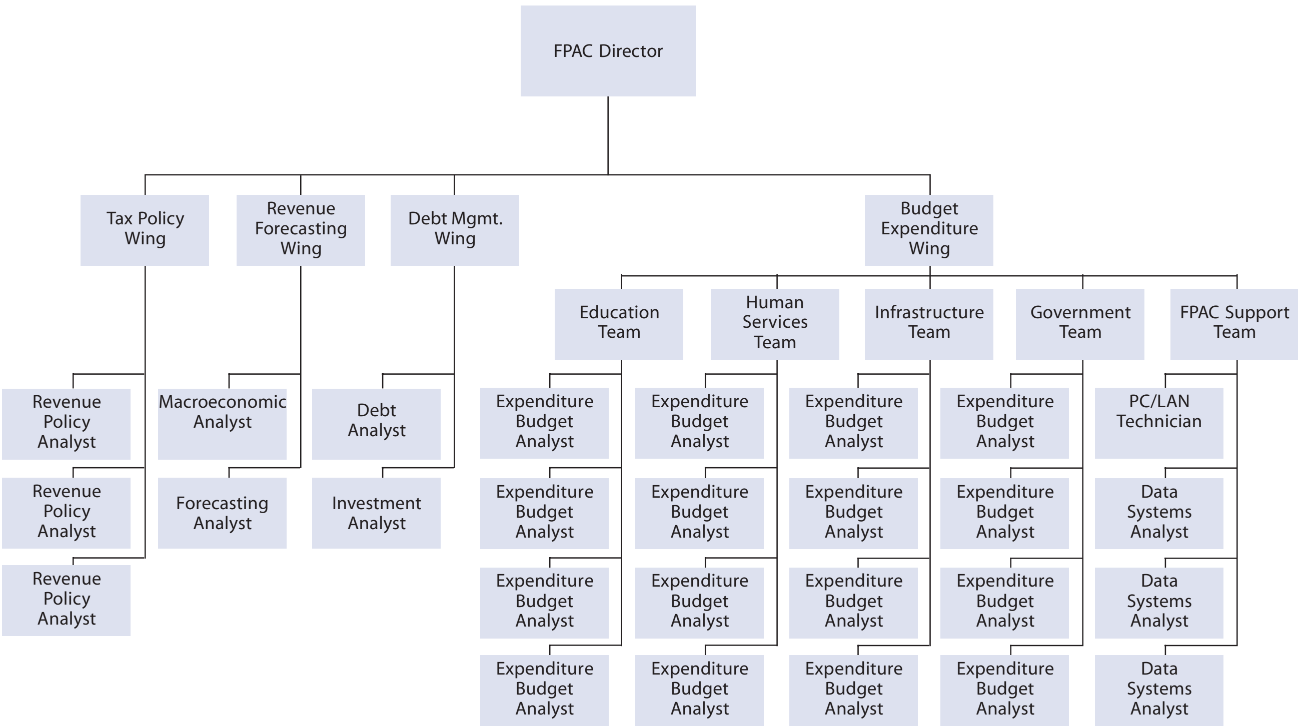
For a more detailed description of a DIMC structure, roles and responsibilities, please see *Volume IV: The Debt & Investment Management Practitioners' Guide.*

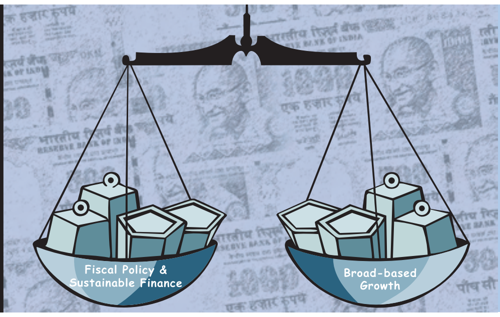
Suggested Organizational Chart

The suggested organizational chart depicted below makes a number of assumptions. It should be viewed as a point of departure when considering how the FPAC might look after some time, therefore this chart might represent an end result rather than a beginning point.

It is more important that the functions described in this implementation guide be included in the state's administrative organizational structure. It is less important that they physically be in a single organizational structure. In addition, the chart should represent the relative strength of these components rather than a definitive number of employees in the FPAC.

FPAC: Recommended Organizational Structure





Section II

Steps to Establishing an FPAC

Implementation Roadmap

The following roadmap is a series of logical steps that a state needs to consider in order to implement an FPAC.

Timing Considerations

A state should consider factors that affect the timing of the FPAC implementation. At its core, the FPAC should enhance fiscal management. A key component of fiscal management is the development of the annual budget. The Finance Department should consider the advantages of phasing in the budget-related components of the cell so that the staff could work into their new duties as the budget process unfolds.

Successful implementation could mean that FPAC members would observe and learn as much as possible by having close organizational access to the Finance Department's processes and procedures in budget development. It would be impossible to have the new FPAC staff fully trained in time to participate in a full and meaningful way in the first year's budget decision-making, but it would be advantageous for them to view the process from the vantage point of their new position in the FPAC.

As members become familiar with the process they would play a more significant role in the budget process during the next year. Moreover, being able to observe the budget presentations to the Legislature could be useful to FPAC analysts with prior finance department experience and especially helpful for the FPAC staff that come from other government and nongovernment organizations.

An aggressive approach to beginning an FPAC may be difficult. For instance, the leadership of the FPAC will be subjected to the intense time pressures that accompany any budget process and might find very little time to oversee the new organization. In addition, some of the very people who might be drawn from their current duties in other Government departments may be in positions that are critical to their department's budget development. Their departure in the short-term could leave the departments in a difficult position.

Another timing consideration relates to the Government's intentions regarding adoption of an MTFP process. If the state plans to move aggressively to fully institute the MTFP platform for the next budget cycle, it would be important to have the macroeconomic and revenue estimation components trained and ready to produce the initial fiscal outlook by late spring or early summer. Additionally, the initial expenditure planning inputs would be required very soon after this process.

The Finance Department must consider the time pressures of the budget calendar. Accordingly, the state must be cognizant of the timing of FPAC creation in context of these important events.

Initial Steps

In connection with the desire to initiate the FPAC as expediently as possible, the REFORM team recommends these initial steps. The major categories and sub categories can be viewed as indicators of progress in implementing the roadmap.

Step 1. Preimplementation Planning

- Obtain the concurrence of the key decision makers in the Department of Finance. Buy-in is critical.
- Determine conditions for the operation of the FPAC. Examples of these conditions could

include requiring a term of three to five years for each posting, protecting the postings from job transfers and job rotations.

- Decide the elements to be included in the FPAC such as the extent of including debt management in the cell.

Step 2. Roll out FPAC

- Issuance of a Government Order as soon as possible will establish the FPAC formally. The order should define any special conditions that accompany its creation.
- Appoint the FPAC Director.
- Finalize job descriptions and position qualifications.

Step 3. Staffing Activities

- Develop strategies for filling positions. Examples of these strategies could be to recruit or assign people from within the Finance Department or from within state government, from public financial agencies.
- Decide strategy for filling positions such as reassignment, deputation, recruitment, and recruitment from outside state government.
- Develop a timetable for staffing the FPAC.
- Establish the vehicle for contracting staff, for use on a case-by-case basis, primarily for appointments from entities outside the Government structure.
- Find suitable candidates and create a list of candidates.
- Develop short lists and make final appointments.

Step 4. Initiate Networks

- Identify state-based academic, institutes, professional associations that can assist in FPAC research activities.
- Officially invite organizations identified above to nominate a member to serve as a FPAC resource person.
- Determine compensation package for resource persons.

Step 5. Initial Training

- Develop training plan for each employee.
- After collaboration with training facilities for appropriate course work, schedule employees for training according to their needs and training plan.

Step 6. Make Assignments for FPAC Members

- Department assignments for Expenditure Budget Analysts.
- Assignments to DIMC.
- Assignments to Tax Analysis wing.
- Assignments to Revenue Forecasting Wing.
- Appointment of FPAC resource persons.

Step 7. Formal Government Order Issued

- Defines scope of the FPAC.
- Defines relationship to state government.
- Officially appoints the FPAC Director.
- Appoints membership positions.
- Describes reporting protocol.
- Defines study protocol.
- Allocates budget line, offices, furnishings, and equipment.

Step 8. FPAC Operationalized

- Operationalize FPAC/DIMC with formal "kick-off" ceremony.
- Ensure regular—at least once a fiscal year—reporting to the state legislature and cabinet.

Step 9. Hold Regular Meetings

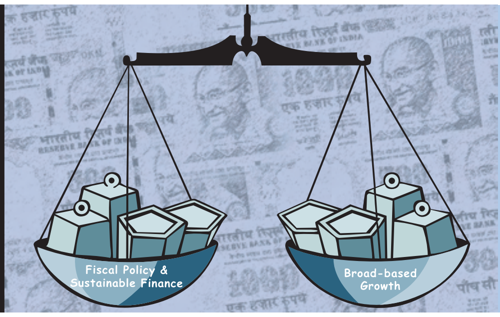
- Establish meeting protocol regarding a quorum and venue.
- Ensure circulation of meeting agenda in advance of meetings.
- Schedule regular meetings of FPAC members and resource persons.
- Ensure participation of Finance Secretary or his designate in meetings.
- Prepare and circulate detailed minutes with clear follow-up action.

Step 10. Prepare Regular Reports

- Establish report format and periodicity—*e.g.*, bi-annual reports. (See Annexure No. 8 for Karnataka example.)
- Determine report recipients.
- Post on web site under the *Right to Information* (RTI) legislation.

Step 11. Publish Completed Studies

- Establish a publication format and periodicity—*e.g.*, annual reports.
- Determine circulation list, which should include—at a minimum—the Chief Minister, his cabinet, principal departmental secretaries, and all state legislators.
- Post on Web site under the *Right to Information* (RTI) legislation.



Annexures

Annexure 1:

Structures and Functional Responsibilities of Select Analytical Units

Annexure 1a: Australia—Experience of New South Wales Office of Financial Management Functional Structure

Economic and Fiscal Directorate

Advice on Economic & Fiscal Strategies

- Recommending an appropriate fiscal strategy.
- Recommending appropriate macroeconomic reforms.
- Advising on fiscal implications of industrial relations.
- Advising on regulatory policy, industry reviews, Productivity Commission, industry and business assistance.
- Facilitating implementation of competition policy.
- Recommending tax and revenue policy.
- Forecasting economic variables (tax receipts, interest rates, etc.).
- Participating in intergovernmental relations.

Resources & Budget Directorate

Budget Management

- Managing and coordinating the State Budget process.
- Managing State Budget aggregates.
- In year monitoring, control and reporting on the State's finances.
- Coordinating Budget Papers preparation.
- Preparing the State Sector Accounts.

Public Sector Management Systems

- Refining and implementing the General Government Sector.
- Financial Management Framework.
- Managing financial legislation and supporting Directions and Guidelines.
- Advising on and implementing appropriate accounting policies and disclosures.
- Advice on the Efficiency and Effectiveness of Public Sector Agencies.
- Human Services.
- Transport Sectors.

General Government Sector

- Monitoring and advising on the performance of agencies.
- Budget formulation and assessment of agency proposals.
- Negotiating and integrating SRAAs and RSPs into the Budget process.
- Conducting strategic reviews.
- Developing, supporting and implementing reforms.

Commercial Sector

- Monitoring and advising on the performance of NSW Government businesses.
- Negotiating SCIs and SBIs.
- Developing, supporting and implementing reforms.
- Resources and Policy Directorate.

Public Sector Policy Reform

- Advising on and over sighting major public sector structural reform, with current emphasis on:
  - Natural resource management; and
  - The energy sector.

Public Sector Management Systems

- Refining and implementing the Commercial Policy Framework that applies to Government businesses, major elements including:
  - Financial Distribution Policy;
  - Capital Structure Policy; and
  - Financial Monitoring Policy.

Advice on the Efficiency and Effectiveness of Public Sector Agencies

- Natural Resources and Environment and Energy Sectors.

Resources and Crown Directorate

Financial Asset and Liability Management

- Setting Treasury Banking System objectives; monitoring manager's performance.
- Setting financial asset portfolio objectives; monitoring manager's performance.
- Advising on management of financial risks.
- Setting debt portfolio objectives; monitoring manager's performance.
- Setting self-insurance arrangements; monitoring manager's performance.
- Advising on insurance and superannuation liability policy issues.
- Accounting for the Crown Entity.

Advice on the Efficiency and Effectiveness of Public Sector Agencies

- Justice and Emergency Services.
- Central Agencies and Financial Services; Education Sectors.

General Government Sector

- Monitoring and advising on the performance of agencies.
- Budget formulation and assessment of agency proposals.
- Negotiating and integrating SRAAs and RSPs into the Budget process.
- Conducting strategic reviews.
- Developing, supporting and implementing reforms.

Physical Asset Policy and Assessment

- Developing policy and supporting implementation of Privately-financed Projects.
- Assessing and monitoring capital investment proposals.
- Implementing procurement policy and supporting agency compliance.
- Implementing asset management policy and supporting agency compliance.
- Monitoring compliance with agreements on projects with major Government risk.
- Developing and implementing strategic capital reform.
- Advice on the Efficiency and Effectiveness of Public Sector Agencies, Property Sector.

Commercial Sector

- Monitoring and advising on the performance of NSW Government businesses.
- Negotiating SCIs and SBIs.
- Developing, supporting and implementing reforms.
- Executive Coordination Unit.
- Providing executive management support and liaison with Treasurer's Office.
- Coordinating OFM communication strategies.
- Corporate Management Unit.
- Advising on OFM budget management and human resource policy and applications.
- Managing service level agreement with CCSU.

Annexure 1b: United Kingdom—Experience of Scotland (Scottish Executive Finance and Central Services Department)

The Executive has a number of groups that provide common services, including personnel, finance, information and support services to all departments.

The Finance and Central Services Department (FCSD) is responsible for coordination of relations with the UK Government and Europe, local government relations, and provides support to the Scottish Cabinet.

The Finance group within FCSD advises Ministers on the allocation of the Scottish Budget and accounts for the budget including the issue of payments and recording of receipts. It also advises other Departments of the Scottish Executive on financial matters and issues guidance to the Executive and other public bodies on propriety and regularity in financial affairs.

The FCSD is responsible for developing and administering policy on local government—its structure, powers, conduct and finance (including council tax and nondomestic rates). The department is also responsible for pursuing the Executive's policies on "Best Value" in local government.

On April 1, 1996, 29 new unitary (all-purpose) authorities replaced the previous two-tier structure of local government in mainland Scotland. The three islands authorities (Orkney, Shetland and Western Isles), which were already unitary, continued in being.

The FCSD sponsors the Local Government Boundary Commission for Scotland, and the Accounts Commission for Scotland (which deals with the audit of local authorities).

Annexure 1c: New Zealand (New Zealand Treasury: Planning and Budgeting Process)

Introduction

The Budget process allows the Government to:

- Plan for the period ahead;
- Allocate resources in line with policy priorities; and
- Seek authority from Parliament for spending.

Supplementary Estimates are prepared for the current year to seek parliamentary approval for:

- Changes to any appropriation type;
- Any further capital investment;
- Changes in output prices;
- New outputs to be produced; and
- Changes relating to other expenses and benefits.

During the strategic phase of the Budget cycle, Ministers determine their Budget strategy for the coming three years.

The Crown's financial year begins on 1 July. Ministers are normally able to advise Departments of their proposed budget allocations before the beginning of the financial year. These proposed allocations are contained in the "Estimates of Appropriations."

The Estimates

The Government's request for appropriations, and supporting information, is presented to the House of Representatives at Budget time in a formal document known as the main Estimates (the full title is Estimates of Annual Appropriations for the Government of New Zealand). The Estimates detail appropriations sought from Parliament by Vote Ministers for expenses, expenditure and liabilities, for all purposes including classes of outputs. The Estimates also state how output classes are linked to the outcomes the Government is seeking.

Appropriation

An appropriation is a Parliamentary authorization for the allocation of resources to a Minister for a specified purpose. In the Estimates, Ministers specify how much they need to purchase particular outputs. The Government requests an appropriation for each class of outputs (whether to be supplied by a department or other organization), capital investment (capital contributions to departments, investments in other organizations and purchase or development of Crown capital assets), and other expenses. Appropriations are also made for benefits or other unrequited expenses, borrowing expenses and the repayment of debt. In all, there are seven appropriation types.

The Budget is the Government's financial plan for each July to June year.

Planning and Budgeting

The budget process leads to the preparation of the "Estimates," which contain Vote Ministers 'requests for authority from Parliament to incur expenditure and liabilities. The Estimates describe how the Ministers' plans fit in with Government's objectives, the resources they need and how the authority is to be used.

Stages of the Budget Cycle

The budget process consists of a number of elements:

- Strategic phase;
- Preparation of Vote budgets;
- Development of budget initiatives;
- Review of budget baselines;
- Consideration of proposed budget initiatives;
- Production and presentation of budget documents; and
- Passing the Appropriation Bill.

Strategic Phase (Normally August to November)

Main Products of the Budget Cycle

- Half-year economic and fiscal update—(December);
- Budget Policy Statement—(February/March);
- Budget Package—(May-July);
- Speech;
- Fiscal Strategy Report;
- Economic and Fiscal Update;
- Estimates of Appropriation;

- Departmental Forecast Reports;
- Appropriation Bill; and
- Supplementary Estimates of Appropriations (April-June).

The December (Half-year) Economic and Fiscal Update (DEFU)

An economic and fiscal update, specified by the Fiscal Responsibility Act, is published each December. This includes economic and fiscal forecasts for the current and following three years, updated with new information received since the main Budget forecasts were prepared. Decisions taken during the strategic phase are the basis for the content of the Budget Policy Statement. This contains Ministers' decisions on budget priorities. The target levels of aggregate spending, revenue, net debt and net worth are important elements of the Budget Policy Statement. This statement is informed by the information in the DEFU and the results of the strategic phase.

The Budget Policy Statement:

- Includes information about the Government's short-term fiscal intentions, long-term fiscal objectives and priorities for the coming Budget;
- Sets the stage for an informed debate in the House on the parameters and priorities for the coming Budget; and
- Is reviewed by the FEC whose report is debated in the House before final Budget decisions are taken.

The Budget Policy Statement is required to be published no later than 31 March each year.

Preparation of Vote Budgets (Normally November to February)

Ministers and chief executives prepare draft budgets and purchase agreements for the coming year. The purchase agreements, while not part of Budget submissions, include proposed departmental outputs, associated performance indicators and the expected costs of producing the outputs. As well as the coming year, draft outputs and departmental budgets are prepared for the two subsequent years. Preparation begins on the main Estimates for the coming year.

In December, the Government publishes an Economic and Fiscal Update, which includes the latest information on economic and fiscal forecasts for the current and following three years. In the latter part of the calendar year, Ministers and Cabinet decide on and prepare the key themes and priorities for the following year's Budget. Decisions taken during the strategic phase are reflected in the Budget Policy Statement, outlining the Government's plans and priorities.

Development of Budget Initiatives (Normally November to February)

Ministers and their departments develop budget initiatives, which will have an impact on revenue and expense levels. These policy proposals are required to be consistent with the Budget priorities and fiscal parameters agreed during the strategic phase.

Review of Budget Baselines (Normally February to April)

Ministers are expected to keep total expenses for each Vote within approved levels. These levels, called baselines, contain amounts for the coming year and the following two years. However, the mix of outputs purchased may be changed so long as total expenses do not exceed approved baselines.

This baseline system avoids small incremental increases in costs adding up to significant additional spending, which may undermine the Government's agreed fiscal and policy objectives. The baseline system also provides greater certainty for medium-term planning by departments. Ministers may request changes to baselines, and Cabinet considers proposals during the review of the baselines prior to the Budget. The circumstances in which baseline changes are agreed are tightly defined. These include changes arising from Cabinet decisions since the previous fiscal update and forecast revisions to demand-driven expenses, such as changes in the numbers projected to receive welfare benefits. At the same time as the preparation and review of the budget baselines for the coming years, Ministers and chief executives agree any Supplementary Estimates proposals for the current year, including any planned changes to outputs. Supplementary Estimates proposals bring together Cabinet decisions and forecasting changes for the current year, which have been made since the last Budget.

From December to February, Ministers and chief executives prepare draft budgets and purchase agreements for the coming year, and make plans for the following two years. From February to April, departments refine budget proposals and Cabinet considers the Ministers' requests. Ministers are expected to keep total expenses for each vote within approved levels ("baselines") for the coming year and the following two years. They may request baseline changes if necessary. "Supplementary Estimates" request authority when circumstances have changed during the year. Ministers are expected to keep total expenses for each vote within approved levels. These levels, called baselines, contain amounts for the coming year and the following two years.

Consideration of Proposed Budget Initiatives (Normally February to April)

During this period, Cabinet reviews Ministers' policy proposals that will have an impact (either increasing or decreasing) on expenditure and revenue levels. Cabinet assesses the consistency of these proposals with the Government's overall strategy, in particular with the Budget priorities and fiscal intentions set out in the Budget Policy Statement. After the House has debated the FEC's report on the Budget Policy Statement, Cabinet makes final Budget decisions.

Production and Presentation of Budget Documents

On Budget day the Minister of Finance presents to the House of Representatives the following documents covering the fiscal year beginning on 1 July:

- The first Appropriation (Estimates) Bill for the new fiscal year;
- Budget speech and Fiscal Strategy Report;
- The Budget Economic and Fiscal Update;
- The main (Budget) Estimates; and
- Departmental forecast reports.

The Budget must be presented in the House of Representatives no later than 31 July each year. In practice, the Budget can be presented in May or June. The first reading of the main Appropriation Bill takes place on Budget day when the Bill is presented in the House. The Minister of Finance delivers the Budget speech, moving the second reading of the main Appropriation Bill, and tables the Budget documents in the House. The second reading of the Bill is then debated in the Budget debate.

Passing the Appropriation Bill

The Fiscal Strategy Report, Budget Economic and Fiscal Update and the Estimates stand referred to the FEC. The FEC allocates Votes to appropriate select committees for the Estimates examination. The select committees examine Ministers and departments about the appropriations requested. Each select committee is required to report back to the House within two months of the delivery of the Budget. In addition the FEC examines the Minister on the Fiscal Strategy Report and the Budget Economic and Fiscal Update. The "committee stage" of the main Appropriation Bill is called the Estimates debate. During this debate, individual Votes are debated. This is referred to as consideration by the committee of the whole House. The debate on the third reading of the main Appropriation Bill must be completed within three months of the delivery of the Budget. The debate on the third reading may include reference to the content of the Fiscal Strategy Report, the Budget Economic and Fiscal Update and FEC's report on these documents. When the Bill has been read a third time, it is passed by the House and becomes law with the assent of the Governor-General. In this way the Government's annual Budget becomes law through an Appropriation Act. Chapter Four explains the appropriation system in more detail.

Annexure 1d: Canada—Experience of Ontario (Ministry of Finance Structure)

The mission of the Ministry of Finance is to establish an environment, which will ensure a dynamic, innovative and growing economy, and to manage the fiscal, financial and related regulatory affairs of the Province of Ontario. To carry out this mission the ministry will create a climate for economic growth and job creation in the province; promote the effective and efficient delivery of government services to taxpayers and reduce spending; ensure prudent management of the province's debt; balance the budget; and ensure that public organizations remain accountable to taxpayers for the use of their funds.

The principal functions of the Ministry are to recommend taxation, fiscal and economic policies, manage provincial finances, develop and allocate the provincial budget, and administer the Province's major tax statutes and tax assistance programs.

Deputy Minister's Office

- Internal Audit Services;
- Legal Services Branch—Toronto; and
- Legal Services Branch—Ottawa.

Counsels the ministry on the interpretation of statutes and regulations, and the preparation and review of proposed legislation, regulations and other legal documents.

Communications and Corporate Affairs Branch

Provides strategic communications advice and planning to the Ministry of Finance, the Deputy Minister, all ministry divisions and, where appropriate, all ministries to support jobs and the economy.

Corporate and Quality Service Division

- Corporate Planning and Finance Branch;
- Freedom of Information and Protection of Privacy Office (FoI);
- Human Resources Branch;
- Revenue Operations;
- Client Services Branch;
- Central Agencies Information and Information

Technology Cluster (CAC);

- Enterprise Business Solutions Branch;
- Enterprise Technology Solutions Branch;
- Corporate Business Solutions Branch; and
- Management Services Office.

Fiscal and Financial Policy Division

Provides the Minister of Finance and the government with advice and assistance on all aspects of fiscal and financial policy, fiscal planning, financial standards and reporting, and overall stewardship of the financial resources of the Province.

- Financial Analysis Branch.
- Fiscal Planning Branch.
- Office of the Provincial Controller.
- Integrated Financial Information System (IFIS) Project.

The IFIS project is implementing a single, integrated financial-management system to replace many of the different financial systems used in the provincial government. The system is being rolled out across the Ontario Public Service over the next two years in small groups of ministries at a time and is now "live" in several ministries and central agencies.

- Business Applications, Change Management;
- Education and Training.
- Information and Information Technology Operations.
- Program Management Office.

Office of Economic Policy

Advises on and oversees the Provinces economic policies. It assists the government by developing economic, demographic and revenue forecasts, pursuing research into macroeconomic policies, international issues, sectoral and regional economic issues, socioeconomic and labor market issues.

- Industrial and Financial Policy Branch.
- Labor and Demographic Analysis Branch.
- Macroeconomics Analysis.
- Policy Branch.

Office of the Budget and Taxation

Acts as the central focus point for the Ontario Budget planning and production processes. The office also formulates policies on taxation, federal-provincial finance, pensions and income security, as well as designing Ontario's Tax and Property Assessment Legislation.

- Corporation and Commodity Taxation Branch.
- Pension and Income Security Policy Branch.
- Personal Income Taxation and Fiscal Arrangements Branch.
- Strategic Research Unit.

Provincial Local Finance Secretariat

- Property Tax Policy Branch; and
- Provincial Local Funding Unit.

Tax Revenue Division

The Tax Revenue Division administers the following acts:

- Community Small Business Investments Fund Act;
- Corporations Tax Act;
- Employer Health Tax Act;
- Fuel Tax Act;
- Gasoline Tax Act;
- Gross Receipts Tax under the Fair Municipal Tax Act;
- Land Transfer Act;
- Mining Tax Act;
- Ontario Guaranteed Annual Income Act;
- Ontario Home Ownership Savings Plan Act;
- Provincial Land Tax Act;
- Race Tracks Tax Act;
- Retail Sales Tax Act;
- Succession Duty Supplementary Provisions Act;
- Tobacco Tax Act;
- Collections and Compliance Branch;
- Corporations Tax Branch;
- Income Tax Related Programs Branch;
- Motor Fuels and Tobacco Tax Branch;
- Retail Sales Tax Branch;
- Special Investigations Branch;
- Tax Appeals Branch.

Annexure 1e: United States—Experience of New York State (Division of the Budget)

Staff units in the Division perform a variety of activities including development of fiscal policy advice in revenue and expenditure forecasting, budget process management, reviewing management systems and intergovernmental relations, and providing internal administrative and computer systems support. Specific Staff Unit responsibilities:

Budget Services Unit

- Coordinates production of the Executive Budget books, related appropriation bills and Division's drafting and review of legislation.
- Manages DOB's internal procedures for preparing budget documents.
- Analyzes issues affecting the State workforce and labor relations, including the fiscal impact of proposed labor agreements.
- Coordinates the Division's review of legislation and transmits the Division's recommendations on legislation to the Governor's Office for final action.
- Informs DOB staff of the status of legislation affecting the Governor's program and budget initiatives.

Economics/Revenue Unit

- Tracks revenues collected by the State in the current year.
- Updates revenue estimates for the current fiscal year based on actual collections.
- Calculates revenue projections used as the basis for preparing Executive Budget recommendations and the State's multiyear Financial Plan.
- Analyzes proposed fiscal and tax policies.
- Studies national and international economic issues that could affect the State's revenues and budget.

Expenditure/Debt Unit

- Prepares state spending estimates.
- Monitors State spending, financial commitments and cash flow.
- Compares spending trends against current estimates and revises projections based on actual spending experiences.
- Coordinates capital debt management issues.
- Assists in preparing the State's Annual Information Statement, multiyear financial plans, and the Capital Program and Financing Plan.
- Manages the annual "Federal Single Audit" of federally-funded programs.

Management and Governmental Relations Unit

- Coordinates the State's fiscal policies and actions affecting Federal/local governments, with particular emphasis on shaping the State's response to fiscally distressed communities and Federal programs/initiatives.
- Analyzes various policy, financial and managerial issues that usually involve multiple agencies and presents recommendations or alternatives for addressing them.

Strategic Analysis Unit

- Assists the Division in developing its multiyear budget strategy.
- Conducts analysis of various fiscal issues.
- Coordinates with the Economics/Revenue and Expenditure/Debt Units on strategic planning for the State's long-term financial plan.

Administration Unit

- Administers the Division's human resources program and serves the "host" HR agency for several miscellaneous State agencies.
- Performs the line budget preparation and budget execution function for the Division, the Executive Chamber and the Office of the Lt. Governor.
- Provides business and financial management support for Division activities.
- Coordinates DOB's internal control program.
- Administers a staff development and training program.

Computer Services Unit

- Manages all Division information technology management assets.
- Coordinates Division computer application development and support activities.
- Aligns information technology management decisions with Division business goals.

Line Units are responsible for preparing and implementing State agency budgets. For the state agencies assigned to their respective unit, each line unit:

- Coordinates the development and execution of agency programs and budgets.
- Analyzes agency budget requests to determine if the request represents sound public policy, improves governmental operations and the agency's ability to carry out its mission, promotes efficiencies, and represents a useful investment of resources.
- Assists agencies in carrying out program and fiscal objectives.
- Monitors agency spending trends and program performance.
- Recommends fiscal and programmatic enhancements.

Transportation/Environment/Economic Development/Public Authorities Unit

- Budgets for agencies and public authorities that administer the State's economic development, transportation and infrastructure programs.
- Budgets for the agencies that deal with then environment, as well as those agencies with programmatic responsibility for the State parks system and the agricultural industry.

Education Unit

- Budgets for education-related agencies and State-supported education and arts programs, including the State Education Department, the State University and the City University of New York.

Health and Mental Hygiene Unit

- Budgets for the agencies that deal with public health concerns, medical assistance.
- Budgets for agencies that develop, deliver and coordinate State and community-based services to the mentally ill, developmentally disabled and those receiving substance abuse treatment.

Public Protection Unit

- Budgets for all criminal justice agencies, as well as those related to public safety and regulation.
- Budgets for central staff agencies (the Office of General Services, the Department of Civil Service, the Office of the State Comptroller and the Department of Law) and the School Tax Relief (STAR) programs.

Welfare Unit

- Budgets for programs administered by the human services agencies, including family assistance programs, Federal block grants to assist needy families, family and children's services, and other Federal and State public assistance programs.
- Budgets for the Department of Labor and its welfare employment programs.

Communications Office

In addition to the Division's line and staff units, DOB has a Communications Office that coordinates the release of public information concerning the State Budget and other fiscal issues, and responds to special information requests from the press, the public or the Legislature.

Annexure 1f: United States—Experience of Minnesota State (Department of Finance)

Commissioners' Office

The Commissioner of Finance oversees the financial affairs of the state. These responsibilities include: coordinating the development of the Governor's operating and capital budgets, providing professional assistance to all state agencies in managing their financial activities, and managing the state's general obligation debt. The Department of Finance is also charged with operating the state's accounting and payroll processes.

Economic Analysis

The Economic Analysis Division provides periodic forecasts of state revenues. Economic Forecasts are issued in February and November of each year and Economic Updates are issued in January, April, July and October of each year. These forecasts set the starting point for the budget process. Sound revenue forecasts make government more efficient by reducing uncertainty for public sector managers and by reducing the need to make short-term adjustments in program activities due to unanticipated fluctuations in revenues.

Budget Division

The division has the responsibility of preparing the Governor's operating and capital budget recommendations. The budget division includes both budget operations and budget services components. Together these two teams are responsible for the analysis, processing and production of the budget recommendations, the economic forecast, and other financial documents. Our mission to ensure accountability of and value for the public dollars guides the division's work.

- Budget Development—Producing the governor's biennial, supplemental, and capital budgets is the program's highest priority.
- Financial Planning and Budgetary Reporting—The program provides policy makers historical, current and projected statewide projections of revenues and expenditures.
- Financial Analysis—Program staff conduct analyses to: identify areas of the budget that suggest budget or financial management problems exist; ensure that state policies and adopted laws incorporate sound financial management principles; and identify budget options and analyze budget issues for executive and legislative considerations.
- Budget Implementation—The program develops and implements statewide budget policies, ensures that agency spending plans conform to state laws, and provides consulting services to agencies on accounting and financial management procedures.

Treasury Division

The Treasury Division is also responsible for debt policy, debt capacity forecasting and the actual sale of state general obligation bonds. The proceeds from these bonds are used to finance the costs of capital projects. The division also works with the Governor's Office, the Legislature, state agencies, local governments and the public to understand what type projects the Minnesota Constitution allows general obligation bonds to be used for. The division projects the maximum size of capital budgets based upon the state debt guidelines and they educate people on the debt management policy and the guidelines to it.

Accounting and Information Technology Services

Accounting Services: This unit provides statewide accounting and payroll services to agencies, including the policies and procedures governing these administrative functions.

Accounting and Payroll Operations: This unit is responsible for directing the operation of the statewide accounting and payroll systems and maintaining the integrity of the information contained in the systems.

Statewide internal Control: This unit strives to develop and maintain statewide internal controls. This includes determining what controls are necessary in statewide financial systems as well as testing the reliability of the controls.

Accounting and Payroll Assistance to agencies: This unit provides training and assistance to agency staff to enable them to use the statewide systems effectively and efficiently to meet their objectives.

Financial Reporting: This unit prepares the state's Comprehensive Annual Financial Report (CAFR) and acts as the lead agency in the preparation of the state's portion of the federal single audit report and reporting for federal cash management activities.

Information Services: Information Services is the technical support team for the state's major administrative information systems, providing systems support for the state's core business applications:

- **Information Access (IA)/Budget Information Systems (BIS)**—This unit manages both the State's data warehouse and the State's budget systems.
- **Information Access (IA)**—This unit develops and manages the state's information warehouse containing data from the accounting, procurement, payroll, human resource and insurance systems. This information is used by agency and legislative decision-makers to manage and analyze resources, spending, account for state funds and make funding decisions.

Budget Information Systems (BIS) —This unit manages three statewide systems that provide online budget information to users within the three branches of state government. They are the biennial budget system (BBS), the capital budget system (CBS), and the fiscal note tracking system (FNTS). The BBS provides support for the preparation of agency operating budgets and governor's recommendations. The CBS provides support for agency capital project requests. Both systems track legislative proposals and appropriations. The FNTS is designed to report and track the fiscal impact of proposed legislation.

Technical Services—This unit manages the department's desktop computer resources, administers the local and wide-area telecommunications (data, audio and video) network connectivity and produces internal personal computer (PC) training and support. This unit maintains both the department's internal and external WWW servers.

MAPS Systems and Programming—This unit is responsible for the continuing operations of the statewide Minnesota Accounting and Procurement System (MAPS).

SEMA4 Systems and Programming—This unit provides the scheduling, related support operations and systems/programming support for the payroll part of the SEMA4 system. SEMA4 is the State's Human Resources, Payroll and Insurance system.

Annexure 1g: United States—Experience of Wisconsin State (Division of Executive Budget and Finance)

Department of Administration

The Division of Executive Budget and Finance provides fiscal and policy analysis to the governor for development of executive budget proposals and assists agencies in the technical preparation of budget requests. It reviews legislation and prepares or coordinates the fiscal estimates that accompany all expenditure bills. It also advises the State of Wisconsin Building Commission and the governor on the issuance of state debt and administers finances for the clean water revolving loan fund program. The division provides program and management evaluation, maintains the management information system for authorized state employee positions and keeps the governor's appointments register. It also established accounting policies and procedures, maintains the state's central payroll and accounting systems, monitors agency internal control procedures and produces the state's annual fiscal and financial reports.

The Division of Intergovernmental Relations maintains state agency ties with local, regional and federal governments. The Office of Land Information Services provides staff support to the Wisconsin Land Council and it administers the Wisconsin Land Information Program in conjunction with the Wisconsin Land Information Board.

Wisconsin Department of Revenue

The Research and Policy Division (R&P) provides detailed analyses of fiscal and economic policies to the Secretary of Revenue, the Executive Office and other state officials. The division assesses the impact of current and proposed tax laws, prepares official general fund tax revenue estimates used to develop the executive budget, issues quarterly forecasts of the state's economy and develops various statistical reports.

Annexure 2:
FPAC Links

Virtual Links

- http://steel.gov.in/Performance%20Budget%20(2007-08)/Outcome%20Budget.pdf
- http://cga.nic.in/pdf/Guidelines_Outcome_Budget.pdf
- http://www.ato.gov.au/budget/2006-07/bp1/html/index.htm
- http://www.mit.gov.in/download/outcomebudget2007-08statusason30092007.pdf
- http://powermin.nic.in/reports/pdf/Outcome_budget.pdf
- http://www.naco.org/CountyNewsTemplate.cfm?template=/ContentManagement/ContentDisplay.cfm&ContentID=21992
- http://www.legis.state.ia.us/lsadocs/IssReview/1996/IR131B.PDF
- http://gov.ua.nic.in/
- www.kar.nic.in
- http://jharkhand.nic.in/

Professional Societies

- www.cbpsindia.org
- www.cbpp.org