

PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No. AB3130

Project Name	A First Himachal Pradesh Development Policy Loan/Credit
Region	SAR
Sector	Sub national Government Administration (50 percent); General Public Administration Sector (50 percent)
Project ID	P105124
Borrower(s)	Government of India
Implementing Agency	Government of Himachal Pradesh
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1. Key development issues and rationale for Bank involvement

Himachal Pradesh (HP) is a small mountainous ‘special category’ state in India.¹ The special category status entitles the state to generous Central government plan grant assistance. HP has several significant achievements in terms of economic growth and social development, in spite of its natural constraints. Since the mid-1990s, HP has grown marginally faster than the rest of the country, and has achieved significant economic diversification—demonstrated in the secondary and tertiary sectors growing at a real annual rate of 7-8 percent, compared to the primary sector growing at around 3.5 percent. HP has the second lowest poverty headcount ratio in India of 11.6 percent, a per capita real consumer expenditure that is almost a third higher than the national average, and is on track to achieve most MDG indicators. Service delivery and infrastructure provision is also superior to most Indian states. Supportive government policies, a transparent and accessible administration, a peaceful political environment, and Central support have contributed to the state’s development.

HP’s recent achievements mask several challenges that confront it. Most importantly, HP’s achievements have been largely led by the public sector. HP realizes that, to a great extent, the state may be reaching the limits of its traditional source of growth and development: one that is heavily dependent on public spending, financed largely by borrowing and Central assistance.

The Government of Himachal Pradesh (GoHP) recognizes that the sustainability of HP’s success will depend on: (a) shifting the *growth strategy* that is still far too heavily dependent on public expenditures—to an increasing focus on growth led by the private sector; (b) creating *productive employment opportunities* for HP’s young and educated labor force, so that reliance on the public sector—which currently accounts for about 85 percent of organized sector employment—as an employer decreases; and (c) leveraging the state’s rich *environment and natural resources* in a sustainable manner to create growth and employment opportunities. HP’s articulated medium

¹ “Special category” states are those having characteristics like strategic border locations, hilly terrain, inadequate infrastructure, large tribal population, and limited resource bases compared to development needs. There are eleven “special category” states in India.

term development priorities focus on precisely these issues. The priority is to exploit the untapped potential in areas such as hydropower and tourism in an environmentally and economically sustainable manner; strengthen the environment management framework in the state, promoting private sector development for faster growth and productive employment—all supported by enabling fiscal and governance reforms.

The major constraint faced by the state is the creation of fiscal space to finance the state's development vision while moving towards a fiscally sustainable position. About 65 percent of Government of Himachal Pradesh's (GoHP) expenditure is committed to salaries, pensions, and interest payments—among the highest in Indian states—squeezing fiscal headroom for investment. GoHP also carries high debt stock of about 74 percent of GSDP—and it has the second highest per capita debt in the country, which strains debt servicing ability. However, GoHP has recently begun to receive substantial non-tax revenue from hydropower royalty, implemented tax reforms (most notably VAT), and achieved expenditure compression putting the state on a track to achieving fiscal sustainability. GoHP would now like to consolidate these achievements.

HP's continuing development would, however, be vulnerable if the state is unable to sustain its macroeconomic performance. GoHP recognizes that state-led development has certain limits, and generous financial flows from the Centre cannot be assumed indefinitely—especially as HP's development achievements influence Central devolution to redistribute resources progressively to weaker states. The special tax incentives that have promoted recent industrial growth are also due to be phased out gradually by 2010. At the same time, past state involvement has raised expectations of economic development which could be difficult to fulfill if Central support is phased out—unless GoHP undertakes reforms, and devises alternate strategies to move the state from being a provider to a facilitator and regulator. Accordingly, GoHP has sought World Bank involvement to support HP to strengthen its overall fiscal situation, improve public financial management, promote better environment management, and develop its two most valuable sectors—hydropower and tourism. Furthermore, from the Bank's perspective, this operation would provide a first opportunity for the Bank to support a special category state in reducing its heavy reliance on Centrally-funded support. It would also provide a valuable learning experience for other states rich in natural resources seeking to harness their development potential sustainably. These provide adequate rationale for staying engaged with HP over the medium term.

2. Proposed Objectives

The overarching objective of the proposed HPDPL1 is to support the implementation of critical structural, fiscal, and administrative reforms needed to achieve sustainable and rapid economic growth and inclusive development over the medium term, while sustaining the environmental heritage of the state. The priority areas for the first operation will be fiscal adjustment, and promotion of environmentally sustainable development with particular reference to the development of hydropower. The overall program will also support reforms to enhance growth and livelihoods, and improve governance and public administration.

Conditional upon a strong fiscal adjustment program and financing needs, adjustment support from the Bank is envisaged to be up to US\$ 500 to US\$ 600 million over 4-5 years. It is expected that this support would be in the form of a series of three or four two-tranche operations, disbursed against upfront actions. The individual size of each operation is to be determined at the time of negotiations depending on the strength and progress of the reform program.

3. Preliminary Description

The proposed first DPL seeks to address four core intertwined policy areas that are critical to accelerating economic growth and attaining fiscal sustainability. The first policy area supports a robust *fiscal framework*: creation of fiscal space through a series of tax, non-tax, and expenditure re-structuring measures, and strengthening the public financial management architecture in the state. The focus is to reduce debt, scale up investment expenditure and expenditure efficiency while strengthening financial accountability mechanisms. The second policy area focuses on developing *hydropower* resources efficiently, sustainably and equitably by strengthening environment management activities, shifting to a holistic river basin management framework, strengthening principles of benefit sharing with communities, and improving the state's hydropower planning and management capacity. The third policy area supports the development of an institutional framework for *environmentally sustainable development*. The operation will support the strengthening of GoHP's fledgling Department of Environment; develop an Environment Master Plan for the state, and mainstream environment management within sectoral agencies by developing suitable guidelines. The fourth area supported by the operation is to put in place policies to encourage *growth and employment* in the secondary and tertiary sectors. Specifically, the operation will seek to improve the general business environment for private sector participation and develop the potential of the tourism sector in the state.

4. Environment Aspects

This is a Development Policy Loan and is therefore not subject to OP 4.01, the Bank's policy on environmental and social safeguards. However, in accordance with good practice, the DPL and the policy dialogue that underpins it have been prepared in keeping with the principles of environment sustainability. The Bank does not foresee direct and significant environmental impacts from the reform measures supported by the DPL. The program will, in fact, directly support improvement of environmental planning and this will have beneficial impacts. The South Asia environment team working on HP in collaboration with the task team has started to prepare an environmental analysis of the program. The full draft analysis will be completed prior to the appraisal review.

5. Tentative Financing

Source:	(US \$mn)
Borrower	Nil
International Bank for Reconstruction and Development	200
International Development Association	Nil
Total	200

6. Contact Point

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