

CONFORMED COPY

CREDIT NUMBER 3527-IN
LOAN NUMBER 4620-IN

Project Agreement

(Karnataka Economic Restructuring Program)

among

INTERNATIONAL DEVELOPMENT ASSOCIATION

and

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

and

STATE OF KARNATAKA

Dated July 26, 2001

CREDIT NUMBER 3527-IN
LOAN NUMBER 4620-IN

PROJECT AGREEMENT

AGREEMENT, dated July 26, 2001, among INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and STATE OF KARNATAKA (Karnataka), acting by its Governor.

WHEREAS (A) the Association and the Bank have received from India (the Borrower) a letter dated May 31, 2001, attaching a letter from Karnataka describing a program of actions, objectives and policies designed to improve and strengthen the fiscal framework and public institutions of Karnataka (hereinafter called the Program), declaring Karnataka's commitment to the execution of the Program, and the Borrower's support thereto, and requesting assistance from the Association and the Bank in support of the Program during the execution thereof;

(B) Karnataka has carried out the measures and taken the actions described in the Schedule to this Agreement to the satisfaction of the Association and the Bank and has maintained a macroeconomic policy framework satisfactory to the Association and the Bank;

(C) by the Development Credit Agreement of even date herewith between India (the Borrower) and the Association, the Association has agreed to make available to the Borrower an amount in various currencies equivalent to fifty eight million nine

hundred thousand Special Drawing Rights (SDR 58,900,000) on the terms and conditions set forth in the Development Credit Agreement, but only on condition that Karnataka agree to undertake such obligations toward the Association as are set forth in this Agreement;

(D) by the Loan Agreement of even date herewith between India and the Bank, the Bank has agreed to make available to the Borrower an aggregate principal amount of seventy five million dollars (\$75,000,000) on the terms and conditions set forth in the Loan Agreement, but only on condition that Karnataka agree to undertake such obligations toward the Bank as are set forth in this Agreement; and

(E) the Program will be carried out by Karnataka with the Borrower's assistance and, the Borrower will make available to Karnataka the local currency equivalent of the proceeds of the Credit as provided in the Development Credit Agreement and of the proceeds of the Loan as provided in the Loan Agreement.

WHEREAS Karnataka, in consideration of the Association entering into the Development Credit Agreement with the Borrower and the Bank entering into the Loan Agreement with the Borrower has agreed to undertake the obligations set forth in this Agreement.

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

Definitions

Section 1.01. Unless the context otherwise requires, the several terms defined in the Development Credit Agreement, in the Loan Agreement and in the General Conditions (as so defined in the Development Credit Agreement and in the Loan Agreement) have the respective meanings therein set forth.

ARTICLE II

Particular Covenants

Section 2.01. Karnataka declares its commitment to the objectives of the Program and, to this end, shall carry out the Program with due diligence and efficiency, and shall provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Program.

Section 2.02. (a) Karnataka shall from time to time, at the request of the Association and the Bank, and in consultation with the Borrower, exchange views with the Association and the Bank with regard to the progress of the Program, the actions specified in the Schedule to this Agreement, the performance of its obligations under this Agreement and other matters relating to the purposes of the Credit and the Loan.

(b) Prior to each such exchange of views, Karnataka shall furnish to the Association, the Bank and the Borrower for their review and comment a report on the progress achieved in carrying out the Program, in such detail as the Association and the Bank shall reasonably request.

(c) Karnataka shall promptly inform the Association, the Bank and the Borrower of any condition, which interferes or threatens to interfere with the progress of the Program, the accomplishment of the purposes of the Credit and the Loan, or the performance by Karnataka of its obligations under this Agreement.

(d) Without limitation upon the provisions of paragraphs (a), (b) and (c) of this Section, Karnataka shall consult the Borrower and exchange views with the Association and the Bank on any proposed action to be taken after the disbursement of the Credit which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program, including any action specified in the Schedule to this Agreement.

Section 2.03. Karnataka shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators satisfactory to the Association and the Bank, the carrying out of the Program and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Association and the Bank, and furnish to the Association and the Bank, not later than six months after the Closing Date, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in carrying out the Program and setting out the measures recommended to ensure the efficient carrying out of the Program and the achievement of the objective thereof; and

(c) review with the Association, the Bank and the Borrower the report referred to in paragraph (b) of this Section, within forty-five (45) days of the receipt of the report and thereafter, take all measures required to ensure the efficient implementation of the Program and the achievement of the objective thereof, based on the conclusions and recommendations of the said report and the Association's views on the matter.

Section 2.04. (a) Karnataka shall utilize the amounts transferred to it by the Borrower pursuant to Section 2.02 (c) of the Development Credit Agreement and Section 2.02 (c) of the Loan Agreement for its budgetary expenditures. Karnataka undertakes that any of such amounts shall not be used to finance expenditures under a contract in respect of which the Association or the Bank determines that corrupt or fraudulent practices were engaged in by representatives of Karnataka during the procurement or execution of such contract, without Karnataka having taken timely and appropriate action satisfactory to the Association and the Bank to remedy the situation.

(b) If the Association or the Bank shall have determined at any time that any such amount shall have been used to make a payment for any expenditure not consistent with paragraph (a) above, Karnataka shall be liable, upon request from the Association or the Bank as the case may be, to refund such amount to the Association or the Bank through the Borrower. Amounts refunded to the Association or the Bank upon such request shall be credited to the Credit Account or the Loan Account, as the case may be, for cancellation.

ARTICLE III

Financial Covenants

Section 3.01. (a) Karnataka shall maintain records and accounts adequate to reflect in accordance with sound accounting practices its operations and financial conditions; and

(b) Upon the Association's and the Bank's request, Karnataka shall:

- (i) have the said records, accounts and financial statements audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association and the Bank;
- (ii) furnish to the Association and the Bank as soon as available, but in any case not later than four months after the date of the Association's and the Bank's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Association and the Bank shall have reasonably requested; and
- (iii) furnish to the Association and the Bank such other information concerning said records, accounts and financial statements as well as the audit thereof as the Association and the Bank shall have reasonably requested.

Section 3.02. (a) Karnataka shall, no later than thirty (30) days after the receipt of the rupee amounts transferred to it by the Borrower pursuant to Section 2.02 (c) of the Development Credit Agreement and Section 2.02 (c) of the Loan Agreement, provide a confirmation to the Association and the Bank showing the date and the rupee amounts received from the Borrower, and stating that such amounts have been credited to the consolidated Fund of Karnataka on that same date.

(b) Upon the Association's and the Bank's request, Karnataka shall, no later than sixty (60) days after the date of such request, provide to the Association and the Bank an audit report by independent auditors acceptable to the Association and the Bank showing the date and the rupee amounts transferred by the Borrower to Karnataka pursuant to Section 2.02 (c) of the Development Credit Agreement and Section 2.02 (c) of the Loan Agreement.

ARTICLE IV

Effective Date; Termination;
Cancellation and Suspension

Section 4.01. This Agreement shall come into force and effect on the date upon which the Development Credit Agreement and the Loan Agreement become effective.

Section 4.02. (a) This Agreement and all obligations of the Association, the Bank and Karnataka thereunder shall terminate on the earlier of the following two dates:

- (i) the date on which the Development Credit Agreement and the Loan Agreement shall terminate in accordance with their terms; or
- (ii) the date twenty (20) years after the date of this Agreement.

(b) If the Development Credit Agreement or the Loan Agreement terminates in accordance with its terms before the date specified in paragraph (a) (ii) of this Section, the Association and the Bank shall promptly notify Karnataka of this event.

Section 4.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

ARTICLE V

Miscellaneous Provisions

Section 5.01. Any notice or request required or permitted to be given or made under this Agreement and any agreement between the parties contemplated by this Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand or by mail, telegram, cable, telex or radiogram to the party to which it is required or permitted to be given or made at such party's address hereinafter specified or at such other address as such party shall have designated by notice to the party giving such notice or making such request. The addresses so specified are:

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

INDEVAS
Washington, D.C.

Telex:

248423 (MCI)
64145 (MCI)

Facsimile:

For the Bank:

International Bank of
Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

INTBAFRAD
Washington, D.C.

Telex:

248423 (MCI)
64145 (MCI)

Facsimile:

For Karnataka:

Chief Secretary
Government of Karnataka
Vidhana Soudha
Bangalore, 560001
Karnataka State
India

Telex:

Facsimile:

845-2239 CSGK IN

91-80-2258913

Section 5.02. Any action required or permitted to be taken, and any document required or permitted to be executed, under this Agreement on behalf of Karnataka may be taken or executed by its Chief Secretary or such other person or persons as Karnataka shall designate in writing, and Karnataka shall furnish to the Association and the Bank sufficient evidence of the authority and the authenticated specimen signature of each such person.

Section 5.03. This Agreement may be executed in several counterparts, each of which shall be an original, and all collectively but one instrument.

Section 5.04. As long as the Bank has not given notice to the contrary to Karnataka, and so long as the Development Credit Agreement shall not have terminated prior to the termination of the Loan Agreement:

(a) the obligation of Karnataka to consult with, and furnish information, documents, plans, reports, records and statements to the Bank shall be satisfied to the extent performance in respect of such obligations is rendered to the Association;

(b) the obligations of the Bank to consult with, and to furnish information to Karnataka shall be satisfied to the extent such obligations are satisfied by the Association; and

(c) all actions taken (including giving of approvals or granting of waivers) by the Association pursuant to the Development Credit Agreement shall be deemed to be taken pursuant to both the Development Credit Agreement and the Loan Agreement, and in the name and on behalf of the Association and the Bank.

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in New Delhi, India, as of the day and year first above written.

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Edwin Lim

Country Director, India

STATE OF KARNATAKA

By /s/ C. Gopal Reddy

Authorized Representative

SCHEDULE

Actions Referred to in Recital (B) of the Preamble to the Development Credit Agreement, the Loan Agreement and the Project Agreement.

1. Karnataka has: (a) approved a Medium Term Fiscal Plan (MTFP) for the State setting out policies, strategies and actions for carrying out a program of fiscal reforms covering the period from Fiscal Year 2000-01 to Fiscal Year 2004-05; (b) undertaken key steps towards institutionalization of the MTFP into the budgetary process; and (c) made the MTFP a public document.
2. Karnataka has reduced in Fiscal Year 2000-01 the non-power budgetary fiscal deficit (fiscal deficit net of gross budgetary support for the power sector) to an estimated 3.2 percent of the Gross State Domestic Product (GSDP) from 3.7 percent of GSDP in the previous Fiscal Year.
3. Karnataka has presented a budget for Fiscal Year 2001-02 consistent with the

MTFP, including a targeted reduction in the non-power budgetary fiscal deficit from an estimated 3.2 percent of GSDP in 2000-01 to 2.4 percent of GSDP in 2001-02.

4. Karnataka has completed the first phase of the preparatory work for the introduction of a system of Value Added Tax (VAT), satisfactory to the Association and the Bank, consisting, inter alia, of issuance of a discussion paper, establishment of working groups, selection of consultants to assist in the process, and introduction of self-assessment for majority of tax payers.

5. Karnataka has completed the first phase of its public financial accountability and management improvement program, satisfactory to the Association and the Bank, consisting, inter alia, of establishment of a Controller's office and task force to lead the program, posting of monthly financial accounts on the internet, and commencement of treasury computerization.

6. Karnataka has enacted: (a) the Karnataka Transparency in Procurement Act, 1999, requiring all government departments to follow more transparent procurement practices; and (b) the Karnataka Right to Information Act, 2000, aimed at making government documents more accessible to the public.

7. Karnataka has approved policies, strategies and actions for carrying out a medium-term program of administrative reform and private sector development set out in the following documents satisfactory to the Association and the Bank:

(a) a Governance Strategy and Action Plan aimed, inter alia, at improving government efficiency and transparency, reducing transfers within the civil service, and curbing corruption, and which has been made a public document;

(b) an Approach Paper on Business Deregulation aimed, inter alia, at reducing excessive government regulations, and improving the enabling environment for private sector development; and

(c) a Policy on Public Sector Reforms and Privatization aimed, inter alia, at reducing the role of the government in commercial activities through sale, closure or restructuring of public enterprises.

8. Karnataka has established a Poverty and Human Development Monitoring System satisfactory to the Association and the Bank, aimed, inter alia, at systematically monitoring the impact of government services, policies and reforms, including the Program, in key areas related to poverty reduction and human development, making this information available to the government and the public on a regular basis, and enabling Karnataka in making more informed policy decisions from the perspective of poverty reduction.

