INDIA - GOVERNMENT FISCAL YEAR
April 1 – March 31

CURRENCY EQUIVALENTS
Currency unit: Rupees (Rs.) as of October 8, 2009
US$1 = Rs. 46.62

ABBREVIATIONS AND ACRONYMS

AG	Auditor General	IFC	International Finance Corporation
		M&E	Monitoring and Evaluation
DFID	Department to International Development	MTFP	Medium Term Fiscal Plan
DPL	Development Policy Loan	PDS	Public Distribution System
FRBM	Fiscal Responsibility and Budget Management	PMGSY	Pradhan Mantri Gram Sadak Yojana
GDP	Gross Domestic Product	PPP	Public Private Partnerships
GoB	Government of Bihar	PRI	Panchayati Raj Institutions
GoI	Government of India	RCD	Road Construction Department
GSDP	Gross State Domestic Product	RD	Rural Development Department
IAMR	Institute of Applied Manpower Research	RTI	Right to Information
IGNOU	Indira Gandhi National Open University		
IDA	Bihar Infrastructure Development Authority	TEMIS	Teacher Management Information System

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FIRST BIHAR DEVELOPMENT POLICY LOAN/CREDIT
Second Tranche Release

TRANCHE RELEASE DOCUMENT

I. INTRODUCTION

1. ***This memorandum summarizes progress in the implementation of the first operation in support of Bihar's medium term development program with a focus on actions taken by the Government of Bihar to meet the specific conditions for the release of the second tranche of the First Bihar Development Policy Loan/Credit*** (Bihar DPL I). It should be read in conjunction with the main Program Document.[1]

2. Bihar DPL I provides financial support for the implementation of critical structural reforms to attain sustainable and inclusive development over the medium term, while improving the delivery of key public services in one of India's largest and poorest states. The Government of Bihar's ("GoB") reform program targets inclusive growth and improved delivery of social services. The program rests on *three inter-related pillars*:

(a) ***Stepping-up public investment and strengthening public financial management and governance***. The pillar is focused on a sustainable increase in fiscal space for development and public investment and improving the effectiveness of public expenditures through improvements in public financial management, agency reforms to improve public service delivery and strengthening local level accountability by supporting the Panchayati Raj Institutions (PRIs).

(b) ***Raising economic growth through agriculture, investment climate reforms and infrastructure***. This pillar supports reforms on multiple fronts to lay the foundations for a dynamic economy. Agriculture reforms include land reform, one window extension service for farmers, participatory irrigation management, improving access to rural credit and furthering competition in agriculture marketing to improve returns to agriculture. The investment climate reform component supports a more conducive legal and regulatory framework to promote rapid clearance procedures for establishing enterprises and improving the legal and policy environment for enabling Public Private Partnerships (PPPs).

(c) ***Improving public service delivery in the social sectors***. Under this pillar the reform program supports education personnel reforms by decentralization of recruitment of teachers to PRIs, strengthening teacher qualification, pedagogical skills and accountability systems. In the health area, the program supports strengthening staffing, outsourcing of services and accountability. The reform program supports modernization of social protection program delivery and provision of social welfare services to vulnerable groups as well as the building of more efficient, capable and credible institutions to oversee and support service delivery.

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[1] See the Program Document for the Operation (IN-P102737), Report No. 40230-IN.

3. GoB has fully complied with all the original tranche-release conditions set out in the legal agreements for this operation.

- Bihar has made progress, satisfactory to the Association and the Bank, in carrying out the Program as set out in Bihar's Letter of Development Policy.

- Bihar has implemented a medium-term fiscal framework and prepared its state budget for Fiscal Year 2008-09 in line with the framework.

- Bihar has taken necessary and appropriate government action to: (i) reduce the number of objects and detailed heads in its budgetary systems; (ii) reduce budget line items that have no object heads; and (iii) align its object heads with those in the Auditor General's systems.

- Bihar has taken necessary government action for Panchayats to complete a second round of teacher hiring that includes provisions for: (i) standardized recruitment criteria, (ii) transparency of candidate review processes with proper registries maintained at local levels; (iii) third party observation in the selection process, and (iv) sample based checking of the recruitment process by independent agency.

As discussed below, GoB has also satisfied an additional tranche-release condition regarding monitoring of civil-service transfers, which was introduced through an amendment to the program agreement.

4. One of the operation's prior actions concerned GoB's policy on transfer of civil servants. The policy adopted in March 2007 had four basic elements: (i) annual transfers of government employees were to be limited to no more than ten percent of each department's actual cadre strength; (ii) with minor exceptions, only those officers who had completed at least three years of service could be transferred; (iii) with some exceptions, transfers could be effected only once a year (instead of twice previously); and (iv) the use of political influence in transfers was banned. The GoB's rationale in formulating this comprehensive transfer policy was to ensure stability in the tenure of civil servants, which is generally understood to have a correspondingly beneficial effect on public-service delivery. Each element of the transfer policy was reflected in a composite prior action and reflected in the operation's program document and in the program agreement between the Bank and the State of Bihar.

5. On May 28, 2008 without previously notifying the Bank, GoB reversed the ten-percent cap on civil-service transfers. The three other elements of the transfer policy remained undisturbed. According to GoB, application of the ten-percent cap had unnecessarily lengthened the tenure of some officials. This was at odds with the transfer policy's objective of ensuring that officers are retained for approximately three years in each position. As a consequence, GoB was forced to make several exemptions to the ten-percent cap, which, in turn, severely undermined the benefit of having such a cap in the first place. Moreover, notwithstanding reversal of the cap, GoB's statistics indicate that the transfer policy's underlying objective of stabilizing transfers for senior officials continues to be met. GoB's data reveals that, after the cap was repealed, there were only 3714 transfers of Class A and B officers in June 2008 - approximately 8% of the total cadre strength of about 46,066. GoB also informed the Bank that it intended to appoint a high-level review body, chaired by the Chief Secretary, to systematically monitor compliance of its transfer policy guidelines for senior officers. In December 2008, after considering GoB's rationale for reversing the ten-percent cap and the overall program's satisfactory progress, Management agreed with Bihar's proposal to substitute the previously agreed ten-percent cap for a new action focusing on GoB's decision to appoint a high-level review body on transfers. GoB

appointed the high-level review body in July 2009, and shortly thereafter, the Bank and Bihar executed an amendment to the program agreement to reflect that action through a new tranche-release condition. This amendment will become effective immediately prior to the actual release of the second tranche.

6. The next Section describes the overall macro-economic policy framework in India as well as recent trends in development outcomes in Bihar. Section III describes progress with implementation of GoB's overall reform program. Section IV describes the status of specific tranche release conditions. The memorandum concludes that the conditions for the release of the second tranche have been met and that substantial progress has been made in implementing the measures outlined in GoB's Letter of Development Policy (see Annex A of the Program Document).

II. RECENT ECONOMIC DEVELOPMENTS

7. **The global financial crisis has impacted India but not as deeply as other countries.** India's growth rate fell to an estimated 6.7 percent in 2008-09 from an average annual growth rate of 8.9 percent between 2003 and 2008. Due to a weak monsoon this year, India's growth is expected to fall further in 2009-10 to between 6.0-6.5 percent. This continued robust growth rate has been driven by strong private investment and a competitive exchange rate that facilitated external trade and strong capital flows. Also important were productivity improvements in manufacturing, an increasing outward orientation, a surge in domestic savings with continued financial deepening, and an increasing share of manufacturing and services sector in GDP. The growth rate of investment accelerated to 16 percent annually between 2003 and 2008 as compared to 5 percent during the previous three years. However, from 2007 the growth in investment began to encounter binding constraints such as infrastructure and skills shortage, monetary tightening to control rising inflationary expectations, weakening global demand and an appreciating exchange rate. This caused quarterly growth rates to begin to slow down even before the global macroeconomic crisis occurred in September 2008.

8. **The domestic slowdown was accentuated by a sharp rise in global commodity price in the first half of 2008.** Prices of food, energy and raw material rose dramatically in India leading to a surge in inflation, which peaked at 12.9 percent in August 2008. The spike in global commodity prices contributed to the widening of both the current account deficit (from 1.5 percent of GDP in 2007-08 to 2.6 percent in 2008-09) and the central government's fiscal deficit (from 2.7 percent of GDP in 2007-08 to 6.2 percent in 2008-09) as oil and fertilizer price increases were not fully passed through to consumers.

9. **The global slowdown adversely impacted trade volumes and the current account deficit.** Merchandise trade declined sharply as exports contracted by an average of 19 percent between 2008 and 2009, while imports declined by 15 percent. Growth in the export of services, though positive, also took a hit increasing by only 16 percent in 2008-09, compared to an annual average growth of 37 percent between 2003 and 2008.

10. **Monetary and fiscal stimulus measures were used extensively to offset the impact of the slowdown.** To meet the initial shortage of foreign exchange in the face of declining capital flows, the Reserve Bank of India employed its foreign exchange reserves. It also introduced a series of measures to provide liquidity. The Cash Reserve Ratio and Statutory Liquidity Ratio were reduced substantially. A number of windows aimed at refinancing banks to provide liquidity to small industries and exporters were established. Key policy rates like the repo and the reverse repo rates were brought down sharply to stabilize money market interest rates. In addition, the

government introduced a series of fiscal stimulus measures consisting of tax cuts and additional spending. As a result of these steps Government of India's (GoI) 2008-09 gross fiscal deficit jumped from a budgeted 2.5 percent of GDP to an estimated 6.2 percent. The consolidated general government deficit is estimated at 10.3 percent. GoI's fiscal stimulus measures will continue through 2009-10 raising the budget fiscal deficit to 6.8 percent. Unless properly managed when growth begins to recover to previous levels, the spike in the fiscal deficit could put upward pressure on interest rates and rekindle inflationary expectations as well as increasing the share of Government debt to GDP already high at 80 percent.

11. **Recent data indicates an acceleration of growth in certain sectors although the poor monsoon continues to be a source of concern.** Industrial production registered positive growth in the first three months of fiscal year 2009-10 growing at 7.8 percent in June. Certain sectors like capital goods, cement, steel and automobiles have shown strong performance. Net FII flows have turned positive in the current financial year and the Bombay Stock Exchange's index 'Sensex' has recovered some lost ground.

12. India's macroeconomic policy framework has responded adequately to the global financial crisis and satisfies the tranche release condition detailed under Schedule 1C of the Loan Agreement.

B. Sub-national Developments

13. **Bihar's challenges lie at the heart of India's inclusive growth agenda**. While Bihar has 8.5 percent of India's population, it accounts for only 1.6 percent of the country's GDP. The state is predominantly rural, with an urbanization rate of only 11 percent compared to nearly 28 percent for India. Landholdings are highly fragmented, with an average size of 0.75 hectares, which is half of the average national level of 1.4 hectares. Nearly half of all households are landless or near landless, with agricultural laborers constituting 48 percent of the labor force, about double the average national level of 27 percent. Female participation rates at about 18 percent are among the lowest in India. The overall literacy rate in India in 2001 was 65 percent while in Bihar it was only 47 percent. The female literacy rate in Bihar in 2001 was even lower at 34 percent as against a national average of 54 percent. Bihar's public services and infrastructure are among the worst in India. Bihar's road density is only 111 kms against the national average of 360 km. Nearly 57 percent of habitations in the state are not connected to roads. Only 21 percent households have access to piped water. Electricity is inaccessible to the vast majority of households. Bihar is the second poorest state in India with 41 percent of the population classified as poor on the basis of per-capita consumption expenditure according to official estimates.

14. **Bihar has grown more slowly than the rest of the economy but growth rates have picked up.** Bihar's long term growth trend from 1999-2008 at 6.5 percent has been below the national average of 7.3 percent. In recent years (2005-08), Bihar's growth rate has accelerated to 7.7 percent but the gap with the national growth rate at 9.4 percent has also increased. Comparisons in terms of per capita income growth are even more disappointing. However, there is evidence of improvements in underlying growth conditions. For instance, the number of motor vehicles in Bihar increased 239 percent in 2007 reflecting improving infrastructure, economic activity and consumer spending. The number of subscribed mobile phones in Bihar increased to 12 million from 1 million in 2004. Improvements in law and order and tourism infrastructure have increased the number of tourist arrivals from 6.9 million in 2005 to 10.5 million in 2007. However, annual growth rates in Bihar are volatile due to recurrent floods and the cyclical behavior of some major horticultural produce such as mangoes. Bihar also suffers from high intra-regional disparities. Broadly, the per capita gross domestic district product (GDDP) figures

indicate that the districts in south Bihar are significantly more prosperous than those in the north. While Patna is the top district with a GDDP of Rs. 29,482, Sheohar at the bottom has a GDDP at about 15 percent of Patna at Rs. 3,967.

15. **Annual floods are a regular feature in Bihar causing severe hardship and substantial economic losses.** In 2007, North Bihar was hit by severe floods taking 1287 lives and destroying crops in 1.1 million hectares. In August 2008, the Kosi flood was declared a national calamity. The flood inundated five districts in the state, forcing the evacuation of a million people affecting up to 3.3 million inhabitants. A massive rescue effort limited casualties to 530 lives but the flood wasted 0.3 million hectares of agriculture land with large deposits of silt and sand and destroyed farm animals and stockpiled grain. Consequently, agriculture GSDP declined by an estimated 8 percent in constant prices. Nearly 90 percent of the rural road network in the five districts, power, health and education infrastructure, and 300,000 houses were damaged along with 251 kilometers of state highways and other major roads. This severely affected the livelihoods of millions of people (many permanently) in these districts.

III. PROGRESS IN IMPLEMENTING THE REFORM PROGRAM

A. Pillar 1: Stepping-Up Public Investment and Strengthening Public Financial Management and Governance

16. ***GoB's fiscal priorities are four-fold:*** (i) increasing fiscal space for development and public investment in a sustainable manner; (ii) increasing the uptake under centrally sponsored schemes; (iii) improve the broad composition of expenditure; and (iv) improving the effectiveness of public expenditure. Bihar continues to make good progress in creating fiscal space under its Medium Term Fiscal Plan. GoB has enacted the *Bihar Fiscal Responsibility and Budget Management (FRBM) Act 2006* seeking to eliminate the revenue deficit by 2008/09 and to contain the fiscal deficit at 3 percent of GSDP from 2008/09 onwards. GoB first registered a revenue surplus in 2004-05 which has been sustained. In 2007-08 the revenue surplus (current surplus) at 4.3 percent of GSDP exceeded the budget target of 3.3 percent and the fiscal deficit at 1.6 percent of GSDP was below the target of 3 percent for the year. According to the preliminary estimates for 2008-09, the revenue surplus is 4.1 percent of GSDP and the fiscal deficit at 2 percent of GSDP is below the budget target of 3 percent and within the revised limit of 3.5 percent prescribed by GoI subsequent to the financial crisis. The primary surplus at 1.8 percent of GSDP in 2007-08 exceeded the target for the year of 0.7 percent. The primary surplus at 1 percent of GSDP indicated in the 2008-09 preliminary estimates exceeded the target for the year of 0.4 percent. While this in itself contributed to a decline in the debt to GSDP ratio, the use of non-debt financing of the fiscal deficit has meant that the addition to the stock of debt was negligible and the debt to GSDP ratio declined from 46 percent in 2006-07 to 39 percent in 2008-09.

17. ***Better fiscal management is underpinned by improved revenue performance and expenditure composition.*** GoB is overwhelmingly dependent on GoI's tax devolution and grants. These constitute almost 80 percent of GoB's receipts and have performed well as a result of a buoyant Indian economy. However, GoB has also been trying to improve its own revenue performance through improvements to tax administration, within the constraint posed by a volatile agrarian and pre-dominantly rural economy. These efforts have seen tax revenue grow at an impressive 19 percent annually from 2005-06. GoB's tax effort has been aided by computerization of the Commercial Tax Department and changes to tax policy. While VAT rates have been adjusted, property registration and stamp duty rates have been reduced to 8 percent in urban and 6 percent in rural areas. The wholesale alcoholic beverages trade has been taken over

by the state's Beverages Corporation. Sales tax concessions are being weeded out and motor vehicles taxes aligned with the neighboring states. These measures have improved tax buoyancy and have begun to shift the tax to GSDP ratio marginally to 5 percent. Government expenditure growth has been steady since 2005-06 and total expenditure increased by 1 percent point to 28 percent of GSDP by 2008-09. But the shift in expenditure pattern has been more important. Impressively, capital outlay has nearly trebled increasing to 6 percentage points of GSDP in 2008-09. Non-wage O&M expenditure increased by nearly 3 percentage points to GSDP relative to 2005-06. Correspondingly the share of salary, pension and interest expenditure has dropped three percentage points to GSDP in 2008-09 relative to 2005-06. The position could change as the implementation of the recommendations of the Sixth Pay Commission begins to take effect from 2009-10. Preliminary estimates indicate that salaries and pensions are expected to increase by Rs. 22.18 billion annually (1.9 percent of GSDP) and arrears of Rs. 56.92 billion (4.9 percent of current GSDP) covering the period from January 1, 2006 have to be paid to civil servants.

18. ***The composition of public expenditure has improved with acceleration in Plan expenditure.*** Total expenditure increased from Rs. 215 billion in 2005-06 to Rs. 350 billion in 2008-09. A bulk of it was on non-wage components (capital outlay, O&M etc.) with share in total expenditure increasing from 50 percent in 2006-07 to 57 percent in 2008-09 (preliminary estimates). Plan expenditure which is synonymous with new development expenditure has nearly trebled from Rs. 49 billion in 2005-06 Rs. 141 billion in 2008-09. Expenditure on the social sectors (education, health, water supply and sanitation etc.) increased nearly 40 percent in 2007-08 and 60 percent in 2008-09 (preliminary estimates). Agriculture, irrigation and flood control, energy and road sectors now account for more than 60 percent of expenditure on economic services.

19. ***GoB has worked hard to modernize its PFM system.*** It has revised its fundamental PFM architecture by rewriting its pre-independence Treasury Code (awaiting state cabinet approval), revising its General Financial Rules, and introducing new budgeting processes and codes. It has introduced major changes in PFM practices – rationalizing the number of codes used in the budget, aligning budget codes with accounting codes, devolving spending authority to officials (while reducing the number of officers authorized to draw money from 50,000 to 5,000), computerizing the Treasuries, and initiating e-procurement. In a very short span of time, these reforms have demonstrated concrete results –budgets have been issued on time, the amount of money available to spend on development has vastly increased, and the use of monetary advances has been limited. The number of object heads of expenditure has been reduced from over 500 to 68 providing more flexibility. This will not only impact the budget process, but also its execution, accounting and financial reporting. The value of lump sum expenditure not assigned object heads while budgeting has declined substantially, from Rs. 161 billion in 2008-09 to Rs. 66 billion in 2009-10, on account of improved availability of information on planned expenditure details at the time of budgeting. A consequence of the reforms is that the number of line items has been reduced by half in the 2009-10 Budget. These changes have taken place against the backdrop of a very rapid expansion of government spending. The overall size of the budget increased by 158 percent between fiscal year 2004/05 and 2008/09, while the amount of planned development spending more than trebled.

20. ***GoB has been creating the foundations for effective management of public money.*** That foundation will be largely in place when the new Treasury Code is approved by the state Cabinet and work on the new General Financial Rules is completed. The new draft Bihar Financial Rules takes the next logical step forward. It seeks to achieve clear demarcation between the Treasury Code and the Financial Rules. Most importantly, it places greater trust in the Heads of Offices and Departments to permit smooth financial operation of the whole government

machinery. A high level task force, the PFM Steering Committee, has been established to oversee PFM reforms and is beginning to shape the implementation of the reform strategy. A new draft internal audit manual has been developed and an exposure workshop held for the internal auditors to discuss and disseminate the new risk based approach. Fifty two out of fifty nine treasuries are now online and the budget for the year 2009-10 has been uploaded in Computerized Treasury Management and Information System.

21. ***GoB continues to make significant progress on a wide range of governance issues.*** The GoB has also sought to discourage corruption by aggressively implementing the Right to Information (RTI) law. GoB has a call center to assist callers with processing requests for information under RTI, popularly called *Jaankaari.* The number of calls received at the *Jaankaari* center between January, 2007 and March, 2009 totaled 29,273. Overall, 17,683 appeals were filed with the State Information Commission between October, 2006 and March, 2009 of which 9,442 cases were resolved during this period. The setting up of 800 rural information kiosks, along with an '*Apki Sarkar Apke Dwar*' program (Government at Your Doorstep) is bolstering the presence of the government in Naxal affected districts. Hiring new staff on contract to fill vacancies, outsourcing of services, better performance management and evaluation, and the use of e-governance have also helped boost the quality of public service delivery in health, education, and roads. Business process reviews are underway in important departments such as Rural Development, Roads, Revenue, Personnel and Registration. Two major initiatives of the Bihar government have won national recognition. *Jaankaari*, won the national e-governance award, while the Registration Department's efforts to combine computerization of 103 registration offices with business process changes won the Prime Minister's Award for Excellence in Public Administration. Agency reforms are being pursued more systematically through the 'Bihar Prashashnik Sudhar Mission', a society created to push administrative reforms in selected departments supported by the DFID. The hiring of about 300 new judges, setting up of a mobile court and an additional court for anti-corruption, better coordination between the executive branch and the district courts have all helped speed up the trial court process, resulting in a higher level of convictions and improved law and order.

22. **GoB intends to take on the issue of corruption in public service delivery more aggressively.** The legislature has passed a new law, The Bihar Special Courts Bill, 2009, which mandates the confiscation of property of those found to have accumulated assets greater than their known sources of income; in addition, GoB plans to set up approximately nine new Special Courts to deal exclusively with cases involving graft in order to ensure speedy prosecution of such offences. A Special Vigilance Unit has been created to pursue cases against high-level civil servants; so far five cases have been filed and are being currently investigated. The Vigilance Bureau, addressing corruption across the civil service, has conducted a survey involving select public services to assess public satisfaction and identify processes vulnerable to corruption. The total number of corruption cases registered by the Vigilance Bureau shot up from 21 in 2005 to 133 in 2007. The Vigilance Bureau has succeeded in drastically shortening the time that it takes to press charges against a suspect to less than 90 days.

23. ***Reinvigorating Public Service Delivery:*** The government has focused on three crucial sectors - roads, health, and education - to strengthen service delivery by following a strategy of decentralization, outsourcing and contractual hiring. All three departments are dealing with the problem of performance management in creative ways. New teachers on contract are subject to the supervision of the PRIs that have hired them. In health, data centers managed by a private company have been established at the block level to collect information on the number of patients visiting a health facility, each doctor's patient list, and the drugs prescribed by her. In roads, third party monitoring of the quality of new road construction has become routine in Bihar, while the

commissioning of a GIS-based Road Information System should enhance the Department's ability to monitor its operations and projects more closely.

24. ***Strengthening local level accountability***. PRIs are responsible for the delivery of 28 identified functions. PRI's are also responsible for identifying beneficiaries under the National Rural Employment Guarantee program, appointing teachers, supervising the mid-day meal program in schools, monitoring the distribution of Public Distribution System coupons and selecting workers under the Integrated Child Development Services scheme. GoI's Backward Region Grant Fund is proving handy in providing discretionary resources to Bihar's PRIs for investment. In 2007-08, Bihar used some 70 percent of its allocation of Rs. 6 billion. Following the Third State Finance Commission's recommendation devolving upto 3% of the GoB's net total tax revenue to PRIs, GoB devolved Rs. 66.6 million for the year 2007-08. GoB also devolved Rs. 171 million towards salary expenses of ZPs for 2007-08.

Pillar 2: Raising Economic Growth rate through Agriculture, Investment Climate reforms and Infrastructure

25. ***Progress in Agriculture Development and Policy Reform***. The abolition of the Agriculture Produce Marketing Committee Act provided an opportunity for Bihar to open up its agri-markets to greater private sector participation and competitiveness. However, large scale investments in agriculture and agri-product markets have not occurred as anticipated. This has led the GoB to fall back on relying on enhancing public investments in agriculture. A detailed road map for agriculture and allied sectors has been formulated to guide agriculture development. GoB has made progress in raising agriculture productivity by increasing seed processing capacity and raising the seed replacement rate. The seed replacement rate of paddy has been raised to 19 percent in 2008-09 against 12 percent in 2006-07 and wheat from 11 percent in 2006-07 to 24 percent during 2008-09. Agriculture extension services have been strengthened and the Agriculture Technology Management Agency now operates in all the districts of Bihar fully staffed and funded. GoB proposes to fill 4000 vacant posts at the district and lower levels during 2009 to cover a shortage of trained manpower that hampers program implementation. To encourage double and multiple cropping, minor irrigation is being strengthened by transferring operation and maintenance of 32 irrigation distributaries involving 110,549 hectares of agriculture land to Water User Associations'. To enhance agri-credit flows, a package of Rs 4.15 billion is being provided to 5342 Primary Agriculture Cooperative Societies for their recapitalization.

26. ***Improving the Investment Climate.*** With a new Industrial Policy announced in 2006, GoB has attempted to promote Bihar as an investment destination. GoB has institutionalized investment promotion efforts through the *'Udyog Mitra'* and 'Bihar Foundation' - a government sponsored society. GoB has also enacted the Single Window Clearance Act to simplify business entry. GoB's State Industries Promotion Board has over the last two years approved 176 investment proposals in a variety of sectors amounting to a total proposed investment of Rs. 1100 billion with an expected employment potential of 125,000. Out of the approved investments 20 are in operation and 56 are in an advanced stage of government clearances. IFC has carried out a business process mapping and simplification study of three key licenses - land allotment, factory license and single window approval. IFC is also lending capacity and technical support for tracking and monitoring of investment proposals. GoB has identified agriculture based industries as a key thrust area. IFC has supported this sector-focused private sector development strategy by providing assistance in carrying out sector competitiveness and value chain studies for sugarcane and maize and drawing up a plan for institutional interventions for attracting investments in the food/agro-processing sector.

27. ***Infrastructure:*** The Rural Works Department (RWD) has outsourced the preparation of engineering design of almost 18,000 km of rural roads of which 13,000 km is ready. This has resulted in Bihar being awarded Rs 32 billion of *Pradhan Mantri Gram Sadak Yojana* (PMGSY) rural road works by GoI. The Road Construction Department (RCD) that has the overall responsibility for major district roads and state highways and the RWD have also undertaken functional assessment of their departments as a precursor to their re-organization. Both the RCD and the RWD have prepared draft institutional development action Plans. The RWD has already implemented some of the recommendations to re-organize its headquarters and establishing 80 dedicated field divisions for the implementation of PMGSY. The RCD has also developed bidding documents for construction plus long term maintenance contracts for the highway network under its responsibility while the RWD has developed a core rural roads maintenance policy. GoB has also: (i) operationalized the Bihar State Infrastructure Development and Enabling Act, 2006 with the establishment of the Bihar Infrastructure Development Authority (IDA) and the Infrastructure Projects Fund, with an initial government contribution of Rs 0.10 billion; (ii) initiated a program for PPP capacity building covering the IDA and line agencies likely to have PPPs; and (iii) initiated 20 projects under the PPP mode. Reports covering three major areas - draft PPP Policy, PPP Process Guidebook and an Institutional Strengthening Plan for the IDA and review of the existing legal framework governing PPPs - have been prepared with PPIAF support. PPIAF is also supporting the drafting of various legal interventions, rules and regulations.

Pillar 3: Improving Public Service Delivery in the Social sectors

28. ***Education:*** The overall enrolment at the primary and upper primary level increased by 8 percent between 2006-07 and 2008-09. The number of out of school children declined nearly 77 percent between 2006-07 and 2008-09. The school mid-day meal program was expanded to cover children in Grades VI and VIII in 2008 increasing the program's coverage to nearly 11 million children and raising the coverage ratio to 60 percent. A survey showed 80 percent of the sampled schools served hot cooked meals. A second round of teacher recruitment to improve Pupil Teacher Ratio to a desirable 40:1 ratio by incorporating the lessons learned from an earlier recruitment process of 100,000 teachers is progressing well. The improved measures related to standardized recruitment criteria and better transparency. Following the process, around 70,000 candidates for PRI teacher posts have been selected. The GoB with a view to enhancing the professional skills of the teachers has tied up with Indira Gandhi National Open University (IGNOU) for training teachers using a distance training mode. About 32,000 teachers undergoing the Diploma in Education course of IGNOU have already given their first year exams. The State Education Council for Education and Training is also engaged in the process of developing a teacher competency assessment tool and pedagogical skills. The process of identifying a firm to develop the Teacher Management Information System (TEMIS) has been completed.

29. ***Public Health:*** Reforms in the health sector are beginning to results. About 4100 doctors have been recruited (nearly 58 percent of available positions). Other interventions include outsourcing of cleaning, pathological and radiological services, free distribution of medicines and indoor treatment. As a result, footfalls in government hospital's outpatient departments have increased from 39 a day in 2006 to 4400 in October 2008. The payment of Rs. 1400 in rural areas and Rs. 1000 in urban areas to mothers availing institutional deliveries has led to a phenomenal growth in institutional deliveries. Institutional deliveries numbered 8,38,481 in 2007-08 and 7,80,000 deliveries in 2008-09 upto December 2008.

30. ***Monitoring and Evaluation:*** There exists strong demand and support for strengthening GoB's Monitoring and Evaluation (M&E) system as evidenced by: (a) the establishment of an M&E Cell attached to GoB's Planning Department and (b) strong demand for evaluation of key programs, including the PDS food coupon experiment, National Rural Employment Guarantee program's process and impact evaluation. GoB already supports an outsourced monitoring facility that covers 130 urban mid-day meal program centres. The M&E cell has worked with 22 key departments in establishing baselines against outcome indicators agreed to under the DPL. In another initiative, the reform support cell in the Rural Development Department has developed user-friendly reporting formats for key anti-poverty programs. An independent monitoring report of the exercise to recruit PRI teachers has also been prepared which was used by GoB as a feedback on the hiring process.

31. ***Social Protection.*** There has been good progress in the reform actions relating to this sector. The evaluation of the new PDS food coupon in rural and urban centers has been completed with positive findings. The reform has significantly improved access to PDS grain among eligible households that received food coupons and improved perception of the PDS program. GoB prepared new Below Poverty Line (BPL) lists for rural areas in January 2008 and is engaged in addressing complaints over inclusion/exclusion. A follow-up family survey is planned to complete the BPL data with respect to all household members, instead of just the household head. There has also been good progress in implementing GoB's disability policy – most of the eighteen departments have responded positively to the draft policy. Critical positions relating to disabilities policy implementation are being staffed. Other institutions such as Juvenile Justice Boards and child welfare committees have been constituted.

32. ***Re-engineering Rural Development Department for improving service delivery.*** The Rural Development Department (RD) is one of GoB's key departments vested with the responsibility of monitoring and implementing programs for alleviation of poverty. A Reform Support Unit established within the RD provides strategic and technical support to strengthening implementation processes and build systems for monitoring and evaluation. A business process review has also been initiated. GoB is also piloting alternative models for delivering key safety nets.

IV. COMPLIANCE WITH TRANCHE RELEASE CRITERIA

33. The legal agreements for this operation require five tranche-release conditions to be met for release of the second tranche of the loan and credit.

Condition One. Bihar has made progress, satisfactory to the Association and the Bank, in carrying out the Program as set out in Bihar's Letter of Development Policy.

34. **This condition has been met.** The reform program is detailed in the Letter of Development Policy and a medium term policy matrix appended at Annex A of the operations Program Document (report No. 40230-IN). The progress in overall implementation of the reform program has been detailed in section III and is found to be satisfactory.

Condition Two. Bihar has implemented a medium-term fiscal framework and prepared its state budget for Fiscal Year 2008-09 in line with the framework.

35. **This condition has been met.** The fiscal position would be considered to have been strengthened if the fiscal outcome in 2007/08 and the estimates for 2008-09 provided by GoB, are in conformity with the targets set under the Medium-Term Fiscal Plan (MTFP) and the 2009-10 Budget has been presented in line with the MTFP. This condition have been met, as discussed in

section III of this document, and is illustrated by the detailed fiscal table presented below (Table 1). The macroeconomic policy framework of GoB has been very conservative and fiscal adjustment path has conformed to GoB's MTFP.

Condition Three. Bihar has taken necessary and appropriate governmental action to: (i) reduce the number of objects and detailed heads in its budgetary systems; (ii) reduce budget line items that have no object heads; and (iii) align its object heads with those in the Auditor General's systems.

36. **This condition has been met.** The number of object heads (including sub-object heads) has been reduced from over 500 to 68 and implemented in the 2009-10 Budget. The number of detailed heads has been reduced by half. A detailed matrix mapping the old object heads to the new object heads has been developed and issued along with the budget call circular issued on September 16, 2008. A letter (WM-140/07/511/F) from GoB provides a list of the sixty eight new object heads. The Auditor General's (AG) concurrence has also been obtained for the introduction of the new object heads and the AG has informed GoB that his office is aligning its object heads with the new object heads released by the GoB from 2009-10 (through a letter from the Auditor General dated October 21, 2008). The volume of such lump sum expenditure assignment without object head details has declined substantially, from Rs. 161 billion in the 2008-09 budget to Rs. 66 billion in the 2009-10 budget. This information is confirmed from GoB's Budget document for 2009-10 and has been indicated separately in a letter from GoB dated August 21, 2009.

Condition Four. Bihar has taken necessary governmental action for panchayats to complete a second round of teacher hiring that includes provisions for: (i) standardized recruitment criteria, (ii) transparency of candidate review processes with proper registries maintained at local levels; (iii) third party observation in the selection process, and (iv) sample based checking of the recruitment process by independent agency.

37. **This condition has been met.** GoB provided details of the actions taken through its letter of May 21, 2009 (No. WM-07/2009/325/F). The condition required GoB to incorporate improvements in the administrative procedures for hiring teachers by PRIs to make the process more transparent, based on lessons learned from the hiring of 100,000 teachers in an earlier round. As a first step, GoB further clarified and standardized the recruitment criteria laid down in 2006 by amending the Bihar Panchayat Elementary Teacher (Recruitment and Conditions of Service) Rules, 2006 on August 25, 2008. The amendments clarified the candidate merit evaluation process, acceptable academic and age qualifications, job posting considerations, appeals process in case of grievance, leave conditions and leave granting authority of PRIs. Based on the amendments, detailed guidelines to guide the recruitment process were laid down with the purpose of: (a) providing information to candidates on available vacancies and application process; (b) increasing the fairness and transparency of the short-listing process; and (c) improving the supervision of the entire recruitment process. The guidelines were shared with recruitment agencies and published in the Government Gazette dated September 5, 2008.

38. The guidelines also laid down a time-table for the recruitment process. Registries with security features were provided to recruitment agencies so that names and applications of empanelled candidates could not be manipulated. Serialized and officially signed registers were used to compile applications. The recruitment committees established at the village, Block and District levels were provided training on the process to be followed for recruitment. Officers were appointed to monitor the recruitment process along with a separate grievance redressal mechanism. Sample based third party evaluation of the process was carried out by the Institute of

Applied Manpower Research (IAMR) with financial and technical inputs from the World Bank. The third party evaluation process was used by the GoB to monitor the process of selection of teachers by PRIs effectively. The evaluation reported that recruitment was transparent, and the process was widely viewed to be objective, with only small degrees of political pressure, quite remarkable given the scale and speed of this operation. The main findings of IAMR were:

- There was widespread awareness of the recruitment and a huge number of applications, for all categories was received (e.g. at the village level applications per vacancy in the 9 districts surveyed ranged from 117-981);
- Recruitment guidelines were implemented properly, for the most part;
- Seventy five percent of applicants interviewed stated they were satisfied with the process.

39. GoB took swift action in numerous cases to correct weaknesses identified by the monitoring teams. In rural areas, the final merit list of candidates selected has been published and counseling is going on. Time schedules for the hiring were, however, revised due to delays on account of: (a) the unprecedented flood in Kosi river in 2008; (b) State wide strike by PRI secretaries in January – February 2009; and (c) the announcement of national elections in March 2009 and hence the election model code of conduct preventing new hiring during the election campaign period. The counseling of selected urban and block teachers was completed in January 2009 and job offer letters have been provided. The process of verifying the credentials of the selected teachers is being carried out after which appointment letters would be issued. A similar process is being followed for PRI teachers. The entire process of appointments is expected to be completed by November 2009. By tightening and improving the recruitment process, seventy thousand teachers were selected thus moving substantively towards the original aim of hiring one hundred thousand teachers. On completion of the appointments Bihar will be close to the pupil teacher national norm of 40:1. The government remains committed to recruiting more teachers to accommodate out of school children (520,000) to meet the needs of expansion and up-gradation of upper primary schools and attrition from teacher retirements. This has been indicated in a GoB letter (No. 285 dated August 20, 2009).

Condition Five: Bihar has appointed a high-level review body chaired by the Chief Secretary to systematically monitor compliance with transfer guidelines for Class A and B officers with the three-year rule in the transfer process.

40. **This condition has been met**. GoB has created a mechanism under the Chief Secretary to monitor compliance with transfer policy for Class A and B officers through an order dated July 2, 2009. The order provides for the Cabinet Secretariat Department to compile transfer orders and data relating to transfers of Group A and B officers. The Chief Secretary will carry out an analysis of the transfers in the context of the transfer policy (including the three year rule) and submit the findings of the review to the Chief Minister. As discussed in paragraph 5 above, this tranche-release condition was introduced through an amendment to the Program Agreement in August 2009, which will become effective immediately prior to the actual release of the second tranche. GoB also reiterated its transfer policy by reissuing its revised guidelines.

V. CONCLUSION

41. In view of the overall performance and progress with the implementation of the program supported by the loan and credit, and in compliance with the specific conditions of release as described in Section IV and listed in Schedule 2 of the Program Agreement, the Bank will inform India (as the borrower of the IBRD loan and the recipient of the IDA credit) that the second tranche of the financing (consisting of IBRD loan of US$74.8125 million and IDA credit of SDR 23.9 million) is available for withdrawal.

Table 1: Key Fiscal Outcomes in Bihar

Rs. Billion	2005/06	2006/07	2007-08	2008/09	2008-09	2009/10
				BE	Pre Actuals	BE
Revenue	178.37	230.83	282.10	335.51	325.19	418.37
State's Own Revenue	40.82	45.44	56.12	56.81	69.58	78.77
Tax	35.60	40.33	50.86	52.59	63.50	73.36
Non-Tax	5.22	5.11	5.26	4.22	6.08	5.41
Central Resources	137.55	185.39	225.98	278.70	255.61	339.60
Shared taxes	104.22	132.92	167.66	190.94	176.93	236.90
Grants	33.33	52.47	58.32	87.76	78.68	102.70
Revenue Expenditure	177.56	205.85	235.65	289.38	274.58	357.15
Salary	57.83	60.16	64.69	73.79	76.69	96.54
Pension	24.60	24.97	27.89	34.38	29.38	37.82
Interest Payments	36.44	34.16	37.07	37.96	37.74	41.70
Subsidies	6.72	10.78	7.20	7.20	7.20	0.00
Transfers	16.54	23.50	33.25	45.55	37.56	56.86
O&M	35.43	52.28	67.19	90.50	86.02	124.22
Revenue Balance	0.81	24.98	46.45	46.13	-50.61	-61.22
Capital outlay	20.84	52.11	61.04	76.35	69.93	94.17
Net lending*	16.97	3.08	2.47	3.03	5.45	4.3
Capital Expenditure (net)	37.81	55.19	63.50	79.38	75.38	98.47
Total Expenditure	215.37	261.04	299.15	368.76	349.96	455.62
Fiscal Balance	**-37.00**	**-30.21**	**-17.05**	**-33.25**	**24.77**	**37.25**
Non-Interest expenditure	178.93	226.88	262.08	330.80	312.22	413.92
Primary Balance	-0.56	3.95	20.02	4.71	-12.97	-4.45
Debt Stock	424.98	442.27	444.76	487.41	480.35	516.82
GSDP	**796.26**	**962.39**	**1092.29**	**1150.83**	**1233.37**	**1294.33**
percent GSDP						
Revenue	22.40	23.99	25.83	29.15	26.37	32.32
State's Own Revenue	5.13	4.72	5.14	4.94	5.64	6.09
Tax	4.47	4.19	4.66	4.57	5.15	5.67
Non-Tax	0.66	0.53	0.48	0.37	0.49	0.42
Central Resources	17.27	19.26	20.69	24.22	20.72	26.24
Shared taxes	13.09	13.81	15.35	16.59	14.34	18.30
Grants	4.19	5.45	5.34	7.63	6.38	7.93
Revenue Expenditure	22.30	21.39	21.57	25.15	22.26	27.59
Salary	7.26	6.25	5.92	6.41	6.22	7.46
Pension	3.09	2.59	2.55	2.99	2.38	2.92
Interest Payments	4.58	3.55	3.39	3.30	3.06	3.22
Subsidies	0.84	1.12	0.66	0.63	0.58	0.00
Transfers	2.08	2.44	3.04	3.96	3.05	4.39
O&M	4.45	5.43	6.15	7.86	6.97	9.60
Revenue Balance	**0.10**	**2.60**	**4.25**	**4.01**	**-4.10**	**-4.73**
Capital outlay	2.62	5.41	5.59	6.63	5.67	7.28
Net lending	2.13	0.32	0.23	0.26	0.44	0.33
Capital Expenditure (net)	4.75	5.73	5.81	6.90	6.11	7.61
Total Expenditure	27.05	27.12	27.39	32.04	28.37	35.20
Fiscal Balance	**-4.65**	**-3.14**	**-1.56**	**-2.89**	**2.01**	**2.88**
Non-Interest expenditure	22.47	23.57	23.99	28.74	25.31	31.98
Primary Balance	**-0.07**	**0.41**	**1.83**	**0.41**	**-1.05**	**-0.34**
Debt Stock	**53.37**	**45.96**	**40.72**	**42.35**	**38.95**	**39.93**

Note: Fiscal /Primary/Revenue Balance in the above table implies Fiscal /Primary /Revenue deficit (-) or surplus (+)
Source: Finance Department, Government of Bihar.