

ASIAN DEVELOPMENT BANK

PCR: IND 29458

PROGRAM COMPLETION REPORT

ON THE

GUJARAT PUBLIC SECTOR RESOURCE MANAGEMENT PROGRAM
(Loan 1506-IND)

IN

INDIA

December 2004

CURRENCY EQUIVALENTS

Currency Unit – Indian rupee/s (Re/Rs)

		At Appraisal	At Program Completion
		19 November 1996	31 December 2000
Re1.00	=	\$0.0282	\$0.020859
\$1.00	=	Rs35.49	Rs47.94

ABBREVIATIONS

ADB	–	Asian Development Bank
AEC	–	Ahmedabad Electricity Company
APL	–	Agrocel Pesticides Limited
BIFR	–	Board for Industrial and Financial Reconstruction
BOOT	–	build-own-operate-transfer
CIP	–	Core Investment Program
GAIC	–	Gujarat Agro Industries Corporation Limited
GCEL	–	Gujarat Communications and Electronic Limited
GEB	–	Gujarat Electricity Board
GERC	–	Gujarat Electricity Regulatory Commission
GHB	–	Gujarat Housing Board
GIDB	–	Gujarat Infrastructure Development Board
GIDC	–	Gujarat Industrial Development Corporation
GIF	–	Gujarat Infrastructure Facility
GIIC	–	Gujarat Industrial Investment Corporation
GMB	–	Gujarat Maritime Board
GMDC	–	Gujarat Mineral Development Corporation
GOG	–	Government of Gujarat
GOI	–	Government of India
GPDC	–	Gujarat Port Development Company
GPSDP	–	Gujarat Power Sector Development Program
GSCB	–	Gujarat Slum Clearance Board
GSEC	–	Gujarat State Export Corporation
GSFC	–	Gujarat State Financial Corporation
GSTC	–	Gujarat State Textile Corporation
GTCL	–	Gujarat Tractor Corporation Limited
ICICI	–	Industrial Credit and Investment Corporation of India Limited
IPP	–	independent power producer
MTFPF	–	Medium Term Fiscal Policy Framework
O&M	–	operations and maintenance
ODA	–	Overseas Development Assistance
SDP	–	state domestic product
SFRF	–	States' Fiscal Reforms Facility
SOE	–	state-owned enterprise
SPFRC	–	State Public Finance Reforms Committee
SRF	–	State Renewal Fund
SSTA	–	small-scale technical assistance
TA	–	technical assistance
VAT	–	value-added tax
VRS	–	voluntary retirement scheme

NOTES

- (i) The fiscal year (FY) of the Government and its agencies ends on 31 March. FY before a calendar year denotes the year in which the fiscal year ends; e.g. FY2004 ended on 31 March 2004.
- (ii) In this report, "\$" refers to US dollars.

CONTENTS

	Page
BASIC DATA	ii
I. PROGRAM DESCRIPTION	1
II. EVALUATION OF DESIGN AND IMPLEMENTATION	1
A. Relevance of Design and Formulation	1
B. Program Outputs	3
C. Program Costs	6
D. Disbursements	6
E. Program Schedule	7
F. Implementation Arrangements	7
G. Conditions and Covenants	7
H. Related Technical Assistance	8
I. Performance of the Borrower and the Executing Agency	10
J. Performance of Asian Development Bank	10
III. EVALUATION OF PERFORMANCE	11
A. Relevance	11
B. Efficacy in Achievement of Purpose	11
C. Efficiency in Achievement of Outputs and Purpose	11
D. Preliminary Assessment of Sustainability	12
E. Environmental, Sociocultural, and Other Impacts	12
IV. OVERALL ASSESSMENT AND RECOMMENDATIONS	13
A. Overall Assessment	13
B. Lessons Learned	13
C. Recommendations	15
APPENDIXES	
1. Status of Program Compliance	17
2. Key State Government Finances of Government of Gujarat (FY1994 to FY2004)	37
3. Status of State-Owned Enterprise Restructuring Program	38
4. Technical Assistance Completion Report	41

BASIC DATA

A. Loan Identification

1.	Country	India
2.	Loan Number	1506-IND
3.	Program Title	Gujarat Public Sector Resource Management Program
4.	Borrower	India
5.	Executing Agency	Finance Department of the Government of Gujarat
6.	Amount of Loan	\$250 million
7.	Program Completion Report Number	PCR: IND 858

B. Loan Data

1.	Appraisal	
	– Date Started	17 June 1996
	– Date Completed	25 June 1996
2.	Loan Negotiations	
	– Date Started	14 November 1996
	– Date Completed	18 November 1996
3.	Date of Board Approval	18 December 1996
4.	Date of Loan Agreement	18 December 1996
5.	Date of Loan Effectiveness	
	– In Loan Agreement	90 days after the date of Loan Agreement
	– Actual	20 December 1996
	– Number of Extensions	
6.	Closing Date	
	– In Loan Agreement	31 December 1998
	– Actual	31 December 2000
	– Number of Extensions	Two
7.	Terms of Loan	
	– Interest Rate	Standard ordinary capital resource terms and conditions
	– Maturity (number of years)	15
	– Grace Period (number of years)	3

8. Disbursements Dates

Initial Disbursement	Final Disbursement	Time Interval
23 December 1996	14 December 2000	43 months
Effective Date	Original Closing Date	Time Interval
20 December 1996	31 December 1998	24 months

C. Program Data

1. Program Cost (\$ million)

Cost	Appraisal Estimate	Actual
Foreign Exchange Cost	250 million	250 million
Local Currency Cost	0	0
Total	250 million	250 million

2. Financing Plan (\$ million)

Cost	Appraisal Estimate	Actual
Implementation Costs		
Borrower-Financed	0	0
ADB-Financed	250 million	250 million
Other External Financing	0	0
Total	250 million	250 million

ADB = Asian Development Bank.

3. Program Schedule

Item	Original Plan	Actual
First Tranche Release	December 1996	December 1996
Incentive Tranche Release	subject to the compliance status	July 1999
Second Tranche Release	December 1998	December 2000

4. Program Performance Report Ratings

Implementation Period	Ratings	
	Development Objectives	Implementation Progress
From 01 Jan 1997 to 30 Nov 1997		A
From 01 Dec 1997 to 12 Jan 1999	S	S
From 13 Jan 1999 to 24 Aug 2000	S	PS
From 25 Aug 2000 to 31 Oct 2000	S	U
From 01 Nov 2000 to 31 Dec 2000	S	PS

Notes: A denotes the implementation progress of the program loan under the category 'without/with a delay of less than 6 months in release of the second tranche'; S denotes satisfactory; PS denotes partly satisfactory; and U denotes unsatisfactory.

D. Data on Asian Development Bank Missions

Name of Mission	Date	No. of Persons	No. of Person-Days	Specialization of Members
Reconnaissance	11-25 Mar 1996	7	74	senior economist, programs officer, economist, young professional, investment officer, counsel, senior project engineer
Consultation Mission	20-24 May 1996	4	20	senior economist, programs officer, young professional, counsel

Name of Mission	Date	No. of Persons	No. of Person-Days	Specialization of Members
Appraisal	17–25 Jun 1996	10	90	senior economist, senior project specialist, investment officer, project engineer, programs officer, environment specialist, economists (2), counsel, senior assistant
Review 1 ^a	17–30 Dec 1996	2	28	senior project specialist, project implementation officer
Review 2	12–23 May 1997	4	44	senior economist, economist (INRM) investment officers (2)
Review 3	16–17 Sep 1997	1	2	economist(INRM)
Review 4 ^b	8 Sep 1998	1	1	economist(INRM)
Review 5	25 Oct 1998	1	1	economist (INRM)
Review 6 ^c	22–24 Mar 1999	5	15	INRM resident representative, senior project engineer, economist, project implementation officer, programs officer
Review 7	25–29 Oct 1999	4	20	senior capital market specialist, financial/capital market specialist, economists (2)
Review 8	21–25 Jan 2000	4	20	senior capital market specialist, financial/capital market specialist, economists (2)
Review 9	16–21 Oct 2000	7	24	financial/capital market specialist, young professional, senior economist & implementation officer, economist, senior program officer, manager, senior capital market specialist.
Assessment 1	10–14 Sep 2001	2	10	senior program officers (2)
Assessment 2	19–30 Nov 2001	1	21	senior program officer
Program Completion Review ^d	22–30 Apr 2004	2	18	public sector resource management specialist, economist

^a The Consultation Mission, covering the progress on the policy matrix in the ports sector under Gujarat Public Sector Resource Management Program loan, follow-up on the establishment of a working group under the Project Administration Strategy, and assistance to the 1997 Program Confirmation Mission.

^b Tripartite Review Meeting for the accompanying TA 2716-IND Capacity Building of the Gujarat Infrastructure Development Board (GIDB).

^c Prior to the Review Mission, a visit to ADB, headquarters by a high-level delegation of government of Gujarat officials was held from 10 to 12 March 1999, to discuss progress on the implementation of the Gujarat Public Sector Resource Management Program.

^d The program completion report was prepared by K. Lao-Araya, public sector resource management specialist, and Y. Elhan-Kayalar, economist, South Asia Department.

I. PROGRAM DESCRIPTION

1. The \$250 million Gujarat Public Sector Resource Management Program loan from the ordinary capital resources of the Asian Development Bank (ADB) to India was approved on 18 December 1996.¹ The objectives of the Program included supporting the Government of Gujarat (GOG) in augmenting domestic resource mobilization, improving the allocation and efficiency of the public sector, and reducing GOG's role in commercial activities while promoting market-oriented policies to enhance private sector participation in infrastructure development. The Program was to be implemented over a 2-year period (from December 1996 to December 1998).

2. The Program comprised the following three components: (i) strengthening the state's public finances and their prudent management; (ii) divesting and restructuring of state-owned enterprises (SOEs) to allow the private sector to take the lead in commercial activities while reducing the burden that SOEs put on the fiscal budget and economy as a whole; and (iii) strengthening the policy, regulatory, legal, and institutional frameworks for private sector participation in critical infrastructure sectors (power, ports, and roads) to evolve an enabling environment. The Program was designed to achieve the following outputs: (i) reducing the fiscal deficit by improving revenue mobilization, fiscal discipline, and fiscal management; (ii) reforming SOEs by exposing them to enhanced competition from the private sector and by improving corporate governance and accountability among SOEs; and (iii) improving the quality of infrastructure provision especially in the key sectors of power, ports, and roads.

II. EVALUATION OF DESIGN AND IMPLEMENTATION

A. Relevance of Design and Formulation

3. The Program's design was rated relevant. The Program was consistent with ADB and GOG development strategies. It comprehensively addressed each of the proposed strategies for improving GOG's medium-term fiscal performance, particularly by augmenting tax and nontax revenue, reforming fiscal management, and restructuring public enterprises. The Program was also designed to reduce GOG's role in commercial activities, while promoting market-oriented policies to enhance private sector participation in the infrastructure sectors. The latter objective anticipated that GOG would not have sufficient fiscal resources to develop infrastructure that would promote economic growth.

4. In 1996, ADB revised its operational strategy for India and decided to direct a portion of its assistance to the states. This change reflected the fact that (i) geographical focus would enable ADB to maximize its development impact on the states concerned; (ii) state-level economic reforms, which were lagging behind initiatives taken by the Government of India (GOI; or the Government), need support and incentives; and (iii) Indian states have considerable autonomy and have major legislative, administrative, and fiscal responsibilities in many economic and social sectors. The Program was consistent with ADB's development strategy for India as stated in the country operational strategy study.² The study emphasized the need to promote economic growth and efficiency by gradually shifting ADB's operations to support more focused policy and project interventions in the domain of state governments. Such proposed interventions at the state level were particularly valued as a deepening of reforms following

¹ ADB. 1996. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to India for the Gujarat Public Sector Resource Management Program*. Manila.

ADB. 1996. *Technical Assistance for Capacity Building of the Gujarat Infrastructure Development Board*. Manila.

² The country operational strategy study was approved by the Government and ADB on 17 April 1996.

implementation of a major national economic reform program in fiscal year (FY)1991 liberalizing investment, finance, and trade regimes and promoting infrastructure development.

5. ADB and GOG recognized two major and related factors that were constraining the overall economic performance of the state, namely a weak fiscal position and inadequate infrastructure. GOG's weak fiscal position eroded the effectiveness and efficiency of public service provisions and public investment. Eroded public investment and the weak fiscal position further prevented GOG from realistically financing infrastructure that would foster the sort of economic activities that would allow the state to realize its potential growth rate. To mitigate the effects of these two factors, GOG decided to open all key infrastructure sectors to private sector participation. The key elements of the consequently adopted operational strategy were: (i) reducing the state's fiscal deficit; (ii) reforming and restructuring public sector enterprises to improve their operating efficiencies; and (iii) supporting reforms in key infrastructure sectors with a view to increasing private investment. Gujarat was the first state chosen for this type of holistic support, and the first loan was made by ADB in December 1996. In fact, Gujarat was the first state to be selected by ADB, in cooperation with the Government, for subnational lending operations in India.³

6. As indicated in GOG's Eighth Five Year Plan (1992–1997), the long-term development strategy was to reduce poverty and unemployment in the state. GOG planned to achieve that by improving the efficiency and productivity of the economy, rebalancing the relative roles of the public and private sectors, and strengthening public sector resource mobilization and its allocation to adequately meet high priority development needs. In April 1994, GOG prepared the Report of the Gujarat State Finance Commission, (also known as the Sanat Mehta report), which served as a road map for fiscal reforms and private sector participation in infrastructure provision. Many of the reforms initiated by GOG were adopted in the Program.

7. At appraisal, the Program envisaged a horizontal, simultaneous and synergistic reform across various areas of public finance and infrastructure development that would be implemented over a 2-year period. Despite the existence of GOG's road map to fiscal reform, the time frame for processing the Program is considered aggressive, since the Program was designed and processed almost simultaneously with the preparation of four advisory technical assistance (TA) undertakings.⁴ As a result, only very preliminary outputs from the four advisory TA undertakings were incorporated in the Program loan design. The Program was formulated in close coordination with and supported by government officials who were reform oriented. The Appraisal Mission was, nonetheless, aware of the political risks involved in undertaking several drastic reform measures.

³ ADB was also a pioneer in state-level operations in India. The World Bank began to develop its own state-level program after ADB's operations in Gujarat. Bilateral donors including Department for International Development (DFID) and Japan Bank for International Cooperation (JBIC) also followed ADB's lead in increasingly targeting assistance to focal states. In this regard, this Program was a pilot project for state-level operations and was intended to have a 'demonstration effect' on other states.

⁴ ADB. 1996. *Capacity Building of Public Sector Restructuring*. Manila. (TA 2530-IND, for \$100,000 approved on 6 February 1996);
 ADB. 1996. *Restructuring of State-Owned Enterprises of Gujarat*. Manila. (TA 2552-IND, for \$600,000, approved on 2 April 1996);
 ADB. 1996. *Capacity Enhancement of Gujarat Industrial Investment Corporation*. Manila. (TA 2579-IND, for \$500,000, approved on 30 May 1996); and
 ADB. 1996. *Support for Gujarat Public Finance Reforms*. Manila. (TA 2668-IND, for \$600,000, approved on 23 October 1996).

B. Program Outputs

8. The Program had policy actions for each of the three program outputs anticipated at loan appraisal (para. 2). The detailed policy actions (11 conditions for the incentive subtranche of the second tranche, 17 conditions for the final subtranche of the second tranche, and 35 actions that were not conditions for tranche release) and their status of implementation are given in Appendix 1. Implementation of the main policy actions is assessed in the following paragraphs.

1. Strengthening of State's Public Finances and their Prudent Management

9. To strengthen GOG's finances, the Program included 3 reform areas: (i) medium-term fiscal policy framework (MTFPF) formulation and implementation, (ii) tax reforms and revenue augmentation, and (iii) budget and fiscal policy management and tax administration. Under the Program, GOG was required to reduce the fiscal deficit to 3.5% and 2.7% of net state domestic product (NSDP) for FY1998 and FY1999, respectively. The actual fiscal deficit to NSDP exceeded these ceilings for both fiscal years. However, the overall fiscal deficit reflected not only GOG's reform efforts but also several factors beyond GOG's control. Several external shocks during program implementation caused GOG to deviate from projected numerical targets. Those shocks included natural calamities (two droughts and one cyclone)⁵ as well as a mandated increase of salary bill recommended by the Government's Fifth Pay Commission and the reduction in central transfers to GOG. Hence, the fiscal deficit indicator was adjusted in order to reflect correctly GOG's fiscal efforts by excluding the fiscal cost of the aforementioned factors. The adjusted fiscal deficit to NSDP for the 2 fiscal years were 2.8% and 2.5%, respectively, which were well below the set ceilings. The past trend and projections of key public finance statistics of GOG can be found in Appendix 2. A detailed economic analysis of the effect of the Program on the state's fiscal performance and the state's economy appears in the assessment report prepared by ADB in November 2001.⁶

10. The MTFPF initiated by the Program created a foundation for state-level fiscal reforms. In 2000, the Government created the States' Fiscal Reforms Facility (SFRF) for state governments to finance structural adjustment costs due to the implementation of fiscal consolidation programs. The first group of state governments eligible for the SFRF was committed to a medium-term MTFPF that covered the period from FY2001 to FY2005. State governments would receive releases from the SFRF based on a single monitorable fiscal deficit target. Each state was expected to achieve a minimum improvement of 5 percentage points in the revenue deficit, as a proportion of their revenue receipts each year until FY2005 over the base year (FY2000). GOG did not sign a memorandum of understanding (MOU) with the Government for fiscal consolidation under the SFRF even though the Program concluded in December 2000, because GOG envisaged the high fiscal cost of rehabilitation to be financed for at least a few years after the massive 2001 earthquake. GOG had to allocate as much as 12.4% and 3.9% of total revenue expenditure for earthquake rehabilitation in FY2002 and FY2003, respectively. (Detailed statistics are in Appendix 2.) Consequently, GOG only submitted to the Government a draft MOU on 20 November 2003 for fiscal consolidation program under the SFRF. Nevertheless, GOG continues to be committed to fiscal consolidation by embarking on the second phase of public sector resource management program. In this respect, the Program has completed a full circle when GOG signed a MOU with the Government for the SFRF committing to medium-term fiscal consolidation through an MTFPF that was modeled after the original Medium-Term Fiscal Plan agreed between GOG and ADB. GOG's second phase and

⁵ A major earthquake, in early 2001, had wide-ranging impact on the public finances.

⁶ ADB. 2001. *Gujarat Public Sector Resource Management Program: An Assessment*. Manila.

commitments under SFRF, together with the experience gained under the Gujarat Public Sector Resource Management Program, helped get fiscal efforts back toward a sustainable path.

11. The Program achieved greater success in reforming state taxes than it did with municipal taxes and user charges. All policy conditions regarding state tax reforms were fully met. The task of reforming municipal taxes was hindered because sufficient resources were lacking to update property values for the collection of property taxes. The decision to abolish *octroi* tax; which is levied by local authorities on goods coming into local areas for consumption, use, or sale; was reversed in seven municipal corporations. The local bodies resisted the abolition of *octroi* because the tax was buoyant and liquid. As for budget and fiscal policy management and tax administration, the Program introduced the Core Investment Program (CIP) as a mechanism to protect capital expenditure. The capital expenditure to NSDP ratio consistently increased throughout the program implementation period despite the deterioration in the government's fiscal position. The actual capital expenditures to NSDP ratio from FY1997 to FY2002 were 3.12%, 3.54%, 4.06%, 5.55%, 9.88%, and 19.52%, respectively. The last two figures for FY2001 and FY2002 were much higher than those of previous years due to reconstruction spending after the massive January 2001 earthquake.

2. Privatizing, Divesting, and Restructuring the State-Owned Enterprises with the Objective of Maximizing Efficiency and Reducing the Government of Gujarat's Role in Commercial Activities

12. GOG should be commended for having adopted a very ambitious SOE restructuring plan under the Program. The Program proposed reforms for 23 of 54 SOEs. The Program's SOE reforms targeted the SOEs that either persistently did or potentially could cause considerable leakages from state finances. The targeted SOEs constituted 47% of total SOE employment and 80% of total SOE outstanding debt. At Program approval, two SOEs were already fully privatized. The biggest SOE in terms of employment had already offered the voluntary retirement scheme (VRS) from the State Renewal Fund (SRF) to about 13,900 workers. The SRF was incorporated in the Program's design to ensure sufficient funding for the VRS. GOG opened a personal ledger account under the SRF for each SOE under the reform program. The SRF was administered by a high-level committee, with clearly defined rules and regulations.

13. In addition to the full privatization of 2 SOEs, the Program further required that the following conditions be met: (i) four more SOEs had to be fully privatized; (ii) six SOEs had to be partially divested, two of which had to make public offerings for the sale of their shares; (iii) six SOEs had to be merged and restructured, and the properties of one SOE had to be leased; and (iv) four SOEs had to be closed. Even though it did not achieve all targets set in the Program, GOG managed to close a number of SOEs and privatize others. (Details of SOE reform implementation are in Appendix 3.) This achievement reflected GOG's strong commitment to reducing the financial burden of SOEs on the state's budget. Particularly, this commitment withstood numerous changes in the political leadership of the state during the Program.⁷

14. The Program had difficulties achieving the targeted privatization schedule envisaged at appraisal. Substantial difficulties were intrinsic to implementing the SOE reforms. Successful marketing of the sales of SOEs required technical and financial finesse on the part of government officials. The need for obtaining legal consent from concerned parties, including the central Government, also prolonged and complicated the reform process. In addition, some GOG officials involved in implementation expressed the view that the program conditions

⁷ There were nine Chief Ministers during the 1995–2001 period.

specifying the schedule of privatization adversely affected the share prices of SOEs scheduled to be privatized. The fact that several SOEs scheduled for privatization were in a weak financial position did not help to expedite their sale. Sufficient operational and financial restructuring were required before proceeding with public offering of the SOE shares. Despite these difficulties, GOG took further steps to realize the privatization and restructuring of certain SOEs.

15. The primary impetus for the successful reform of SOEs in Gujarat was the continued commitment of GOG to the SOE reform agenda. Since the Program was completed, GOG embarked on its own on a second phase of public sector resource management, an important focus of which is restructuring the remaining SOEs.

3. Developing an Enabling Environment for Public Sector Involvement in Infrastructure Sectors

16. Before the Program's implementation, various government agencies had independent responsibilities for developing specific infrastructure facilities. Shortly before the Program was approved, GOG established the Gujarat Infrastructure Development Board (GIDB) as a strategic umbrella organization. GOG gave GIDB the authority to formulate integrated infrastructure sector policies and promote private sector participation in statewide infrastructure development. GIDB was made responsible for these functions and seeks to mobilize private sector funding and coordinate the infrastructure development plan across sectors. GIDB is also playing an active role in project selection and prioritization.

17. GOG made substantial progress in achieving program goal, due to the establishment of GIDB. GIDB secured private sector investment in the three key sectors of ports, power, and roads. In addition, GOG enacted the requisite regulatory reforms, such as the Gujarat Infrastructure Development Act, 1999. The act is a landmark law in India because it constitutes the first time a state created a clear legal and institutional framework for private sector participation in infrastructure. The act proclaims competitive bidding to be the only mode for private sector participation in infrastructure and accords legal sanctity to the bidding procedure. In other words, the levels and periodicities of tender bid notices are specified in the law. Various modes of structuring projects are recognized, such as build-operate-transfer, build-own-operate-transfer, build-own-operate-maintain, build-lease-maintain-transfer, lease management, rehabilitate-own-transfer, and rehabilitate-own-operate. An ADB TA undertaking accompanied the Program to help GOG build the capacity of GIDB and draft the Gujarat Infrastructure Development Act, 1999 (Appendix 4).

18. Since the establishment of GIDB, the private sector has invested in a large number of infrastructure projects. Gujarat already awarded six ports projects to the private sector, involving a total investment of \$2.14 billion. In the power sector, 10 independent power producers commenced generation. The capacity addition in these is approximately 3,000 megawatts and entails a total investment of \$2.85 billion. The roads sector completed six projects and one project is under implementation. Investment in the roads sector totals about \$250 million. The success of GIDB has become a model for other states such as Karnataka and Punjab, where agencies similar to GIDB were created.

19. GOG formulated and introduced a blue print for infrastructure called Vision 2010, which was prepared by GIDB. Vision 2010 suggested 383 needs-based projects in various infrastructure sectors. Priority was given to private sector development of projects in key infrastructure sectors, including power, ports, roads, urban infrastructure, and information technology. Such projects were identified on the basis of preliminary studies of demand and

supply for these facilities. GIDB subsequently conducted feasibility studies in conjunction with the relevant agencies that oversee the various sectors. On the basis of the conclusions drawn from these feasibility studies, GIDB selected specific projects to develop. For this purpose, GIDB established project development cells within all government departments that deal with infrastructure. Since GOG began implementing the Program, GIDB expanded from three to 11 the infrastructure sectors for which GIDB is seeking private sector participation. In addition to the initial sectors of ports, power, and roads, private sector participation is now also being sought for railways, airports, water supply, information technology, gas, and tourism, as well as urban infrastructure and industrial parks.

C. Program Costs

20. While the Program did not earmark funds for these specific components, loan proceeds were deemed to have been used for adjustment costs related to revenue losses and increased expenditure necessitated by the Program over the medium term. These costs included restructuring of loss-making SOEs; rationalizing the tax structure and tax reforms; undertaking institutional strengthening and capacity building of government agencies; completing fiscalization (fiscal injections to settle off-budget public sector debt or restructuring public sector enterprises so that the long-term unsustainable fiscal burdens would be controlled) including financial settlements of GOG's arrears and liabilities; and VRS payment to SOE employees.

21. The cost of adjustment at the start of the Program was estimated at about \$740 million, which was spread over the 2-year implementation period. The size of the Program loan of \$250 million was only 40% of the estimated cost of adjustment. However, a part of the overall cost of adjustment was expected to be offset by revenue gains resulting from enhanced tax compliance that resulted from lower tax rates and a wider tax base; reduced subsidies and budgetary burdens of SOEs, due to their closure, privatization, or divestment; and various proceeds from the divestment of SOEs. The estimated adjustment cost included about \$302 million in revenue foregone due to tax rationalization and reforms, \$413 million in SOEs' debt settlements and liabilities and payment of VRS funds to SOE employees (about \$130 million), and the remainder in provision of budgetary support to make GIDB operational and to finance project development and feasibility studies for the critical infrastructure sectors.

D. Disbursements

22. All three tranche releases were envisaged to be disbursed during the 2-year implementation period. Given not only the sheer number but also the complexity of the policy conditions under the Program, the appraisal disbursement schedule was viewed as very ambitious. The first tranche, equivalent to \$100 million, was disbursed in December 1996, after the loan effectiveness date. At the time of the first tranche's release, the Government had achieved 42 policy actions in the three program components: (i) strengthening of state's public finances (12 actions), (ii) restructuring the public sector (14 actions), and (iii) evolving an enabling environment for private sector involvement in infrastructure sectors (16 actions). Three institutions were to be established to facilitate the reform process in the three components. Those institutions were (i) State Public Finance Reforms Committee (SPFRC), for coordinating and supervising reforms related to strengthening public finances; (ii) SRF, for developing a social safety net mechanism for SOE restructuring; and (iii) GIDB, for developing overall supportive policy and regulatory and institutional mechanisms for key infrastructure sectors, i.e. ports, power, and roads. Subsequently, the incentive subtranche of the second tranche, in the amount of \$50 million, was disbursed in July 1999, upon satisfactory compliance with the agreed conditions of the first phase of SOE divestment, including those related to the

effectiveness of tax reforms, and roads and ports sector policies announcement for the private sector. Finally, the final subtranche of the second tranche, amounting to \$100 million, was released in December 2000, long after GOG covered much of the adjustment costs.

E. Program Schedule

23. The \$50 million incentive subtranche of the second tranche of the program loan, which was targeted for release around June 1997, was significantly delayed until July 1999. The main causes of the delay were unexpected exogenous shocks and the adverse market's effect on the prices of privatized and/or divested SOEs. The negative exogenous shocks weakened GOG's ability to raise targeted revenue. To avail of the incentive tranche, GOG had to meet 11 policy conditions. The two conditions that GOG had the most difficulty with involved the reform of certain SOEs, namely Gujarat Communications and Electronic Limited (GCEL), Gujarat Industrial Investment Corporation (GIIC), and Gujarat Tractor Corporation Limited (GTCL). Consequently, the date for the final subtranche of the second tranche, originally scheduled by December 1998, was adjusted to the end of 1999 and then again to the end of 2000. The conditions that GOG had the most difficulty with were again related to the reform of SOEs and the increase in power tariffs charged to subsidized users (i.e., farmers, for enhanced cost recovery).

F. Implementation Arrangements

24. Overall, implementation arrangements were partly satisfactory. The Finance Department of GOG acted as the Executing Agency for the Program. GOG established several new committees and institutions to help supervise and monitor the program implementation. GOG established (i) a high-power Expenditure Prioritization Committee (chaired by the state's chief minister) to review and approve the CIP that supported faster completion of high priority social and physical infrastructure and (ii) GIDB (also chaired by the state's chief minister) to promote privatization of key infrastructure sectors. GIDB is an apex body that designs, formulates, and monitors integrated plan of different key infrastructure sectors in Gujarat. GOG also established a SPFRC in June 1996, to serve as an advisory body for fiscal reforms and to interact with trade and industry to solicit their views and create public awareness of tax reforms. And additional 3 working groups were established to support SPFRC on tax reform, expenditure management and control, and computerization and training. The TA undertaking *Support for Gujarat Public Finance Reforms* (footnote 4) provided advice and support to these working groups on the design and implementation of tax and expenditure reforms to minimize adverse consequences. However, it took GOG a few years to constitute the SPFRC.⁸ The first meeting of the Committee was held in January 1999. Therefore, consultants under TA undertaking *Support for Gujarat Public Finance Reforms* (footnote 4), implemented from September 1997 to February 1999, did not have an appropriate counterpart as envisaged, to receive feedback on policy recommendations.

G. Conditions and Covenants

25. The Program was envisaged to cover 2 years, from December 1996 to December 1998, and was supported by three tranches. Each of these tranches was to be released on compliance with specified policy conditions that fostered structural reforms in state finances. The program loan comprised a total of 104 policy actions, of which 42 were satisfied before loan

⁸ GOG enacted a Gujarat Government Resolution dated 28 November 1996 for the establishment of the State Public Finance Reforms Committee. The constitution of the SPFRC was completed in September 1998.

approval. The first tranche of \$100 million was then released upon loan effectiveness on 20 December 1996. The remaining 28 were conditions for tranche releases (11 for the second tranche and 17 for the final tranche) and 34 were covenants that were not tranche conditions.

26. At the time of the incentive tranche (or the subtranche of the second tranche) release, GOG fully complied with 9 of 11 conditions. The remaining two conditions were partially met. The incentive tranche of \$50 million was originally envisaged to be released by June 1997, but was actually released on 13 July 1999, a delay of over 2 years (para. 23). The final tranche release (or the final subtranche of the second tranche) in the amount of \$100 million was not released until December 2000. The loan closing date was extended twice from the original date of 31 December 1998 to 31 December 2000, to accommodate delays in the program implementation caused by factors mostly beyond the control of GOG. Of the 17 tranche conditions, 11 were fully met, 2 were substantially met, and 1 was partially met. GOG requested amendments of the 3 unmet conditions stipulated under the final subtranche of the second tranche.

27. As mentioned in para. 23, the policy conditions that GOG had the most difficulty complying with were related to reforms of SOEs and an increase in power tariffs, particularly for agriculture users. For the incentive tranche release, both of the partially complied with conditions were related to targeted privatization and/or divestment of SOEs, namely (i) privatization of 51% of GCEL and GTCL, and (ii) divestment of 26% of GIIC. GOG and the potential buyer of GIIC, the Industrial Credit and Investment Corporation of India Limited, could not reach an agreement on the valuation of the shares. The potential buyer knew that GIIC needed to divest shares before ADB would release the incentive tranche. Consequently, the buyer may have offered an unreasonably low bidding price for GIIC shares. Nevertheless, it was also true that GIIC was in a very poor financial state at the time of the sale and was therefore unlikely to obtain a higher share price.⁹ For the final tranche release, 4 of 5 conditions that were not fully met were related also to the targeted privatization/divestment of certain SOEs, namely (i) full privatization of GCEL and GTCL, (ii) reduction in GOG's shareholding in GSEC to 26%, (iii) reduction in GOG's shareholding in GIIC to not more than 49%, and (iv) reduction in GOG's shareholding in Gujarat Mineral Development Corporation (GMDC) to not more than 49%. The last condition that was amended by the final tranche release was the increase in power tariffs to maintain a 3% rate of return on Gujarat Electricity Board's fixed assets. The amendments of these conditions were justified mainly by the fact that GOG had applied the best effort to comply with the conditions but could not meet the conditions because of external factors beyond GOG's control. Appendix 1 presents the detailed status of compliance including rationales for amendments.

H. Related Technical Assistance

28. An attached TA grant, *Capacity Building of the Gujarat Infrastructure Development Board* (footnote 1), was provided to assist GOG in achieving the third component of the Program, i.e. building an enabling environment for private sector participation in critical infrastructure sectors (power, ports, and roads) by strengthening policy, regulatory, legal and institutional frameworks. GIDB was established to be the apex body that oversees the overall infrastructure development plan of the state. The TA aimed at building capacities of GIDB, so that it could play a strategic and nodal role in the formulation of infrastructure policies and promote private sector participation in infrastructure development. The detailed TA completion

⁹ ADB's own analysis of Gujarat Industrial Investment Corporation (GIIC) undertaken as part of the fact-finding indicated that GIIC had a high level of non performing assets (NPAs).

report of the Capacity Building of the Gujarat Infrastructure Development Board Project is in Appendix 4. Four advisory TA activities were also approved in 1996, prior to the approval of the program loan (para. 7 and footnote 4). The reviews of these four activities are presented in the following paragraphs.

29. **Capacity Building of Public Sector Restructuring.** This was a small-scale TA undertaking that was approved on 6 February 1996 in the amount of \$100,000. The objective of the small-scale TA was to develop capacities of GOG officials in designing and implementing the Public Sector Restructuring Program. The small-scale TA aimed to familiarize policy makers, implementers, and other concerned groups with approaches, modalities, and institutional frameworks for privatization and expose GOG officials to international experience in this area. The small-scale TA funded (i) study tours for two high-level officials, to attend a course on options, techniques, and financing of privatization, at the Asian Center for Development Studies in Kuala Lumpur, Malaysia from 14 to 23 March 1996, and an additional high-level official, to attend a course on privatization and regulatory reforms at Harvard Institute for International Development, Harvard University, Massachusetts, United States, from 30 June to 25 July 1997 (in the amount of \$70,736), and (ii) a workshop on restructuring and privatization for approximately 40 middle- and junior-level staff members, organized by the Indian Institute of Management in Ahmedabad, Gujarat, from 9 to 12 November 1998 (in the amount of \$11,718).

30. **Restructuring of State-Owned Enterprises of Gujarat.** This undertaking was approved on 2 April 1996 in the amount of \$600,000. The activity was to support institutional strengthening of the Technical Secretariat, which is the responsible entity for restructuring SOEs, to ensure the effective, smooth, and transparent restructuring of SOEs. The timing and formation of the undertaking were appropriate because they supported the formulation and implementation of policy actions for restructuring SOEs under the Program. The TA completion report prepared in February 1999 rated the TA generally successful. The institutional capacity of the Technical Secretariat and the concerned SOEs was considered to have been enhanced through the preparation of the restructuring proposal and also by the workshops.

31. **Capacity Enhancement of the Gujarat Industrial Investment Corporation.** This TA undertaking was approved on 30 May 1996 in the amount of \$500,000. The TA was aimed to enhance GIIC's capacity to promote infrastructure development and appraise, mobilize funds for, and supervise the implementation of infrastructure projects sponsored by the private sector in Gujarat. The TA was rated generally successful. The capacity of GIIC was considered to have been enhanced through a series of training programs and manuals provided and prepared under the activity. GIIC was later required to be privatized under the Program.¹⁰ This TA was approved in May 1996, 5 months prior to the approval of the Program loan in December 1996. The TA was expected to be closed by September 1997. The Program included condition that GOG was to divest 26% of its shareholding in GIIC by June 1997 and then reduce its shareholding of GIIC to not more than 49% by June 1998.

32. **Support of Gujarat Public Finance Reforms.** This TA undertaking was approved on 23 October 1996 in the amount of \$600,000. The objective of the TA was to strengthen public finances at the state level through structural reforms on the revenue and expenditure sides. The TA was concerned mainly with building institutional capacities of the Finance Department, to

¹⁰ GOG was required to bring its shareholding in GIIC down by 26% by the incentive tranche release, and further to not more than 49% by the final tranche release. GOG only partially met these conditions for both tranche releases (see detailed explanation in Appendix 1: Status of Program Compliance).

improve budget policy, planning, management and control systems, and to modernize and computerize the tax and expenditure departments. The TA was rated generally successful in the TA completion report prepared in July 1999, since it delivered important inputs to GOG's effort of reforming revenue and expenditure management. The report indicated that the TA reports and workshops provided important inputs to Gujarat's public finance reform process, although they came late, due to the implementation delays and a lack of government support. The TA performance audit report prepared in March 2004 rated the TA partly successful, because it delivered a few good outputs but overall operated in isolation from GOG. The Program assessment report prepared in November 2001 indicated that the TA enhanced the technical capacity of government officers to deal with the complexities of budget management. On a larger scale, however, the report stated that ADB overlooked the large sales tax exemptions given by GOG during the program period, the impact of which has now emerged and has weakened overall fiscal performance.¹¹

I. Performance of the Borrower and the Executing Agency

33. The performance of the Government and the Executing Agency was rated partly satisfactory. The Finance Department, as the Executing Agency, generally met loan administration requirements, and its performance was satisfactory. Government officials, particularly key high-level officials of the Executing Agency, were proactive and supportive of the Program reforms. The pace of program implementation, however, was much slower than anticipated at appraisal. The main reasons for the delay were the frequent changes in the political leadership (para. 12) and the frequent natural calamities that occurred in Gujarat during the implementation period, which deviated resources and attention from the timeliness of reform achievements. The Executing Agency's officials were very cooperative and readily available for policy dialogues with ADB staff members.

J. Performance of Asian Development Bank

34. The performance of ADB was rated partly satisfactory. ADB did not monitor program implementation as regularly and frequently as it could have. A lack of staff members limited ADB's capability to closely monitor the Program during the implementation period. ADB staff members could only periodically monitor the Program's implementation. There were gaps between review missions after loan approval in December 1996. The first review mission was fielded in May 1997, the second in September 1997, the third in September 1998, and the fourth in March 1999. The frequency of the review missions during the implementation period was less than that of the missions during the processing year (Details can be found in the Basic Data). The long delay in fielding review missions was also explained by political instability in Gujarat in 1997. Two general elections were held, one in May 1996 and the other in March 1998.¹² Nonetheless, each of ADB's loan review and country consultation missions thoroughly monitored implementation status, identified impediments, and engaged government counterparts in meaningful dialogues. ADB's responses to GOG's requests were prompt, and the disbursements were undertaken quickly. ADB also invested significant efforts to build and enhance capacities of the Executing Agency and relevant agencies during the implementation through related TA (para. 28-32).

¹¹ As investment incentives, many state governments provided sales tax exemptions to investors. Due to high competition for investment across states, GOG did not agree to either abolishing the exemptions already given to existing privileged investors or refraining from giving new sales tax exemptions as incentives to new investors.

¹² The Government's attention during part of 1998 was focused on international reactions to the May 1998 nuclear testing.

III. EVALUATION OF PERFORMANCE

A. Relevance

35. The Program was assessed as relevant. In the early 1990s, Gujarat was a progressive and reform-oriented state, with a stable political environment. It had strong industrial and economic growth potential, which was constrained by the weak fiscal position of GOG and inadequate infrastructure throughout the state. Hence, Gujarat was chosen carefully among Indian states, and the Program was designed to support GOG. The Program was designed to strengthen domestic resource mobilization, improving efficiency of public sector, and reducing its role in areas where the private sector could potentially play a greater role. The objectives of the loan were in accordance with the development agenda of Gujarat, as outlined in the five-year development plans, and ADB's country operational strategy for India.

36. Bringing forth the recommendations of the Sanat Mehta report, the Program's focus, scope, and components were identified jointly by ADB and GOG. The Program had strong ownership by GOG from the design stage. During the Program's design and implementation, a number of "champions of reform," i.e., senior officials in GOG, who were well-informed and highly regarded in the state, took core responsibilities in carrying out tax and SOE reforms in the state. The success of implementation owed a great deal to this cadre, which drove the process.

B. Efficacy in Achievement of Purpose

37. The Program was assessed as efficacious. It effectively guided GOG in rationalizing public finances and improving revenue sources, while introducing austerity on the expenditure side. Public resource mobilization and allocation was improved; efficiency of public resource use was enhanced, with a view to promoting industrialization during the course of program implementation. The fiscal deficit was contained along parameters identified in the MTFPF, excluding impacts of external shocks, such as mandatory increases in GOG's salary bills, resulting from Central Pay Commission recommendations. Tax reforms were undertaken at the state and the municipal levels, and the tax structure was streamlined. Capacity for higher fiscal discipline was developed within various echelons of GOG. All SOEs were carefully reviewed, and those that were financially non-viable were closed, while others were substantively reformed, and opened to private entrepreneurs to enhance competition, and improve corporate governance, and accountability.

38. As demonstrated in Appendix 1, a horizontal reform process, whereby reforms in several sectors were carried out simultaneously, was necessary during program implementation. The various reform areas included in the policy matrix were necessary to start the reform process and to fully exploit the synergies among various sectors under scrutiny. However, they may not have been sufficient in ensuring expeditious adoption of reform measures. For instance, adequate regulatory and institutional mechanisms for private sector participation are not yet operational, and private sector participation in the three core infrastructure areas (power, ports and roads) has still not reached its potential. The second phase being adopted by GOG is expected to address these issues further over the next 5 years.

C. Efficiency in Achievement of Outputs and Purpose

39. The GOG's reform agenda supported by the Program was implemented as efficiently as possible, considering the adverse impact of various natural disasters, including the devastating earthquake in January 2001. Certain slippages occurred in the Program's tranche release

timetable. The commitment of GOG to reforms, along the lines identified in the Program, remained firm, although managing the devastation caused by the 2001 earthquake occupied a central role in the 2001–2002 period. At that time, pace of reforms relating to fiscal management and divestment slowed down. But GOG managed the fiscal impact admirably and continued with the development agenda set forth in the Program.

40. For projects that are implemented over a number of years, it may not always be possible to retain the same cadre to oversee the execution of tasks identified. Similarly, many staff members working on this Program on the ADB and GOG sides were replaced. Fortunately, the people that drove the Program's SOE reform and tax reform components stayed in office throughout the critical phases of implementation and, literally, championed the reform process thorough execution.

D. Preliminary Assessment of Sustainability

41. The Program's sustainability was assessed as likely, given follow-up measures GOG has adopted after program completion. A second phase for public resource management was designed and is being discussed by GOG, with a view to enabling it to carry forward the work started with the Program and to continue consolidating the fiscal performance following the adverse impact of the 2001 earthquake. GOG is committed to SOE reforms. The general rule adopted is that SOEs, which are not integral to the state government's social objectives, should either be sold or shut down. Similarly, GOG accelerated the pace of private sector participation in the infrastructure sector, advancing beyond the reforms envisaged under the Program. Considerable work is also being done on further reforming the tax structure of Gujarat, in consultation with other states and the Government.

42. Provided that the political environment remains stable, and the state is not affected by unanticipated exogenous shocks, all indicators suggest that the reform process started under the Program will continue in Gujarat.

E. Environmental, Sociocultural, and Other Impacts

43. The Program was categorized as Environmental Category B and had no direct environmental impact. GOG is assessing the loan covenants in terms of environmental impact. The social fallout of downsizing and other reform measures was also, to some extent, mitigated by proactive social measures and safety nets. However, with the closure of a number of SOEs, the people and small business owners living and working close to these SOEs would have been financially affected. The Program included in its design, training, and rehabilitative services for those employees that were retrenched from the SOEs. But no provision was made for people whose livelihoods would be affected by the change in spending capacities of the retrenched workers. No clear indicator exists as to what extent the secondary socioeconomic impact of SOE closures may have been. No study was undertaken regarding population movements in the vicinity of SOEs after they had been closed.

IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

A. Overall Assessment

44. The Program was rated successful. The overall assessment was based on the systematic program performance evaluation outlined in section III.¹³ The Program was rated relevant, efficacious, less than efficient, likely to be sustainable, and significant in terms of other impacts. Specific weights were assigned to each issue examined. Items 'Relevance' and 'Efficacy' were each assigned a 25% weight, while 'Efficiency' and 'Sustainability' were each assigned a 20% weight. The remainder 10% was assigned to 'Other Impacts.' To derive the rating result, the evaluators examined and assessed several issues under each item. The assessment also took into account comments of relevant ADB staff members as well as the Government and the Executing Agency's comments and concerns. Even though the Program was rated successful, in hindsight the Program could have been prepared and designed differently for improved program performance. Lessons learned and recommendations sections below will address this in detail.

45. The Program was largely implemented as conceived, despite its ambitious and complex nature, which encompassed all aspects of the management of the state's public finances. In addition to seeking to augment revenue mobilization and strengthen public management, the Program included intrinsically complex activities regarding privatization and divestment of money-losing SOEs and enhancing private sector participation in infrastructure through regulatory, policy, and institutional reforms. The program framework was properly designed and comprehensive. Performance monitoring was generally satisfactory, despite some difficulty resulting from GOG's frequent administration changes and certain gaps in fielding review mission.

B. Lessons Learned

46. **Program Preparation and Design.** Gujarat was selected as the first Indian state for which ADB would provide assistance to undertake this type of program lending because of its reform orientation. The Program showed that strong commitments from high-level officials who were champions of the reform were critical to carrying the Program through numerous obstacles, including external shocks and implementation difficulties. However, the Program's successful implementation also required support ownership from different levels of government, including local government bodies, and different levels of government officials across various relevant departments.

47. Although several advisory TA activities were provided prior to the processing of the program loan, the Program was prepared without a specific comprehensive preparatory TA. The policy conditions were based on thorough policy dialogue between ADB and GOG high-level government officials, who were champions of tax reforms and SOE restructuring. However, an in-depth analysis and projection of baseline and reform scenarios would have helped the Program's design by identifying reform measures that were carefully prioritized, appropriately sequenced, and well balanced among various reform areas (revenue, expenditure, and public enterprise reform) and achievable within the planned time frame. Particularly, the Program set specific numerical fiscal targets for future years during program implementation and identified these targets as tranche conditions, without allowing for adjustment in the case of deviation from

¹³ The evaluation system was designed by the Operations Evaluation Department of ADB. A total of five spreadsheets were linked, and rating criteria were imbedded in the spreadsheets.

the underlining assumptions. Therefore, the links between deviations from the Program's economic assumptions and the targeted fiscal deficits were not integrated into the policy matrix. Such in-depth analysis could have provided a clear link between policy actions and desirable outcomes, such as a reduction in fiscal deficit and debt burden. The effectiveness of each policy action would also be assessed through such analysis.

48. Divestment of a specific, identified SOE may not have been suitable as a tranche condition in the policy matrix, since it undermined the state government's leverage in price negotiation with the potential buyers of the SOE shares. The public's knowledge of the tie between divestment of SOE shares and tranche release could have motivated the potential buyers to offer much lower prices than those that were fair for the shares. Low share price offerings may not have occurred if the divesting SOEs had great profit potential. Unfortunately, most of the SOEs that were to be restructured and/or privatized did not have such potential.

49. The Program's design should have taken into account the ground reality in terms of legal environment, political commitments, public support, and government capacity and resources. Legal impediments, both at state and national levels, to proposed policy actions must be checked thoroughly.¹⁴ When setting goals, program designers should also take into account political cycles, particularly the timing of future elections and budgetary cycles. Fiscal reforms may have adverse impacts in the short term through increased tax payments and user charges, reduced opportunity to be recruited in offices in the public sector, and closed SOEs. But in the long term, reforms should bring about sustainability in the fiscal stance of not only a focal state but also the fiscal stances of other states and the Government as a whole. Program design should recognize the spillover effect of proposed reform initiatives. Specifically, program design should examine whether a state government or ADB's future focal state can be fiscally sustained if it is to follow suit in adopting similar reform initiatives. Therefore, terms of payments for settling past liabilities of a state government and its SOEs, including debt outstanding to financial institutions and salary arrears, should be carefully negotiated with creditors.

50. **Implementation Arrangements.** ADB's monitoring of program implementation should have been more rigorous, especially for a program that was envisaged to be completed in two years. In addition, the Program should have taken into account government constraints in terms of human resources, both in quantity and quality, in implementing the reforms. Since the Program aimed at undertaking several areas of fiscal reforms all at once, the TA to the state government during implementation should have been prepared in a comprehensive manner. This requires either a single comprehensive TA undertaking or several TA undertakings that concertedly help build or enhance the capacity of government officials in ushering all intended structural adjustments. However, the accompanying TA only covered one aspect of the Program (creating an enabling environment for the private sector to participate in investing in key infrastructure sectors through the establishment of GIDB). Capacity building in the other important reform areas, namely tax reforms, expenditure management, and SOE restructuring, was not incorporated in the accompanying TA. Even though two stand-alone capacity-building TA activities¹⁵ for strengthening the restructuring of SOEs and public finances that were implemented concurrently with the Program, coordination and supervision mechanisms among

¹⁴ One of the final tranche release conditions required GOG to divest 51% of Gujarat Mineral Development Corporation (GMDC) to the private sector; this would have required amending the Mining Regulation Act of the Central Government which reserves mining rights for the public sector, thus making full compliance of this condition not feasible.

¹⁵ ADB. 1996. *Restructuring of State-owned Enterprises of Gujarat*. Manila.
ADB. 1996. *Support for Gujarat Public Finance Reforms*. Manila. (footnote 4).

all capacity-building TA activities including the accompanying TA, were not provided for under the Program at appraisal.

C. Recommendations

1. Program-Related

51. **Further Actions on Program Areas.** The formulation of a comprehensive policy-based program loan similar to the Program requires extensive dialogue and ownership from not only an executing agency but also across different line departments and levels of governments and government officials. The preparation for such a program loan would require sufficient time and specific program preparatory TA that addresses all aspects of reforms in a comprehensive manner. The priority and feasibility of each of the plausible policy actions would be able to be examined with a holistic view. In addition, capacity and efficiency of financial and human resource management systems could be assessed so that TAs and/or project loans attached to a program loan can be processed with that program loan to ensure the achievement of desired policy actions. Both capacity building TAs and project loans for modernizing public finance and management systems in the case of Indian states are particularly critical, as they provide value addition to the government-funded SFRF, which is aimed at promoting fiscal consolidation among state governments.

52. Since state-level public sector resource management program loans are complex and sensitive to changes in the external environment, including changes in central government policies and natural calamities, the design of such program loan should build in flexibility in a transparent manner. Numerical targets for the fiscal deficit to gross state domestic product (GSDP) ratio should not be set as policy conditions, since various external factors influence fiscal deficit outcomes. These targets should be set as a result of an in-depth analysis using a well-structured financial programming model that is constructed with reasonable economic assumptions. This in-depth analysis would enable stakeholders to measure the extent to which a program loan assists the state government in achieving fiscal consolidation and moving toward a sustainable fiscal reform path. Additional assistance in terms of capacity building, including training and consulting services and information technology systems that help the state government realize the policy actions should be assessed, identified, and included in the comprehensive package of a sector development program, to ensure that the Government achieves the desired policy reforms in a timely manner.

53. **Additional Assistance.** GOG already started embarking on the second phase of the Program, which continues focusing on the restructuring of the remaining SOEs and various other economic measures, including expenditure management and control. One of the Program's major achievements is the continuity of the fiscal reform process that originated with ADB support and was carried on by GOG after the program completion, successfully cultivating reform culture and full ownership within GOG beyond the program implementation period. Continued interaction with GOG, as well as with the Government on assisting the fiscal reform efforts in the second phase of the public sector resource management reforms may be considered, to foster sustainability of fiscal reforms.

2. General

54. The recommendations for future program appraisals generally include the following:
- (i) Program frameworks should be complete, comprehensive, and well balanced among different components of reform areas.
 - (ii) Executing Agency's capacity to carry out each of the reform measures within the envisaged time frame should be carefully assessed.
 - (iii) Implementation arrangements should be formulated, taking into account the Executing Agency's capacity.
 - (iv) Required TA cost to enhance capacity of the Executing Agency and relevant government agencies should be assessed, and such TA provided in a timely manner, to provide effective support for capacity building.
 - (v) Necessary procurement of information technology equipment, to facilitate the relevant government agencies in modernizing and integrating their financial and human resource management systems, and related cost and financial planning should also be assessed and included.

55. **Need to Include the Public Awareness Program.** A public sector resource management program should also include a public awareness program that explains the rationale of the reforms and the benefits to the general public, government officials, and all stakeholders, particularly taxpayers and user charge payers. The benefits of the reforms including a sustainable path of fiscal position; efficient public sector resource management; and adequate infrastructure, which promotes economic growth and greater job opportunities, should be communicated to the public. The awareness program should emphasize increased transparency and accountability in public administration.

STATUS OF PROGRAM COMPLIANCE

A. TRANCHE RELEASE CONDITIONS

Condition	Status at Tranche Release	Current Status
I. Incentive Subtranche		
A. Strengthening of State Public Finances and its Prudent Management		
1. Reduce the fiscal deficit to 3.5% of state domestic product (SDP) in the state's budget for (fiscal year) FY1998.	Fully met. The actual unadjusted indicator was 4.2% of net state domestic product (NSDP). Adjusted fiscal deficit to NSDP was 2.8% after the exclusion of the fiscal cost of unforeseen expenditures on civil service wage increase resulting from the central Government's Fifth Pay Commission recommendations and natural calamities in the state.	The fiscal deficit to NSDP deteriorated after the 2001 earthquake. The actual unadjusted indicator was 7.3%, 8.6%, and 6.1% of NSDP for FY2000, FY2001, and FY2002. The Government of Gujarat (GOG), however, started launching the second phase of fiscal consolidation, to contain the fiscal deficit. GOG recently submitted a draft memorandum of understanding (MOU) to the central Government under the States' Fiscal Reforms Facility (SFRF). The monitoring indicator used in the MOU is the revenue deficit as a percentage of revenue received.
2. Introduce the following tax reforms including the merger of turnover tax with the sales tax: (i) Reduce the number of sales tax rates from 23 items to about a third thereof. (ii) Reduce the number of items on the prohibited list from 63 to about a third thereof. (iii) Introduce simplified tax assessment through a single tier system. (iv) Merge turnover tax with sales tax.	Fully met. (i) Rate structure of sales tax was consolidated to six categories with four special rates in 1997. (ii) Item numbers were reduced from 63 to 33 in the FY1998 budget and to 24 in the FY1999 budget. (iii) Assessment systems were simplified by introducing a single tier system of assessment from April 1998. (iv) Turnover tax was merged with sales tax in April 1997.	Status of (i), (iii) and (iv) remains the same as reported for the final tranche, which was released in December 2000. As for (ii), this has been further reduced and currently 16 items are on the prohibited list.
3. Introduce a rationalized stamp duty schedule based on ad valorem rates and initiate steps to improve the valuation system for the stamp duty.	Fully met. The rate schedule was adjusted. Rates for some items were reduced or converted to ad valorem rates. For improvement of the valuation system, the automatic reckoning	

Continued on next page

Condition	Status at Tranche Release	Current Status
	mechanisms for valuation of immovable properties were updated in June 1998 and again 1999 for the purpose of stamp duty assessment.	
4. Rationalize the profession tax.	Fully met. The rate schedule was adjusted. Rates for some items were reduced or converted to ad valorem rates. For improvement of the valuation system, the automatic reckoning mechanisms for valuation of immovable properties were updated in June 1998 and again 1999 for the purpose of stamp duty assessment.	
5. Introduce a new rate schedule for tax on goods and passengers that reduces the number of rate categories from 15 to about a third thereof.	Fully met. The rate schedules of tax on goods and passengers (TG&P) and motor vehicle tax (MVT) were merged on goods and passenger vehicles to simplify the schedule from April 1997. The number of rate categories for goods vehicles were reduced from 15 to 7.	
6. Shift from the weight-based MVT to a composite ad valorem MVT. Also, replace the existing sales tax and lifetime tax on private cars with a single one-time composite and ad valorem tax.	Fully met. An ad valorem MVT on private cars was introduced from August 1998. The new rate structure was simplified carrying a single rate of 4%.	GOG further restructured MVT structure and rates to mobilize tax revenue. Tax rates for omnibuses were increased in FY2001. Sleeper bus coaches were subjected to MVT starting in FY2004. Stamp duty exemptions for tractors used for agriculture purposes were withdrawn from 1 April 2003.
B. Reform of State-Owned Enterprises		
7. Privatize Gujarat Communications and Electronic Limited (GCEL) and Gujarat Tractor Corporation Limited (GTCL) by selling off 51% of the State's shares in each, through a transparent procedure.	Partially complied with. GOG adopted a properly designed and transparent bidding procedure that was acceptable to all parties. GCEL: While GOG followed identical bidding procedure for GTCL, it could not find a suitable buyer. A GOG cabinet subcommittee decided to reinvoke bids while restructuring GCEL. GOG successfully reduced the workforce from 1,390 to 740 and retendered the sale offer in January 1999.	GCEL: Upon the decision to close GCEL, GOG provided the voluntary retirement scheme (VRS) to all employees. On 18 February 2002, the Gujarat High Court passed the order to close the company and appoint an official liquidator.

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Condition	Status at Tranche Release	Current Status
	<p>GTCL: In August 1998, GOG and Mahindra & Mahindra Ltd., a leading tractor manufacturing company in India agreed on all details including the settlement price, for Mahindra & Mahindra to acquire 51% of GOG's shares. However, Mahindra & Mahindra is reconsidering its offer.</p>	<p>GTCL: No progress was made in further privatizing GTCL.</p>
<p>8. Offer up to 25% of Gujarat State Financial Corporation (GSFC) equity for public issue, as permissible under existing law.</p>	<p>Complied with. Public issue of Rs235 million of GSFC equity, which was equivalent to 25% of pro-forma shares, was floated in February 1997. The price of the issue was fixed at Rs20 per share (premium of Rs10). The issue was oversubscribed and over 60% was acquired at the retail level. The allotment of shares was completed in May 1997. Allowing for the Industrial Development Bank of India's shareholding, GOG's holdings in GSFC were reduced to about 49% (which is a condition of the second tranche). GSFC substantially reduced its nonperforming portfolio. Financial restructuring has also improved GSFC's capital adequacy ratio from 8.4% in March 1996 to about 13% in March 1997.</p>	
<p>9. Reduce by 26% the state's shareholding in Gujarat Industrial Investment Corporation (GIIC) and Gujarat Mineral Development Corporation (GMDC) and cause GIIC to (i) enter into an agreement with a technical collaborator for enhancing its capacity, and (ii) initiate implementation of its organizational and financial restructuring.</p>	<p>GIIC: Partially complied with. GOG selected Industrial Credit and Investment Corporation Limited (ICICI), Infrastructure Leasing and Financial Services (IL&FS) and Housing Development Finance Corporation (HDFC) for divesting 26% of its shareholding in GIIC and completed valuation of GIIC's assets through an independent consultant after finalizing the accounts for 1997-1998. A cabinet subcommittee on state-owned enterprise (SOE) reforms approved the sale and constituted a committee to negotiate a purchase price for issue of fresh equity to the buyers. However, the offered price by ICICI after their due diligence was not acceptable to GOG. GOG is seeking the possibility of entering into a technical collaboration agreement with IL&FS.</p>	<p>GOG converted outstanding loans amounting to Rs992.2 million into equity capital during FY2001. GIIC has also mobilized an amount of Rs1,499.6 million through issuance of long-term bonds guaranteed by GOG. GIIC carried out internal restructuring during this period.</p>

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Condition	Status at Tranche Release	Current Status
	<p>Organizational restructuring was implemented based on various studies by outside consultants. GOG took steps for financial restructuring.</p> <p>GMDC: Complied with. In October 1997, GOG successfully divested 26% of its equity in GMDC to the general public by offering for sale 8,268,000 shares of Rs10 each with a premium of Rs120 per share, totaling Rs1.07 billion. The Offer has met with resounding success despite sluggish market conditions. The offer was oversubscribed by more than two times.</p>	
C. Evolve an Enabling Environment for Private Sector Involvement in Infrastructure Sectors		
10. Announce a state roads sector policy	Complied with. A road policy was announced in January 1997, to encourage private sector participation in construction and maintenance of roads. The roads sector policy aims to provide an efficient roads network across the state and also includes specific guidelines for private sector participation in this sector.	Condition satisfied.
11. Announce a policy for private sector participation in the state's ports sector and associated facilities including the policy for creating a regulatory framework.	Complied with. GOG approved and announced its build-own-operate-transfer (BOOT) policy for the ports sector in July 1997, which includes a package of BOOT principles serving as a framework for the involvement of the private sector in the construction and operation of these new ports. The scope of BOOT policy guidelines includes issues such as the rights and responsibilities of developer and government regulatory control.	Condition satisfied.
II. Final Subtranche		
A. Strengthening of State Public Finances and its Prudent Management		
1. Reduce the fiscal deficit to 2.7% in the FY1999 state budget. This is to be achieved by raising current revenues annually by about 0.5% of SDP	The condition was amended to establishing a fiscal process based on a sound fiscal framework agreeable to the Asian Development	See I. A.1. above.

Continued on next page

Condition	Status at Tranche Release	Current Status
and a proportionate reduction in the current expenditure to SDP ratio.	Bank (ADB). Taking exogenous factors and slow progress in power sector reforms into consideration, the fiscal deficit would have been 2.5% of NSDP, with the mandated wage bill increase accounting for 2.0%, recurring natural calamities accounting for 0.2%, decreased central transfers accounting for 0.4%, and high power subsidies due to delay in power sector reforms accounting for 1.6%.	
2. Revise power tariffs to maintain a 3% rate of return on Gujarat Electricity Board's (GEB's) fixed assets by FY1998.	<p>In view of changed circumstances, the Government requested an amendment of this policy condition.</p> <p>GEB met the 3% rate of return on its net fixed assets with subsidies of \$214 million in FY1997, although GEB made a net loss of \$199 million. Delays in power sector restructuring increased GEB's net losses, and in FY1998 GOG was no longer able to subsidize power sector operations to the extent of meeting the 3% return. GEB's return on fixed assets fell to negative 5% with subsidies and negative 26% without subsidies in FY1998 and to negative 5% with subsidies and negative 38% without subsidies in FY1999.</p> <p>GOG established the Gujarat Electricity Regulatory Commission (GERC), an independent regulatory authority for awarding power tariffs, in November 1998, but GERC was unable to revise power tariffs due to political and social considerations. Its revision came on 10 October 2000. GERC reviewed all relevant operational data submitted by GEB and other independent power corporations and undertook public hearings during March to October 2000 to revised electricity tariffs. The revision including substantial upward revision</p>	<p>Raising the agriculture sector tariff remains politically challenging. GOG informed the program completion review mission that GOG continues to be committed to further raising power tariffs on farmers despite political pressure. GEB has also been implementing an intensive meter installation program to replace old meters with sealed, tamper-proof meters in the agriculture sector where the majority of users were unmetered. GOG also enacted the Gujarat Electricity and Regulation Act in 2003, which followed the central Government's enactment of Electricity Act in 2003. A target tariff rate was set to be at least two-thirds of total supply cost by 2006. The remaining one-third will be financed by cross subsidy from the industry to the agriculture sector.</p> <p>GEB's return on fixed assets deteriorated greatly in FY2000 and FY2001 to negative 24% and negative 25%, respectively, but improved in FY2002 and FY2003 to 6% and 4%, respectively.</p> <p>GEB continues to be a loss making SOE despite the restructuring and</p>

Continued on next page

Condition	Status at Tranche Release	Current Status
	<p>for agricultural tariffs were announced and made effective immediately. This will reduce power sector subsidies to the capped level of Rs11 billion (\$236 million) for FY2001.</p> <p>The revised power tariffs will not enable GEB to make 3% returns on its fixed assets for a few more years. This target level must be met in combination with GEB's own efforts in undertaking rigorous financial and operational restructuring. The then-proposed Power Sector Development Program Loan scheduled to be discussed by the ADB's Board in December 2000 was expected to address some of GEB's problems inherent to all State Electricity Boards in India in the context of comprehensive restructuring of the power sector industry in Gujarat.</p>	<p>reorganizing efforts. GEB was divided functionally into generation, transmission, and distribution companies. GEB transferred its generating units to its existing subsidiary company for generation. A transmission company (Gujarat Electricity Company Ltd.) was also created to take over the transmission business. Four distribution companies were created to look after distribution functions in four regions of the state. GEB remains as the holding entity to oversee remaining functions such as bulk power purchase and bulk supply functions.</p> <p>GEB has implemented several measures to control cost and expenditure including reduction in fixed cost of independent power producers through renegotiation; optimization of fuel mix, to reduce high-cost fuel consumption; renegotiation with creditors, to restructure high-cost loans; and attrition with no replacement combined with 20% cut in manpower and other measures. These measures resulted in substantial reduction in the cost of power purchase and net cash loss. GEB also received an incentive grant of Rs5,360 million under the central Government's Accelerated Power Development and Reforms Program scheme.</p>
3. Increase irrigation charges to levels agreed with ADB.	Fully met. During loan negotiations, a 50% increase in irrigation charge was agreed to be the acceptable rate of increase. On 25 October 2000, Gujarat issued an order to raise irrigation charges from the existing rates by 3.0 times on rice, 2.5 times on sugarcane, and 2.0 times on other crops starting February 2001.	Condition satisfied.

Continued on next page

Condition	Status at Tranche Release	Current Status
4. Introduce the Core Investment Program (CIP) context of the Ninth Five-Year Plan and institute arrangements to institutionalize and roll over the CIP annually, while protecting it from ad hoc budgetary cuts.	Fully met. The CIP was introduced in the context of the Ninth Five-Year Plan from 1996 to 1997. An 'earmarking' system, which prioritizes sectors, projects, and schemes, was institutionalized and implemented. The system was properly established, followed by the state on an annual basis.	Condition satisfied.
5. Raise the capital expenditures from 2.1% of SDP in FY1997 to about 2.6% of SDP by FY1999 in line with the Medium-Term Fiscal Policy Framework (MTFPF).	Fully met. Capital expenditure rose to 3.2% of NSDP in FY1999 and was 3.1% in FY2000.	Capital Expenditures were protected.
B. Reform of State-Owned Enterprises		
6. Fully privatize GCEL and GTCL by selling all of the State's shares in GCEL and GTCL.	<p>Condition amended to fully privatize GTCL and approve closure of GCEL.</p> <p>GCEL: GOG has decided to close GCEL. GOG failed to reach an agreement with GCEL's final bidder on payment of wages in arrears resulting from the Fifth Pay Commission's wage increases. GOG discontinued its attempt to divest GCEL and decided to close the enterprise. On 9 October 2000, GCEL's closure was approved by a cabinet subcommittee.</p> <p>GTCL: GOG's 60% shareholding of GTCL was divested. GOG's 51% shareholding of GTCL was sold to Mahindra & Mahindra Ltd. on 18 December 1999. An additional 9% of GTCL was transferred to Mahindra & Mahindra Ltd. on 30 May 2000. Under the sale-cum-shareholders agreement, Mahindra & Mahindra Ltd. has an irrevocable option to purchase the remaining 40% share at a predetermined price, binding the state to sell the remaining stake in GTCL on request by Mahindra & Mahindra Ltd.</p>	See I.B.7. above.
7. Reduce the State's 56% shareholding in Gujarat State Export Corporation (GSEC) to 26% or less by transferring the same along with management	Partially met. Gujarat is reducing its 56.6% of GSEC shareholding to 11.0%. The divestment process was prolonged due to GSEC's	GOG now possesses 26% shareholding in GSEC. The bid from Ms Adani Exports Ltd. for acquiring 45.6% equity, thereby

Continued on next page

Condition	Status at Tranche Release	Current Status
control to a strategic partner.	possession of an air cargo complex, which required approval from the central Government for transfer of ownership at the time of divestment. Central Government approval was given. On 9 October 2000, a cabinet subcommittee confirmed the sale, for which final bids were received on 23 June 2000. The selected corporation's quote price was Rs1,500 per share, against the underwriter's estimated share price of Rs5,000. While the difference is substantial, the investment amount is not significant. Gujarat is confident that an agreement on the price will be reached since the number of shares is limited (6,840 shares) and the company is profitable. Furthermore, no labor disputes exist.	reducing GOG shareholding to 11% had not materialized.
8. Reduce GOG's shareholding in GIIC to not more than 49%.	Partially complied with. GOG selected ICICI, IL&FS and HDFC for divesting 26% of its shareholding in GIIC and completed valuation of GIIC's assets through an independent consultant after finalizing the accounts for 1997–1998. A Cabinet subcommittee on SOE reforms approved the sale and constituted a committee to negotiate a purchase price for the issuance of fresh equity to buyers. However, the offered price by ICICI after their due diligence was not acceptable to GOG. GOG is seeking the possibility of entering into a technical collaboration agreement with IL&FS. Organizational restructuring has been implemented based on various studies by outside consultants. GOG took steps for financial restructuring.	See I.B.9. above.
9. Reduce GOG's shareholding in GMDC to not more than 49% and GMDC to enter into an agreement with a technical collaborator for enhancing capacity. GMDC to sell its inefficient and unprofitable units.	Complied with. In October 1997, GOG successfully divested 26% of its equity in GMDC to the general public by offering for sale 8,268,000 shares of Rs10 each with a premium of Rs120 per share, totaling Rs1.07 billion. The Offer has met with resounding success despite sluggish market conditions. The offer was	Condition satisfied.

Continued on next page

Condition	Status at Tranche Release	Current Status
<p>10. Reduce GOG's shareholding in GSFC not more than 49% and implement financial and organization restructuring of GSFC along with the plan for upgrading its information and technology.</p>	<p>oversubscribed by more than 2 times.</p> <p>Complied with. Public issue of Rs235 million of GSFC equity, which was equivalent to 25% of pro-forma shares, was floated in February 1997. The price of the issue was fixed at Rs20 per share (premium of Rs10). The issue was oversubscribed and over 60% was acquired at the retail level. The allotment of shares was completed in May 1997. Allowing for the Industrial Development Bank of India's shareholding, GOG's holdings in GSFC were reduced to about 49% (which is a condition of the second tranche). GSFC has substantially reduced its nonperforming portfolio. Financial restructuring also improved the capital adequacy ratio of GSFC from 8.4% at the end of March 1996 to about 13.0% in March 1997.</p>	<p>Condition satisfied.</p>
<p>11. Adopt, as agreed with ADB, the recommendations of the study and</p> <ul style="list-style-type: none"> (i) corporatize GIDC and divest 26% of GOG's shareholding; (ii) offer leaseholders option to convert leaseholds to freeholds in state-owned industrial estates if legally feasible; and (iii) strengthen regulatory and planning framework for existing and new industrial estates. 	<p>Fully met. As recommended by ADB, GIDC will retain its regulatory, planning, and land acquisition functions and divest those pertaining to estate management and estate development. GIDC accepting ADB's recommendation, approved GIDC's restructuring plan on 12 June 2000. GOG has, however, opted not to corporatize and to retain its statutory position and to continue its regulatory role.</p> <p>To proceed with its restructuring plan, GIDC offered voluntary retirement schemes to its staff members and 615 employees (22% of the total staff) were retrenched as of 28 February 2000. On its divestment of estate management, GIDC faced reluctance from industries to take over because of low returns from these estates. However, GIDC has transferred water supply schemes of 15 estates and in accordance to GOG's decision, GIDC will transfer 21 estates that will be managed by an independent agency, and divest 51 estates situated in municipal limits to</p>	<p>Condition satisfied.</p>

Continued on next page

Condition	Status at Tranche Release	Current Status
	<p>municipalities and local bodies.</p> <p>For all new investments, GIDC will put up 26% of the capital and the remaining 74% will be provided from the private sector. GIDC invited tender offers for two projects for the development of a residential township in Atali, Dahej and Ankrleshwar on a build-own-maintain basis. Private sector interests, however, have not been encouraging. The proposals are currently being reviewed for restructuring to attract higher private sector interest.</p>	
<p>12. Divest 49% of GOG's shares in Gujarat Agro Industries Corporation Limited (GAIC) and close uneconomic units and/or divisions of GAIC.</p>	<p>Substantially met. GAIC sold its two subsidiaries and closed down all commercial activities, including uneconomic units and/or divisions, with the exception of pesticides and its distribution network. Voluntary retirement schemes will be offered to all employees of the closed units in accordance with GOG order of 12 April 1999.</p> <p>GOG will maintain GAIC's distribution network, used mainly to provide price-controlled fertilizer (urea) and offer agricultural inputs and technical advice to the remote areas of the State. The distribution network was streamlined by disengaging 400 independent members of the network out of 800 and adding 150 new members on the basis of a minimum performance target set by GAIC. However, due in part to the recurrent droughts, selling off the pesticide operation and distribution network was possible, as these operations remain commercially nonviable.</p> <p>The uneconomic units undergoing liquidation accounts for approximately 60% of GAIC's net fixed assets and 50% of employees. In view of the fact that private sector interest is likely to be low for servicing remote areas of the state, GOG opts to retain 100% of GAIC, and dedicate GAIC as a developmental and/or promotional</p>	<p>Status remains. (See also Appendix 3.)</p>

Continued on next page

Condition	Status at Tranche Release	Current Status
	agency for the state's agriculture.	
C. Evolve an Enabling Environment for Private Sector Involvement in Infrastructure Sectors		
13. Develop a time-bound action plan for the development of a regulatory framework for the power sector in consultation with ADB.	Fully met. A plan for developing a power sector regulatory framework was developed and substantially implemented. GERC was established in November 1998 under the Electricity Commission Act of 1998 as an independent organization empowered to determine the power tariffs for wholesale, bulk, grid and retail electricity. Under the new regulation, GEB and other licensees are requested to submit their proposals for tariff revisions to GERC based on actual data of operation. Upon receipt of such proposals, GERC assesses the proposals together with the operational data and conducts public hearings, subsequently revising the power tariffs. The process may be undertaken on an annual basis if required.	GERC has continued to operate. It prepared the Gujarat Electricity and Regulatory Act, which was in harmony with the central Government's Electricity Act 2003. The Gujarat Electricity and Regulatory Act became effective in 2003. The act set a target of two-thirds of the supply cost to be financed by tariffs by 2006.
14. Set tariff objectives based on economic and financial principles by September 1997. Following this, revise and raise the port charges based on specific objectives, including, in particular, the cost of services rendered.	Fully met. The Ports and Fisheries Department revised port charges based on economic and financial principles including costs incurred, pursuant to notifications issued on 12 May 1998. The new charges became effective as of 14 May 1998.	Condition satisfied.
15. Develop an implementation plan for a suitable regulatory framework for public and private ports development.	Fully met. GOG approved and announced build-operate-own-transfer (BOOT) policy for the ports sector in July 1997, which included a package of BOOT principles serving as a framework for involving the private sector for construction and operation of new ports. The scope of BOOT policy guidelines covered such matters as rights and responsibilities of developers and government regulatory control.	Condition satisfied.
16. Levy tolls on at least two designated state road and bridges projects under construction at levels sufficient to recover at least 50% of annualized construction, maintenance and financial costs.	Fully met. Tolls determined on the basis of construction, maintenance, and financial costs were levied for Magdalla Bridge on Magdalla Ichhapor road from 1 September 1998 and	In addition, two toll roads were completed in 2003 (Ahmedabad-Rajkot) and 2004 (Bagodra-Vasad). Four tolled bridges were also built and operated,

Continued on next page

Condition	Status at Tranche Release	Current Status
	Roads Over Bridges at Gujarat Narmada Valley Fertilizer Company Limited on Bharuch bypass joining Bharuch and Dehej State Highway to National Highway No. 8 from 7 February 1999.	namely Mahi, Watrak, Narmada, and Mahi bypass.
17. Cause Roads and Bridges Department (R&BD) to provide GIDB with a report on experience gained from negotiations of at least two private sector roads or bridges projects, together with recommendations for changes, if any, to the policy and regulatory framework for private sector road development.	Fully met. R&BD submitted to GIDB its report based on experience in handling build-operate-transfer (BOT) projects, although relatively small in size, and the same was provided to ADB on 24 December 1999. Subsequent to completion of a large-scale BOT project in November 1999, a report containing recommendations for changes in policy and the regulatory framework for road development by private sector was provided.	Condition satisfied.

B. APPROVAL OF RELEASE COVENANTS UNRELATED TO THE TRANCHE

Covenant	Status at Tranche Release	Current Status
A. Covenants to be achieved by the release of the Incentive Tranche		
1. Provide a report on the review of property tax and <i>octroi</i> to the Bank.	<p>Complied with.</p> <p>Property Tax: The analysis of the various aspects of an area-based assessment and rationalization of property tax rates was entrusted to experts. The expert team has carried out a study and submitted detailed reports to the GOG for all six municipalities of the state. The reports were submitted in October 1998 to ADB. GOG initiated action to extend a new system.</p> <p><i>Octroi</i> Tax: GOG established a committee under the chairmanship of the principal secretary of the Urban Development Department to examine measures to rationalize structural reform and procedural rationalization. GOG constituted a high-level committee under the chairmanship of</p>	Condition satisfied.

Continued on next page

Covenant	Status at Tranche Release	Current Status
	the finance minister comprising representatives from all fields to study <i>octroi</i> alternatives.	
2. Initiate implementation of Core Investment Program (CIP).	Complied with. Expenditure prioritization was implemented under the system of earmarking the selected sectors, projects, and schemes. This system was established in the state and GOG is regularly and successfully following it.	Condition satisfied.
3. Initiate steps to (i) design and implement tax and expenditure restructuring; (ii) upgrade budget policy formulation, planning, management, and control systems; (iii) computerize the various revenue, expenditure, treasury, and debt accounts; and (iv) improve tax administration for enhancing tax compliance and enforcement.	Complied with. (i) GOG established and made operational the State Public Finance Reforms Committee (SPFRC) as well as appointed a renowned economist as Head of SPFRC; (ii) Three working groups on expenditure management and control, tax reforms, and computerization and training, were constituted based on the resolution of July 1998; and (iii) GOG made funds available for computerization of the sales tax department.	Condition satisfied.
4. Reorganize and establish a full-fledged Directorate of Taxation with separate wings for major taxes and strengthen the research and analytical capability of this directorate.	Complied with. GOG notified establishment of the directorate in April 1998. The directorate's functions were under overall supervision of the Additional Chief Secretary (Finance). Joint Secretary (Tax) was appointed as Director of Taxation. Suitable personnel are being identified for the purpose of strengthening research and analytical capabilities.	Condition satisfied.
5. The Technical Secretariat is to submit a progress report for SOEs that were divested or restructured.	Complied with.	Condition satisfied.
6. Make appropriate allocation for the State Renewal Fund (SRF) in the FY1998 state budget.	Complied with. The necessary budgetary allocation was made. Rs150 million was asked as a budgetary allocation for SRF in FY1999 in addition to the remaining balance of Rs101 million. SRF has therefore sufficient balance to meet the expenditure likely to be incurred for the voluntary retirement scheme (VRS) for the SOEs, which would be completed.	Condition satisfied.
7. Make GIDB operational with adequate staffing and budgetary allocation for project development	Complied with. GIDB was made operational through a form of society in July 1997, and a	Condition satisfied.

Continued on next page

Covenant	Status at Tranche Release	Current Status
and feasibility studies for key infrastructure sectors and develop its technical expertise in these areas to build capacities of sector ministries.	full-time chief executive officer and sector specialists and professionals were appointed for day-to-day administration. All policy decisions to be taken in respect of objectives of the board are handled in the Executive Committee and full meetings of the board. Budgetary allocation was made for identification and feasibility of infrastructure projects.	
B. Covenants to be achieved by the release of the Final Tranche		
1. Implement MTFPF, regularly assess its progress, and prepare projections annually in line with revised base year data starting from FY1998.	Fully met. A MTFPF was formulated in FY1997 and thereafter its progress has been assessed regularly and projection revised in line with base year data. SPFRC prepared a medium-term fiscal consolidation plan in December 2000 for adoption starting FY2002.	The MTFPF was submitted to the Cabinet for adoption starting FY2002. A draft MOU between GOG and the central Government for the MTFPF was prepared based on this plan. SPFRC was dissolved after the completion of medium-term fiscal consolidation plan.
2. Finance Department to take into account the recommendations of ADB-financed technical assistance to: (i) develop a value-added tax (VAT) blue-print plan, model legislation and a credit system for input taxation; (ii) initiate upgrading and modernizing of sales tax administration and training of staff members in tax administration including VAT; (iii) launch a public information campaign; and (iv) examine options for eliminating industrial concessions and exemptions and tax relief for bankrupt industries in line with the recommendations of the Committee of State Finance Ministers (CSFM) along with the implementation of similar actions by neighboring states.	Fully met. (i) Gujarat adopted the blueprint prepared by the Committee of Chief Ministers for implementing VAT nationwide by 1 April 2002. In preparation for the switch, a committee was appointed to design VAT for Gujarat, based on the model VAT legislation prepared by the National Institute of Public Finance and Policy (NIPFP). The national model envisages gradual reduction in the central sales tax rate from 4% to 1% in 3 years and a three-tier VAT tariff structure effective from 1 April 2002. (ii) GOG is implementing a \$3.4 million computerization program to modernize sales tax administration, which was to be completed by 2002. (iii) GOG constituted a committee for supervising VAT implementation. The committee will launch a broad-based public information campaign once the scope of the VAT is finalized. (iv) GOG has implemented the recommendations of the Committee of State Finance Ministers to eliminate all sales tax	VAT preparation including legislation, computerization system, training and workshop, and public awareness campaign, was completed. The VAT bill was passed by the State Assembly and submitted to the central Government for approval. The Government still has not approved the submitted Bill. Nationwide, the central Government decided to postpone the original plan of VAT introduction (1 April 2002) indefinitely. Note that the proposed three rates are 4%, 8%, and 12%. In 1999, about 13,000 companies had industrial exemptions for sales tax. Currently, about 3,000 companies enjoy such exemption. About 500 companies are expired yearly. By 2009, no companies will enjoy any such privilege.

Continued on next page

Covenant	Status at Tranche Release	Current Status
	incentives to the industry (exception to those already in the pipeline) from 1 January 2000, and agreed on uniform floor rates of sales taxation to avoid tax competition, effective 1 January 2000. The floor rate regime is expected to bring additional revenue of Rs3 billion to Rs5 billion. Removal of incentives will increase tax buoyancy after 2 years and increase the tax revenue base by approximately 20% in 5-6 years.	
3. Improve further the valuation system for stamp duty.	Fully met. To strengthen the valuation system, tax tables were updated in June 1998. In consultation with the Revenue Department, regular updating of tax tables is being institutionalized.	Another survey was carried out in 1999. A survey will be carried out to revise the valuation of land by zone. The revision should be completed in 2 years.
4. SPFRC, with ADB technical assistance support, is to prepare proposals for improvement in tax administration of a profession tax, ^a tax on goods and passengers (TG&P) and motor vehicle tax (MVT), to support effective implementation of state tax reforms.	Fully met. Based on recommendations of TA 2668-IND: Support for Gujarat Public Finance Reforms, the profession tax, TG&P and MVT structures were improved, effective April 1997.	GOG still continues to improve tax administration for effective and efficient tax administration of profession tax, and other small taxes. GOG is reviewing consolidation of profession and entertainment taxes.
5. Develop, in consultation with the municipal corporations and municipalities, ^b a time-bound action plan for property tax reforms, including a tax table (as an automatic reckoning mechanism) for valuation of properties to support tax assessment.	Fully met. GOG is implementing an action plan for property tax reform while the study for reforms in valuation systems was completed and the tax table prepared.	GOG continues implementing the reforms in valuation systems.
6. Implement, in consultation with the municipal corporations and municipalities, recommendations of study on the property tax, including introduction of a criteria-based valuation system for property tax.	Substantially met. The Bombay Municipal Corporation Act was amended to permit levy of property tax under the new matrix-based system in six municipal corporations in Gujarat. Ahmedabad City took the initiative to introduce the system and has surveyed three of four zones in the city to collect information on tax base (area of properties, number, and characteristics) to design revenue neutral tax rates for implementation from FY2002. GOG conducted workshops to educate other municipal corporations and smaller municipalities on the system and GOG plans to amend the Gujarat Municipal Act to facilitate	No further progress.

^a this will not be required if profession tax is abolished.

^b The municipal corporations are governed under the Bombay Municipalities Corporation Act, 1949 and the municipalities governed under the Gujarat Municipalities Act, 1963.

Continued on next page

Covenant	Status at Tranche Release	Current Status
	introduction of the new system of property tax in all municipal areas.	
7. Implement, in consultation with municipal corporations and municipalities, recommendations of studies on <i>octroi</i> designed to develop uniformity in the <i>octroi</i> system across these bodies, and to streamline <i>octroi</i> administration and procedures.	Substantially met. The decision to abolish <i>octroi</i> was taken by the state. A draft entry tax law was prepared to replace <i>octroi</i> and sent to the central Government for approval. The law will be enacted and implemented upon receiving federal approval. GOG recommended that local bodies rationalized <i>octroi</i> , and take measures, including implementation of uniform rates. Local bodies expressed concerns that the new impost, which will be collected by the state government and passed on to them, may not be as buoyant and liquid as <i>octroi</i> . The state government incorporated safeguards in the draft legislation to ensure high buoyancy and automatic transfer of revenues to local bodies.	The decision to abolish <i>octroi</i> was reversed. Seven municipal corporations are exempted from the <i>octroi</i> abolition. Revenue from <i>octroi</i> is buoyant and liquid in these seven exempted local bodies.
8. Finance Department is to take into account the recommendations of ADB-financed technical assistance for enhancing cost recovery for key socioeconomic services, such as those for the transport and social sectors.	Continued progress. SPFRC formulated overall guidelines for cost recovery for key socioeconomic services and made specific recommendations. GOG has accepted several recommendations by SPFRC and took action to increase cost recovery in transport, technical education, and irrigation. GOG considers enhancing cost recovery as an ongoing process and is focusing on its improvement as part of the medium-term fiscal consolidation framework.	GOG implemented several measures to increase nontax revenue and reduce subsidy expenditure. In January 2004, water charges were increased. The fee in secondary and higher secondary schools, colleges, and technical institutes were revised in June 2003. The electricity charges for the agriculture sector were also increased.
9. Introduce improvements in budget plan, management and control systems, and computerize tax and expenditure systems as well as treasury and debt management systems.	Fully met. The entire Finance Department operation and the budget divisions of various departments were computerized. The office of Directorate of Accounts and Treasuries was also fully computerized. Software was developed for compiling the state's budget and is currently being tested. Budgetary management was substantially computerized. Software was being developed for the sales tax.	GOG commissioned the National Informatics Center to establish the Gujarat Wide Area Network, which connects all departments. By FY2006, all departments will be computerized. At the moment, the Treasury Department has its own computerization system that is used to monitor and manage cash on a daily basis. However, the system used has not yet been linked with other units within the Finance Department.

Continued on next page

Covenant	Status at Tranche Release	Current Status
10. Submit to SPFRC a progress report on public finance reforms for review by GOG and ADB by December 1997. This report, among others, includes reform proposals for (i) VAT, property tax, and <i>octroi</i> , and (ii) improvements in expenditure management and control. The recommendations of SPFRC's report, as agreed between ADB and GOG, will be adopted by April 1998.	Fully met. SPFRC was formed in November 1996. Reform proposals for VAT, property tax, and <i>octroi</i> , and improvements in expenditure management and control were submitted to the state in October 1998. Further studies were undertaken to manage public resources more strategically and better contain the fiscal deficit. A fiscal consolidation plan is to be completed in December 2000. Implementation procedures are being deliberated by relevant state departments.	The fiscal consolidated plan was completed in December 2000. The plan was submitted to the state cabinet. Data and analysis in the plan was used as a foundation for preparing the draft MOU between GOG and the central Government for the state to avail of the States' Fiscal Reforms Facility. The draft MOU was submitted to the central Government on 20 November 2003 for approval.
11. The Technical Secretariat to submit a progress report for SOEs that have been divested or restructured; and prepare strategies for restructuring of 8 other SOEs.	Fully met. The progress report on the status of SOE divestment and restructuring together with strategies for restructuring 8 SOEs was submitted to ADB in September 1999.	GOG through the Technical Secretariat carried forward the SOE restructuring agenda in the second phase of the Public Sector Resource Management Program, initiated by GOG. GOG is contemplating a new target of SOE restructuring for FY2005. However, no specific time bound and targeted restructure plan was adopted.
12. State approval for the proposed reform of 8 SOEs.	Fully met. Approve for restructuring 8 SOEs was given by the cabinet subcommittee.	
13. Finalize the study on technical and restructuring option for Gujarat Industrial Development Corporation (GIDC).	Fully met. The study was finalized on 10 November 1997. The study proposed to restructure GIDC by unbundling its operations. Estate development, estate management, and lease and/or financing would be divested while maintaining planning and regulation, land acquisition and land ownership under GIDC.	Condition satisfied.
14. Merge: (i) Gujarat State Leather Industry Development Corporation with Gujarat Rural Industries Marketing Corporation and (ii) Gujarat State Handicraft Corporation with Gujarat State Handloom Corporation.	(i) Substantially met. The Company Law Board, Department of Company Affairs, Government of India approved the merger, and an announcement of the merger was made on 22 January 2000. No objection on the merger was made, and the formal notification of the merger would be published in the official gazette. (ii) Substantially met. The Company Law Board, Department of Company Affairs, Government of India approved the merger. Objections were received from the employees union and co-	The necessary procedure for registering the merger with the Registrar of Companies has been completed and the merger has become effective from 9 January 2001. Settlement has still not reached a conclusion. GOG assigned Institute of Rural Management, Anand (IRMA) to study the proposed merger, and examine the manpower, financial and operational terms of the merged corporation. A

Continued on next page

Covenant	Status at Tranche Release	Current Status
	operative bodies. Negotiation with the objecting parties are on-going and settlement was expected by end December 2000.	preliminary report was submitted and examined by the department.
15. Lease or sell another 20 properties of Tourism Corporation of Gujarat Limited (TCGL).	Partially met. Of the 20 properties, 10 properties were leased or sold. For seven leased properties, litigations were filed and court judgements from the High Court of Gujarat are pending. Problem arose due mainly to the inadequately prepared lease deeds. Having learned from this lesson, consultants were hired for assessing the lease value and preparing the lease deeds for the remaining 10 properties. These properties will be either leased or sold.	The leasing or selling processes were held up, due to litigation.
16. Restructure Gujarat Housing Board (GHB) and Gujarat Slum Clearance Board (GSCB) by transferring all construction of low-income housing from GSCB and rationalizing GSCB activities.	Fully met. A cabinet subcommittee suspended the activities of GSCB by transferring slum clearance activities to local bodies and/or nongovernment organizations and the assets to Gujarat Housing Board. GSBC employees will be offered VRS. The closure of GSCB is being implemented by the Urban Development Department.	The Urban Development and Urban and Housing Development Department initiated action according to the Cabinet Subcommittee's decision. Activities of GSCB were closed down. Almost all employees were paid through VRS. The Urban Development and Urban and Housing Development Department has yet to initiate action to restructure GHB.
17. GOG reports on settlement of creditors' dues from the closed textile mills in cases where closure was approved by the relevant statutory authorities, and downsizes Gujarat State Textile Corporation (GSTC).	Fully met. A report on settlement of creditors dues was submitted in October 2000. GSTC was ordered to be liquidated by the Gujarat High Court on 6 February 1998 and the High Court appointed an official liquidator in accordance with the provision of the Company Act. A sales committee consisting of commercial banks and GOG representatives was formed to facilitate the liquidation process. However, its completion is expected to take a few more years. The 17 textile mills under GSTC at the time of liquidation was valued and workers were given VRS.	Condition satisfied. The liquidation process is ongoing.
18. GOG and ADB to review the status of the preparation of closure of three SOEs.	Fully met. GOG approved closure of the three SOEs, namely Gujarat State Construction	GOG closed down five SOEs. Apart from the three identified SOEs, GOG closed

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Covenant	Status at Tranche Release	Current Status
	Corporation (GSCC), Gujarat State Textile Corporation (GSTC) and Gujarat Film Development Corporation (GFDC).	down two additional SOEs, namely Gujarat Small Industries Corporation (GSIC) and Gujarat Dairy Development Corporation (GDDC).
19. Take necessary steps for closure of three SOEs and where required seek Board for Industrial and Financial Reconstruction (BIFR) approval for such closure.	Fully met. Three SOEs, Gujarat State Fisheries Corporation, Gujarat Small Industries Corporation and Gujarat State Construction Corporation were closed down. The liquidation process began, and employees will be given voluntary retirement schemes.	For the closure of Gujarat Dairy Development Corporation (GDDC), GOG sought BIFR approval. The BIFR case was registered. GOG directed the Agriculture Department to close GDDC activities. Almost all employees were given VRS.
20. The Technical Secretariat is to review the implementation of the SRF and submit a progress report on SRF to the state and ADB.	Fully met. The report was submitted to ADB in September 1999. According to the report, Personal Ledger Account of SRF as part of the social safety net under the program of SOE restructuring, was made operational with disbursements totaling Rs2,770 million covering 17,143 SOE employees as of September 1999.	SRF is still in operation and is under the purview of the Technical Secretariat that has a mandate for SOE restructuring. So far a total of 17,800 employees were given VRS at the cost of Rs3,280 million. When the latest VRS package for 3,040 employees becomes effective, a total of 20,840 employees will have been given VRS at a cost of Rs4,240 million.
21. GOG is to provide a report to ADB on progress made by GIDB in performing its role and function.	Fully met. The progress report has been submitted to ADB in September 1999. The report outlined the progress achieved by GIDB, including the adoption of the Gujarat Infrastructure Development Act, 1999 (also called the Build-Operate-Transfer Act) and the preparation of Vision 2010, identifying the shelf of projects in each of the infrastructure sectors for this decade.	The road map, Vision 2010, was completed and is accessible through GIDB's Web site. The document incorporates 10 infrastructure sectors, including ports, roads, power, water, gas urban infrastructure, and industrial park.
22. Prepare the CIP for the power sector for 1997–2012 period on the basis of a least-cost expansion plan.	Fully met. The progress report was submitted to ADB in September 1999. The report forecasts the power demand of the State to 2010 under different scenarios. The line-up of projects to meet the demand was prioritized, in accordance with pre-established parameters. The CIP for the power sector on the basis of this report was included in the state's overall CIP.	Condition satisfied.
23. GEB to convert, on a pilot basis, two of its distribution districts or circles into independent profit	Fully met. The distribution circles of Rajkot and Kheda began operation as profit centers with	Condition satisfied.

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Covenant	Status at Tranche Release	Current Status
centers, to increase cost efficiencies of these circles through greater commercialization of their operations.	the aim of increasing cost efficiencies and achieving greater commercialization of their operations.	
24. Provide a progress report to ADB on the restructuring of Gujarat Maritime Board (GMB) and make Gujarat Port Development Company (GPDC) operational.	Fully met. The progress report on GMB restructuring was provided to ADB in December 1999. Under the plan, GMB proposes to maintain its commercial operations while establishing a separate independent regulatory body for the ports sector and downsizing its workforce. GDPC is in operation as a joint venture with Adani Port Ltd., a private sector corporation and will be developing Mundar Port.	Condition satisfied.
25. Finalize the proposed ports sector CIP for inclusion by GOG in the overall state CIP.	Fully met. The CIP was prepared in late 1998 and a report was provided to ADB in December 1998. The CIP for the subsector was included in the state's overall CIP.	GOG no longer prepares the CIP. The capital expenditure was planned under the state's five-year plans.
26. In the second phase, establish a port service development corporation to handle dredging and related port services.	Fully met. GMB out-sourced loss-making operations such as dredging, rather than maintain them under a port service development corporation.	Condition satisfied.
27. Finalized the proposed roads sector CIP based on the Roads and Bridges Department (R&BD) strategic options study for inclusion by GOG in the overall state CIP.	Fully met. The CIP was provided to ADB in December 1998. Of the roads examined under the strategic option study, which covered 3,000 kilometers of roads in Gujarat, a World Bank project supported a study of 2,000 kilometers. The CIP for the roads sector was finalized on the basis of this study and included in the state's CIP.	Condition satisfied.

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KEY STATE GOVERNMENT FINANCES OF GOVERNMENT OF GUJARAT (FY1994 TO FY2004)

(Rs Million)

Sr. No.	Item	FY1994 Accounts	FY1995 Accounts	FY1996 Accounts	FY1997 Accounts	FY1998 Accounts	FY1999 Accounts	FY2000 Accounts	FY2001 Accounts	FY2002 Accounts	FY2003	FY2004
											R. E.	B. E.
1	Revenue Receipts	70,300	78,064	85,440	96,680	111,254	127,427	138,738	157,386	159,861	178,753	201,458
2	Revenue Expenditure	69,338	75,442	87,661	102,594	121,432	156,062	175,171	220,408	227,176	214,401	236,074
3	Revenue Balance ((1)-(2))	962	2,622	-2,221	-5,914	-10,178	-28,634	-36,433	-63,022	-67,315	-35,648	-34,616
4	Revenue Balance/Revenue Receipts	1.4	3.4	-2.6	-6.1	-9.1	-22.5	-26.3	-40.0	-42.1	-19.9	-17.2
5	Recurrent Expenditure on Natural Calamities–Non-earthquake	183	125	330	537	1,582	1,445	3,469	9,035	243	3,193	3,554
6	Recurrent Expenditure on Natural Calamities– Earthquake	0	0	0	0	0	0	0	8,691	22,577	2,907	251
7	Capital Expenditure on Natural Calamities–Earthquake	0	0	0	0	0	0	0	0	5,500	5,413	7,114
8	Total Expenditure on Earthquake Rehabilitation ((6)+(7))	0	0	0	0	0	0	0	8,691	28,077	8,320	7,365
9	Total Expenditure on Earthquake Rehabilitation/Revenue Expenditure	0	0	0	0	0	0	0	3.9	12.4	3.9	3.7
10	Fiscal Balance	-5,264	-12,924	-17,456	-23,583	-31,745	-56,190	-67,920	-79,876	-65,108	-106,863	-94,572
11	Fiscal Balance/NSDP	-1.2	-2.3	-2.8	-3.2	-4.1	-6.3	-7.3	-8.6	-6.1	-9.3	—
12	Fiscal Balance/GSDP	-1.1	-2.0	-2.4	-2.7	-3.5	-5.3	-6.3	-7.2	-5.2	-8.2	-5.7
13	Debt Stock	81,020	90,440	104,850	119,760	140,590	170,800	210,750	274,397	344,591	407,944	528,166
14	Debt Stock/NSDP	19.0	16.1	17.0	16.1	18.2	19.0	22.5	29.5	32.5	35.7	—
15	Debt Stock/GSDP	16.5	14.2	14.6	14.0	15.4	16.2	19.6	24.8	27.6	31.4	31.8
Memorandum Items												
16	GSDP	491,940	635,160	718,860	858,300	911,880	1,053,040	1,076,180	1,104,490	1,249,050	1,297,550	1,660,640
17	NSDP	425,600	560,030	617,360	741,830	772,660	898,100	935,560	929,940	1,060,990	1,144,050	—
18	Total Number of Government Employees	—	558,150	555,196	548,654	536,026	582,575	571,853	582,036	582,529	583,182	576,382
19	Total Number of Pensioners	—	103,731	195,167	202,003	214,811	229,467	230,372	244,868	249,526	265,751	278,988

FY = fiscal year, BE = budget estimates, GSDP = gross state domestic product, NSDP = net state domestic product, RE = revised estimates.

Sources: Reserve Bank of India Publications on State Government Finances and Finance Department, Government of Gujarat.

STATUS OF STATE-OWNED ENTERPRISE RESTRUCTURING PROGRAM

Table A3.1: Status under the Program Requirements

No.	Name of the SOEs	Conditionality in Policy Matrix	Implementation Status
Fully Privatize Two SOEs:			
1	Gujarat Tractor Corporation Ltd. (GTCL)	Fully privatized in phased manner (100% divestment)	Condition met. The Government of Gujarat (GOG) transferred 60% of its shares to a strategic buyer (Mahindra & Mahindra Ltd.).
2	Gujarat Communications and Electronics Ltd. (GCEL)	Fully privatized in phased manner (100% divestment)	Condition met. GOG made two privatization attempts but could not succeed. Finally, GOG decided to close GCEL and provide voluntary retirement schemes (VRSs) to all its employees. Accordingly, all employees were given VRS. Recently, on 18 February 2002, Gujarat High Court has passed the order to close GCEL and appointed an official liquidator.
Public Offering of Two SOEs			
3	Gujarat Mineral Development Corporation (GMDC)	Divestment up to 51% in two stages through public offering	Condition partially met. Twenty-six percent of GMDC equity was diluted by permitting GMDC to issue fresh equity through prospectus through a public issue offer for sale to the public from October to November 1997, with a premium of Rs120 on a share of Rs10. The issue met with astounding success with over subscription of 2.5 times in very depressed stock market conditions, and 31,800,000 equity shares of GMDC were listed on the national stock exchange with effect from 17 December 1997. GOG pointed out at the review for final tranche release that the divestment of 51% to the private sector would require amending the Mining Regulation Act of the central Government which reserves mining rights to the public sector, thus making full compliance of this condition not feasible. For the further divestment of the remaining 23% of GOG's equity in GMDC, GOG is looking for suitable market conditions.
4	Gujarat Industrial Investment Corporation (GIIC)	Divestment up to 51% in two stages through public offering	Condition partially met and amended. Eleven percent was divested in favor of GSFC (5.5%) and GNFC (5.5%) equally. Options of restructuring are being explored by GOG.
Partial Disinvestment of Four SOEs			
5	Gujarat State Export Corporation (GSEC)	Reduce GOG stake to 26%	Better progress than required. All GOG shares (100% privatization) were transferred to a strategic buyer (Adani Co. Ltd.) in February 2004.
6	Gujarat State Financial Corporation (GSFC)	Reduce GOG stake to 49% in two stages	Condition met. GOG's stake was reduced to 49% by offering 25% of GSFC equity to the public.
7	Gujarat Agro Industries Corporation (GAIC)	Divestment up to 51%	Condition substantially met. GOG has agreed to sell uneconomic divisions and/or units. Company has initiated action. The seven loss-making

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No.	Name of the SOEs	Conditionality in Policy Matrix	Implementation Status
			manufacturing units of GAIC were closed. All employees of these units were given VRSS.
8	Gujarat Industrial Development Corporation (GIDC)	Corporatize and divest of 26% GOG's shareholding	Condition amended. GOG requested to forego corporatization of GIDC in order to allow GIDC to maintain its regulatory and land acquisition functions. GIDC is in process of implementing the recommendations of a PriceWaterHouse Report.
Merger/Restructuring of Six SOEs			
9 and 10	Gujarat State Leather Industry Development Corporation (GSLID) and Gujarat Rural Industries Marketing Corporation (GRIMCO)	Merger	Condition was substantially met at the time of review of the final tranche release. The merger has subsequently been completed.
11 and 12	Gujarat State Handloom Development Corporation and Gujarat State Handicrafts Development Corporation.	Merger	Condition was substantially met at the time of review of the final tranche release. The merger was approved by the central Government. The actual merger exercise is in process.
13 and 14	Gujarat Slum Clearance Board (GSCB) and Gujarat Housing Board (GHB)	Transfer all construction activities of GSCB to GHB and close GSCB	Condition met. GSCB: All activities were stopped. Almost all employees (only 15 remain) were paid through a VRS. Residual work related to closure is in progress.
Closure of Four SOEs: GSTC plus Three more out of proposed Five SOEs			
15	Gujarat State Textile Corporation (GSTC)	Closure	Condition met. The Gujarat High Court passed an order of liquidation in February 1997. All employees were paid through a VRS. The liquidation process is on-going.
16	Gujarat Water Resources Development Corporation (GWRDC)	One out of five to be chosen for closure	Not chosen to be closed and no action initiated. The State Finance Committee (SFC) recommended that GWRDC be closed, but no action has been initiated yet.
17	Gujarat State Construction	One out of five to be chosen for closure	Chosen to be closed and the condition was met. All activities were stopped and corporation closed down. Almost all employees (only eight remains)

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No.	Name of the SOEs	Conditionality in Policy Matrix	Implementation Status
	Corporation Ltd. (GSCCL)		were paid through a VRS. Residual work related to closure is in progress.
18	Gujarat Fisheries Development Corporation (GFDC)	One out of five to be chosen for closure	Chosen to be closed and the condition was met. All activities along with staff members and assets and liabilities were transferred to Gujarat Fisheries Central Co-operation Association. Residual work related to closure is in progress.
19	Gujarat Dairy Development Corporation (GDCC)	One out of five to be chosen for closure	Chosen to be closed and the condition was met. BIFR has approved the scheme and the company is in process of implementing it. All activities closed. Almost all employees (only 15 remain) were paid through a VRS.
20	Gujarat Rural Development Corporation (GRDC)	One out of five to be chosen for closure	Not chosen to be closed and no action was initiated.
Leasing of Properties of One SOE			
21	Tourism Corporation of Gujarat Ltd. (TCGL)	Either sell or lease 30 properties	Condition partially met. Selling or leasing process was initiated but held up due to litigation. Ten of 20 properties were sold or leased. After selling or leasing ten properties, the process was discontinued. Tata Consultant Services was appointed to explore various alternatives of privatization. The consulting firm submitted the final report, and all concerned parties attended a meeting organized by the Finance Department.

BEYOND THE PROGRAM REQUIREMENTS

No.	Name of the SOEs	Conditionality in Policy Matrix	Implementation Status
1.	Gujarat Small Industries Corporation Ltd. (GSIC)	No recommendation	The government of Gujarat directed the Industries and Mines Department (IMD) to close GSIC. Accordingly, IMD initiated necessary actions and stopped all activities of the corporation. Almost all employees (only 10 remain) were paid through a VRS. Residual work related to closure is in progress.

TECHNICAL ASSISTANCE COMPLETION REPORT

Division: SAGF

TA No. and Name TA 2716-IND Institutional Strengthening of the Gujarat Infrastructure Development Board (GIDB)			Amount Approved: \$850,000		
			Revised Amount: \$792,604.00		
Executing Agency: Industry and Mines Department (IMD) of Government of Gujarat		Source of Funding: TASF	TA Amount Undisbursed \$80,531.90	TA Amount Utilized \$712,072.10	
Date			Closing Date		
Approval	Signing	Fielding of Consultants	Original	Actual	
18 Dec 1996	23 Dec 1996	1 Jun 1997	23 December 1998	1 Jan 2004	
Description					
<p>1. At the TA design stage, Gujarat was one of the most progressive states in India and the government of Gujarat (GOG) had already introduced policies oriented toward private sector investment. Gujarat was a highly industrialized and urbanized state with one of the best infrastructure facilities in the country in terms of both quantity and service quality. However, the growth in infrastructure started to fall behind the economic development and urbanization of the state. Congested roads, shortfalls in power supply, dependence on congested ports and lack of adequate expansion of urban infrastructure threatened the state not being able to realize its full potential economic growth.</p> <p>2. Reviews of each individual infrastructure sector revealed that GOG had insufficient fiscal capacities to finance investments required to meet the desirable growth targets. Under the circumstances, GOG adopted a policy to empower the private sector to be a partner in development by simultaneously mobilizing additional resources and availing of efficiency-enhancing strategies and management practices. GOG had embarked on privatization in key infrastructure sectors, including roads, power, and ports. On 19 June 1995, GOG established the Gujarat Infrastructure Development Board (GIDB) through a special resolution to encourage the private sector to participate in infrastructure development. GIDB, chaired by the chief minister of Gujarat, was given a mandate to (i) formulate policies for infrastructure development particularly through privatization modes; (ii) coordinate individual infrastructure sectors' development plans to ensure a cohesive and integrated development plan; and (iii) facilitate the mobilization of private investments.</p>					
Objectives and Scope					
<p>3. The TA aimed to build capacities of GIDB so that it could play a strategic and nodal role in the formulation of infrastructure policies and could promote private sector participation in infrastructure development. The TA assisted in capacity building of GIDB by (i) strengthening GIDB to play a role in advising on policy, legal and regulatory frameworks of key infrastructure sectors, (ii) developing in-house expertise of GIDB in specialized areas, for example, project development, finance, promotion and marketing; and (iii) preparing documentation for build-own-operate (BOO) and/or build-operate-transfer (BOT) projects and designing and conducting a related training program. The TA was to contribute to the effective implementation of infrastructure sector policy reforms envisaged under the Gujarat Public Sector Resource Management Program loan, which had three main outputs: (i) strengthening state public finances and their prudent management, (ii) reducing the role of the public sector in commercial activities, and (iii) strengthening the policy, regulatory, legal, and institutional frameworks for private sector participation in critical infrastructure sector namely power, ports, and roads to evolve an enabling environment. This TA supported the Program in realizing the latter output.</p>					
Evaluation of Inputs					
<p>4. The TA design and the terms of reference for the consultants were appropriate and adequate to accomplish the intended objectives. Consulting services were provided comprising 18 person-months from international experts and 12 person-months from domestic consultants. The international consultants included an investment advisor/team leader and a financial advisor, and the domestic consultants included sector/technical specialists and a lawyer. The firm mobilized the consultants on 1 June 1997 and proposed to complete the fieldwork by 31 May 1998. However, there were as many as 10 contract variations during the implementation, resulting in a delay of project implementation. The final completion date was October 1999. The major setback in terms of consultants' inputs was the premature departure of the team leader after only three months from commencement, due to a personal emergency. The recruiting process for a replacement took time resulting in a nearly 5-month delay. Other contract variations focused on additional technical training courses, minor adjustments in time inputs of individual team members; and, replacement of certain positions, such as lawyer. The final contract variation was requested by GIDB for minor follow-on assistance using the TA savings and remaining contingency. Despite numerous contract variations, the actual cost of TA implementation did not overrun the original budget.</p>					

5. The TA accompanied the Program loan. The TA letter was signed on 23 December 1996. A contract was executed with the consulting firm on 7 May 1997 for \$790,000, and consultants were fielded on 1 June 1997. The TA was estimated to require 12 months for implementation. The implementation and performance of the consultants were generally satisfactory, although the finalization of the report and manuals were much delayed due to the major setback explained in the earlier paragraph. A technical secretariat was created to support GIDB and oversee implementation of the TA through the following tasks: (i) review of agency plans and coordination of the overall infrastructure development plan; (ii) appraise projects proposed for public-private partnership; (iii) monitor policy implementation, to address policy issues, policy gaps, and impediments of implementation guidelines; and (iv) promote and market Gujarat's BOT Program. In addition, nodal agency group meetings were organized with participation from both government and private sector representatives from the power, road, and ports sectors to review sector-specific policy and implementation issues. Information from those group meetings was used as inputs in policy directive of the infrastructure master plan.

6. The Executive Agency's support to the TA was satisfactory. Office space, transportation, communication, and equipment provided were adequate. The TA provided budgetary allocation for the procurement of a set of computer hardware and software, printers, and a photocopying machine to support project implementation. This equipment was transferred to GIDB's use after the TA completion. The project was satisfactorily administered and monitored by ADB. ADB review missions concluded that the key objectives of the TA were adequately met. However, a review mission in January 2000, after the physical completion of the TA, indicated that GIDB still required further assistance in new technical know-how and new infrastructure sectors in addition to what was already incorporated in the TA, to strengthen and fully establish the role of GIDB as the prime mover of Gujarat's BOT program.

Evaluation of Outputs

7. The consultant submitted inception report, interim report, draft final and final report, progress reports, and various manuals. An inception report was submitted in July 1997 and a mid-term report in July 1998. The draft final report was submitted in September 1998. A tripartite meeting was held in October 1998 to present the draft final report comprising seven volumes. Manuals for four infrastructure sectors were generally comprehensive and well prepared. The final report discussed comprehensively overall progress and achievement of the TA. After reviews by ADB and GOG, the consultant made the suggested revisions and submitted acceptable final report/manuals in November 1998.

8. A BOT training program was participated by 40 officials from GIDB and key implementing agencies who were directly involved in implementing BOT projects. The training program included (i) briefing and roundtable discussion on the policy framework of the draft BOT Law and evaluation guidelines on BOT concession agreements, (ii) BOT project development and evaluation, and (iii) financial analysis and application of a computer-based model.

9. The TA's terms of reference were properly covered after incorporating comments from GOG and ADB. The final report included procedures for implementing BOO/BOT policies and related financial analyses and project evaluation. ADB commented that the draft BOT Law lacked the precision expected for a legal document. This may have been the result of frequent changes in the original lawyer position. In addition, a review of the final report noted that GIDB's success in continuation of formulating, monitoring, and supporting integrated infrastructure master plans depends greatly on reforms in other supporting agencies and institutions. Many of the recommendations and supporting analysis tended to be of a generic and short-term nature. GIDB's role in attracting private sector participation in the three key sectors had to follow drastic reforms in the agencies' human resource policy and internal management. For example, private participation in the power sector was not possible when 40% of total power sales were not metered.

Overall Assessment and Rating

10. The TA is rated successful as it facilitated compliance of not only all related tranche release conditions but also all related non-tranche release covenants under the Program, which are conditions/covenants under outcome (iii) of the Program. GIDB is still in operation and is a central body that formulates high-level infrastructure policies. Since the completion of this TA, GIDB has expanded its responsibility to cover as many as 11 sectors including ports, power, roads, railways, airports, urban infrastructure, water, information technology, industrial, gas, and tourism. The risk to the private sector when participating in infrastructure project was mitigated through the enactment of the BOT Law in October 1999, since it provided a clear framework for private sector participation in terms of financing, constructing, operating, and maintaining infrastructure projects.

Major Lessons Learned

11. There appears to be some trade-offs in GIDB's functioning. Even though a powerful board, with Chief Minister as chair, was highly effective, board meetings were infrequently scheduled due to the busy schedules of the high-level board members. Another trade-off lies between GIDB's role of coordinator across sectors and agencies. As a result, GIDB appears as another layer in the bureaucracy of the existing system. GIDB is an apex body that was created to develop integrated master plans formulated with inter-sector coordination and synchronization. The responsibility to implement the plans, however, rests mostly within the agencies. The effective implementation of the plans required that

each agency share common interests with GIDB, including privatization, which was not natural to the agencies. Therefore, the success of GIDB's mission depends greatly on quality communications that are carried out not only bilaterally (between GIDB and each agency) but also among all GIDB members. In addition, political support of GIDB's mission is also important to ensure the cooperation from agencies. Better communication requires both mandated frequent meeting of the board, and even more frequent meetings among members of the technical secretariat and working groups. A local area network that links data and information of infrastructure projects of different infrastructure sectors would also be useful for gathering information for policy development, implementation, and monitoring.

Recommendations and Follow-Up Actions

12. The promotion of private sector participation in infrastructure sectors also needs support from other financial corporations that promote private sector infrastructure projects. Under the existing institutional setting, Gujarat Industrial Investment Corporation (GIIC), which is a financial intermediary that promotes industrial investment in Gujarat, was initially chosen for capacity strengthening to promote infrastructure development and mobilize financing for the implementation of infrastructure projects sponsored by the private sector especially in the key infrastructure sectors (roads, ports, and power). GOG contemplated establishing a new lending facility, Gujarat Infrastructure Facility (GIF) to provide financial assistance to support private sector infrastructure projects with ADB assistance. While GIF was not established, due to, among other things, delays in privatizing GIIC, ADB approved the Private Sector Infrastructure Facility at State Level Project in December 2001, which covered operations in Andhra Pradesh, Gujarat, Karnataka, and Madhya Pradesh.

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