

CONFORMED COPY

CREDIT NUMBER 3341 IN  
LOAN NUMBER 4546 IN

Project Agreement

(Uttar Pradesh Fiscal Reform and Public  
Sector Restructuring Program)

among

INTERNATIONAL DEVELOPMENT ASSOCIATION

and

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

and

STATE OF UTTAR PRADESH

Dated May 16, 2000

CREDIT NUMBER 3341 IN  
LOAN NUMBER 4546 IN

PROJECT AGREEMENT

AGREEMENT, dated May 16, 2000, among INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and STATE OF UTTAR PRADESH (Uttar Pradesh), acting by its Governor.

WHEREAS (A) the Association and the Bank have received from India (the Borrower) a letter dated March 22, 2000, attaching a letter from Uttar Pradesh describing a program of actions, objectives and policies designed to improve and strengthen the fiscal framework and public institutions of Uttar Pradesh (hereinafter called the Program), declaring Uttar Pradesh'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) Uttar Pradesh 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 ninety three million three hundred thousand Special Drawing Rights (SDR93,300,000) on the terms and conditions set forth in the Development Credit Agreement, but only on condition that Uttar Pradesh 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 one hundred twenty-six million two hundred seventy thousand dollars (\$126,270,000) on the terms and conditions set forth in the Loan Agreement, but only on condition that Uttar Pradesh agree to undertake such obligations toward the Bank as are set forth in this Agreement; and

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

WHEREAS Uttar Pradesh, 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. (a) Uttar Pradesh 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) Uttar Pradesh shall from time to time, at the request of the Association and the Bank, and with the participation of 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, Uttar Pradesh 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) Uttar Pradesh 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 Uttar Pradesh of its obligations under this Agreement.

(d) Without limitation upon the provisions of paragraphs (a), (b) and (c) of this Section, Uttar Pradesh shall 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. For the purpose of assisting in the implementation and monitoring of the Program, Uttar Pradesh shall maintain the Governance and CSR Core Group, the Reform Implementation Task Force, and the Poverty Monitoring and Evaluation Cell with adequate powers, functions, structures, staff and resources satisfactory to the Association and the Bank.

Section 2.04. Uttar Pradesh 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, including the impact of implementation of the program on the poor in accordance with the PSMS;

(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 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 2.05. (a) Uttar Pradesh shall use 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 in support of the Program. Uttar Pradesh 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 Uttar Pradesh during the procurement or execution of such contract, without Uttar Pradesh 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, Uttar Pradesh shall promptly upon request from the Association or the Bank as the case may be, 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

#### Particular Covenants

Section 3.01. (a) Uttar Pradesh shall maintain records and accounts adequate to reflect in accordance with sound financial management and accounting practices the High Priority Development Expenditures of its relevant departments or agencies.

(b) Uttar Pradesh shall:

(i) have the records and accounts referred to in paragraph (a) of this Section audited for Fiscal Year 1999-2000 in accordance with terms of reference satisfactory to the Association and the Bank, and 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 six months after the end of such Fiscal Year,  
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 from time  
to time reasonably request.

Section 3.02. (a) Uttar Pradesh 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, Uttar Pradesh 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 3.03. Uttar Pradesh shall, no later than thirty (30) days after the  
disbursement of the proceeds of the Credit and the Loan to the Borrower, provide to  
the Association and the Bank respectively an audit report by independent auditors  
acceptable to the Association and the Bank showing the date and the amount of the  
proceeds of the Credit and the Loan transferred by the Borrower to Uttar Pradesh  
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 Uttar Pradesh 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 Uttar Pradesh 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)

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)

For Uttar Pradesh:

Chief Secretary  
Government of Uttar Pradesh  
Lucknow 226001 UP, India

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 Uttar Pradesh may be taken or executed by its Chief Secretary or such other person or persons as Uttar Pradesh shall designate in writing, and Uttar Pradesh 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 Uttar Pradesh, and so long as the Development Credit Agreement shall not have terminated prior to the termination of the Loan Agreement:

(a) the obligation of Uttar Pradesh 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 Uttar Pradesh 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 R. Lim

Country Director, India

STATE OF UTTAR PRADESH

By /s/ S. C. Tripathi

Authorized Representative

#### SCHEDULE

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

#### Policy Papers

1. Uttar Pradesh has obtained Cabinet approval to implement policies, strategies and actions for carrying out a medium-term program of fiscal and governance reforms set out in the following documents, and has tabled these documents in the Legislative Assembly of the State:

(a) A Policy Paper on Fiscal Reforms aimed at achieving sustainability over the medium-term through growth-oriented fiscal adjustment, by reducing its fiscal deficit to no more than four percent (4%) of the Gross State Domestic Product (GSDP) by Fiscal Year 2003-04, its non-power fiscal deficit (fiscal deficit net of support for the power sector restructuring) to no more than three percent (3%) by achieving a primary (fiscal deficit net of interest payments) surplus by such date.

(b) Policy papers on Governance Reform, Civil Service Reform, Public Enterprise Reform and Privatization, and Financial Management and Accountability Strategy.

#### Fiscal Policy

2. Uttar Pradesh has initiated the implementation of a medium term fiscal framework, satisfactory to the Association and the Bank, with the objectives of, inter alia, reducing in Fiscal Year 1999-00 the non-power fiscal deficit to no more than Rs 98 billion or 6 percent of the GSDP, from 6.7 percent in the previous year; capping debt and guarantees at no more than 38 percent and three percent (3%) of GSDP respectively; and containing salary and pension payments to within Rs. 101 billion.

#### Public Expenditure Policy

3. Uttar Pradesh has:

(a) Restricted new recruitment to downsize the civil service by at least two percent (2%) through attrition.

(b) Taken measures to reduce the fiscal impact of the Fifth Pay Commission pay increases, including abolishing staff entitlement to encash outstanding leave.

(c) Imposed a freeze on higher and secondary education grants at their 1998-99 level and approved an increase in user charges in canal irrigation, professional education and hospital care.

(d) Imposed a ban on new credits to public enterprises, with the exception of power and for payments under voluntary retirement schemes.

(e) Prepared a strategy for developing a Medium-Term Expenditure Framework.

(f) Finalized the components of high-priority developmental expenditures to be protected in Fiscal Year 1999-00, and issued orders to all treasuries to ensure that these components get priority in clearance of bills.

#### Tax Reform

4. Uttar Pradesh has initiated the implementation of a program of tax policy and administration reforms, satisfactory to the Association and the Bank, and has taken, inter alia, the following actions:

(a) Implemented floor rates for sales tax per agreement with the Government of India, and obtained approval of its cabinet to reduce the number of trade tax rates to no more than five and to simplify the system by reducing the number of commodity classification.

(b) Abolished tax holidays and deferrals for new investments.

(c) Obtained Cabinet approval of amendments to the Trade Tax Act to tighten enforcement, amended the Motor Vehicles Tax Act to simplify rate revisions, and introduced an entry tax on selected commodities.

#### Civil Service Reform

5. Uttar Pradesh has initiated the implementation of a program of civil service Reform, satisfactory to the Association and the Bank, and has taken, inter alia, the following actions:

(a) Published its Annual Transfer Policy on the web and initiated monitoring of compliance.

(b) Created and staffed a Technical Working Group under the Governance and CSR Core Group to conduct intra and inter departmental functional reviews; and initiated a review of civil service terms and conditions.

(c) Abolished about 10,000 vacant positions identified as redundant.

(d) Initiated implementation of a consultative mechanism for overseeing transfers of civil servants. Anti-Corruption Strategy

6. Uttar Pradesh has initiated the implementation of an anti-corruption strategy, satisfactory to the Association and the Bank, and has taken, inter alia, the following actions:

(a) Conducted independent surveys on the perception of business, households and civil servants on the incidence and magnitude of corruption in key departments.

(b) Published Citizen Charters for 18 departments specifying service standards and remedial measures.

(c) Established a broad based Governance Reform Task Force for rationalizing and strengthening key accountability institutions.

(d) Established a Deregulation Committee to begin to streamline and modernize the regulatory framework.

(e) Approved a code of access for documents of local government, financial institutions and development agencies.

#### Decentralizations

7. Uttar Pradesh has initiated a program of decentralization and has taken, inter alia, the following actions:

(a) Transferred responsibility, assets and control over staff and funds (4% of the state's own net tax revenue) of selected departments to lowest tier of rural local bodies - including elementary education, reproductive health and drinking water supply.

(b) Redefined accountability relations between the executive and elected local bodies at the district level; published training manual and initiated training for local government representatives; and empowered local bodies to recruit new staff under terms and conditions to be determined by them.

#### Public Enterprise Reform

8. Uttar Pradesh has initiated the implementation of a program of public enterprise reform and privatization, satisfactory to the Association and the Bank, and has taken, inter alia, the following actions:

(a) Established a Divestment Commission and an institutional framework for implementing the program.

(b) Obtained Cabinet approval of the scope of the first implementation phase of the program (involving about twenty units and about 19,000 workers) as well as the guidelines and implementation procedures, including sale, closure, treatment of labor, and environmental issues.

(c) Completed the closure and sale of assets of one public enterprise.

#### Financial Management and Accountability

9. Uttar Pradesh has initiated the implementation of a program of reform to strengthen the system of financial management and accountability, satisfactory to the Association and the Bank, and has taken, inter alia, the following actions:

(a) Established a broad based Task Force to recommend improvements to financial management, including a mechanism for public disclosure of government financial statements.

(b) Appointed a Controller, and initiated consultations with the Comptroller and Auditor General (C&AG) of India for modernizing the financial management and control system.

(c) Requested the C&AG for the conduct of special audits of procurement, and of high priority development expenditures under terms of reference satisfactory to the Association and the Bank.

#### Implementation Arrangements

10. Uttar Pradesh has established structures and indicators satisfactory to the Association and the Bank, for the purpose of implementing and monitoring the progress of the Reform Program, including its impact on the poor.

