

ASIAN DEVELOPMENT BANK

TAR:IND 36343

TECHNICAL ASSISTANCE

(Financed by the Government of the United Kingdom)

TO

INDIA

FOR PREPARING THE

RURAL FINANCE SECTOR RESTRUCTURING AND

DEVELOPMENT PROJECT

December 2003

CURRENCY EQUIVALENTS

(as of 2 December 2003)

Currency Unit	–	Indian rupee/s (Re/Rs)
Re1.00	=	\$0.022
\$1.00	=	Rs45.65

ABBREVIATIONS

ADB	–	Asian Development Bank
CCS	–	cooperative credit structure
EA	–	executing agency
MF	–	microfinance
MFI	–	microfinance institution
NABARD	–	National Bank for Agriculture and Rural Development
NGO	–	nongovernment organization
RF	–	rural finance
RBI	–	Reserve Bank of India
RFI	–	rural finance institution
RRB	–	regional rural bank
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government ends on 31 March.
- (ii) In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. The Government of India requested the Asian Development Bank (ADB) to provide technical assistance (TA)¹ for preparing a rural finance (RF)² project for reforming rural finance institutions (RFIs) to enhance their poverty reduction and income expansion contributions. Accordingly, the Country Strategy and Program for 2003 includes a TA for preparing the Rural Finance Sector Restructuring and Development Project. A TA fact-finding mission visited India in February 2003, and held discussions with the federal and state governments, central bank, apex agencies, RFIs, and other stakeholders including nongovernment organizations (NGOs) and bilateral funding agencies. This report reflects the findings of the mission and the understanding reached with the Government on objectives, scope, cost, implementation arrangements, and terms of reference for the TA. The TA framework is in Appendix 1.

II. ISSUES

2. In recent years, India has made significant progress in reducing poverty. The absolute number of poor declined significantly in the second half of the 1990s, from 320 million to 260 million, and poverty incidence has declined from 36% in 1993–1994 to 26% in 1999–2001. Seven of the 30 states have a poverty incidence of below 10%. However, regional disparities remain pronounced and inequalities exist between population groups even within states. Inequalities have also increased between rural and urban areas, with 75% of the poor living in rural areas. Poverty reduction is thus the overarching goal of the Tenth Five-Year Plan (2002–2007). The aim is to reduce poverty incidence by five percentage points by 2007 through emphasis on the employment-intensive rural development and agriculture sectors.

3. In response to rural poverty in a predominantly agricultural economy, the RF paradigm in India over the last five decades has been driven by credit expansion through RFIs and targeted programs for priority sectors. This helped establish a largely state-owned RF system with one outlet for approximately every 5,000 population. At the aggregate level there are nearly 85 million rural borrowers as against 300 million rural savers, including those who save at post offices. RF is credited with contributing to agricultural growth leading to food self-sufficiency and a food surplus, as well as to poverty reduction and employment generation.

4. The widely dispersed formal RF sector consists of 32,637 rural and semiurban branches of commercial banks; 196 regional rural banks (RRBs) with 14,465 branches; and the provincial short-term and long-term cooperative credit structures (CCSs) with 94,663 outlets. While commercial banks and RRBs are subject to Reserve Bank of India (RBI, the central bank) supervision, the CCS are supervised by both RBI and provincial governments. The semiformal sector includes about 500 microfinance institutions (MFIs)³ and the nation-wide Swarnajayanti Gram Swarozgar Yojana (SGSY).⁴ Noninstitutional or informal sources, supplying nearly one-third of the RF services, comprise traders, moneylenders, landlords, relatives, and friends.

¹ The TA first appeared in *ADB Business Opportunities* on 29 January 2003.

² In this document, the scope of RF includes savings, credit, payment services, insurance, and commodity trading. From the client's perspective, RF can be classified as financial services provided to rural farm and nonfarm households, a large proportion of whom are poor and low-income households. Microfinance (MF), as an RF subset, targets the poor. While RFIs also serve the poor, low-income households, and the nonpoor, microfinance institutions (MFIs) exclusively focus on the poor. MF is primarily rural, even though MFIs also target the urban poor. In this document, the terms "RF" and "RFI" include "MF" and "MFI", respectively. The terms "MF" and "MFI" are used only for specific MF-related references.

³ Registered under the Societies Registration Act, or Cooperative Societies Act, or are nonbank finance companies.

⁴ SGSY or Golden Jubilee Rural Self-Employment Scheme is a holistic program that provides credit and subsidy-financed assets to groups of poor or self-help groups, along with skills development and marketing support.

5. The National Bank for Agriculture and Rural Development (NABARD), the main apex RF agency, provides refinance and technical support to RFIs and commercial banks. The Small Industrial Development Bank of India and Rashtriya Mahila Kosh, an apex MF agency, provide equity and refinance support to MFIs. Linkages between commercial banks, RFIs, MFIs, NGOs, and self-help groups augment the retail capacity aimed at the lower segment of the RF market comprising the landless poor, subsistence farmers, and microenterprises.

6. The substantial RF network is accompanied by systemic policy issues and pervasive institutional weaknesses. Government interventions through directed credit, state-owned RFIs, and subsidized interest rates gradually increased the tolerance for loan defaults, waivers, and postponements. Lack of autonomy and weak governance have affected sustainability of RFIs and constrained outreach. This, among others, impedes diversification to nonfarm activities for supporting value addition and employment generation. Further, the risks in RF due to droughts and floods are accentuated by the weak rural infrastructure and by production and marketing bottlenecks. The resulting low prices, productivity, and profitability make it difficult for the rural sector to compete for capital with urban areas. Rural credit is only 10% of total commercial bank advances. Thus, a demand and supply gap exists, despite the extensive RF network. The rural poor and women, in particular, have inadequate access to RF services.

7. CCSs are usually poorly governed and politicized institutions with inadequate capital and high levels of loan delinquency. CCS in many states operate due to regulatory forbearance and outmoded accounting concepts. In addition, the RRBs have drifted from their core objective of banking with the poor and have accumulated overheads without regard to efficiency. With aggregate repayment rate at 70% of demand, the portfolio quality of RRBs remains dubious. Concerned at the magnitude of these issues, the Government is considering to reform the CCSs and RRBs through good governance, re-capitalization, and reduction in nonperforming loans.

8. Over the years, bilateral funding assistance for MF development has introduced best practices. The commercial banks and RFIs use self-help groups organized and trained through intermediary NGOs for delivery of MF services. While this reduces transaction and risk costs, the arrangement provides little scope for voluntary savings and risk mitigation. The amount of credit is often less than the investment cost for supporting income-generating activities. The status of many MFIs to undertake savings remains unclear, which discourages investment in institutional capacity and consequently affects outreach to the poor. MFIs also exhibit wide variations in scale and efficiencies. Currently, a task force of the Prime Minister's Office and sub-committees of RBI are working on measures for enhancing MF outreach.

9. The disadvantages that the rural poor face due to limited access to RF are accentuated by the inadequacy of risk-mitigating instruments to insure against default risks, for instance, due to property loss or illness. As a result, the poor forgo potentially viable new technologies, production choices, and income opportunities due to risk aversion. So far, insurance services are not widespread in rural areas because of scant client information to assess risks, weak contract enforcement, and high transaction costs. Establishment of an insurance company for the agriculture sector is being considered by the Government to address some of these issues.

10. For rural growth and poverty reduction, it is important that producers receive remunerative prices on time. However, production and price volatility due to dependence on the monsoon and poor price discovery affect farm profitability and raise the default risks for RFIs. The commodity markets that can help reduce such price volatility remain segmented commodity-wise and regionally. In addition, the spot and forward markets in commodities are not integrated. Responding to these concerns, a National Multi-Commodity Exchange has been

set up and effective market regulation is being considered. The entire downstream system will require significant strengthening for enhancing the participation of small rural producers.

11. The RF problems in India remain rooted in weak governance, inadequate autonomy of RFIs, and political interference in loan collection. Perpetually weak RFIs overshadow positive impacts of savings and credit expansion. In addition, direct poverty interventions are beset by problems of beneficiary identification, leakages, and few sustained benefits. Central and state governments realize the need for reforming the RF system for ensuring sustainability and pro-poor orientation. Properly governed RFIs are considered necessary for equitable participation in local economy for rural poor and employment generation in farm and nonfarm sectors through increased access to affordable RF services. There is a growing realization that the poverty reduction impact of RF can be maximized if price and production risks are mitigated. Success in these interventions will facilitate the realization of the poverty reduction goal set for in the Tenth Five-Year Plan, which is consistent with the ADB country strategy for India.⁵

12. RF is already moving into a transition. Task forces of the Government are formulating RF reform frameworks. This project preparatory TA will provide appropriate inputs for contributing to policy and institutional reforms for pro-poor banking; strengthening governance and regulation of RFIs; and enhancing risk mitigation measures. ADB's significant experience in RF and its MF development strategy⁶ will enable lessons to be drawn from a number of countries in Asia. Further, the findings of the poverty assessment and the study on improving the poverty reduction impact of the financial system in India will also feed into the TA.⁷ The TA will help build a long-term relationship between the Government and ADB for RF development. Linkages with key sector institutions and other funding agencies will be established.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

13. The main purpose of the TA is to prepare an RF project, in support of the Government's reform agenda for RF and suitable for ADB financing, for rural poverty reduction and income expansion through increased access to sustainable RF services. The TA will develop and prioritize reform opportunities based on in-depth review and analysis of the following.

- (i) **CCSs and RRBs.** Financial and institutional status of and restructuring options for CCSs and RRBs in five states;⁸ and the role of state governments, apex agencies, and sponsoring banks in policy, supervisory, and operational aspects.
- (ii) **MF.** Status of MF policy, legal framework, governance, supervision, and sustainability; delivery models for outreach expansion; resource needs; pilots for product and process innovations; delivery options for social intermediation services; and the role and participation of the private sector in MF.

⁵ ADB. 2003. *Country Strategy and Program 2003–2006*. Manila.

⁶ ADB. 2000. *Finance for the Poor: Microfinance Development Strategy*. Manila; and ADB. 2000. *Rural Asia: Beyond the Green Revolution*. Manila.

⁷ ADB. 2000. *Participatory Poverty Assessment at the State Level*. Manila; ADB. 2002. *Participatory Poverty Assessment at the State Level, Part II*. Manila (funded by the Government of the United Kingdom); and ADB. 2002. *Improving the Impact of the Financial System on Poverty Reduction*. Manila.

⁸ The review will cover three of the following ADB focal states—Assam, Chhattisgarh, Gujarat, Kerala, and Madhya Pradesh, and two of the following—Andhra Pradesh, Jharkhand, Punjab, and West Bengal. States will be selected by the executing agency in consultation with ADB.

- (iii) **Risk Mitigation.** Options, products, and financial derivatives for risk mitigation and the possibility of service delivery through poverty reduction programs, RFIs, and MFIs; and the agriculture insurance sector, including scope for policy, product, and institutional support for the proposed agriculture insurance agency.
- (iv) **Commodity Markets.** Policy and institutional framework for strengthening commodity futures market including regulation and supervision, downstream products and services, and information dissemination needs.
- (v) **Sector Support.** Operational status of NABARD, including the need for onlending resource support; training arrangements for RFIs; and RFI monitoring.

14. The five component outputs will be subsector frameworks with options for policy and institutional support. A project proposal will be developed in consultation with the Government from these options for the delivery of affordable RF services, especially to the rural poor and women. A summary poverty and social analysis is in Appendix 2.

B. Methodology and Key Activities

15. The TA will link up with the substantial RF sector work by the Government, bilateral funding agencies, and others in formulating policy and institutional reforms. This will enable stakeholder participation from the outset and eliminate duplication. The TA inputs will facilitate development of a reform agenda, strategic priorities, and implementation plans. The outputs will thus provide options for the proposed RF project as well as for other funding agencies and for implementation by the Government. The modular TA plan will allow (i) subsector-wise identification of sustainable design elements for enhancing the poverty reduction impact, and (ii) inclusive stakeholder consultations for successively prioritizing TA outputs for ensuring pro-poor orientation of the ensuing project design. Accordingly, the team of experts will include specialists in social and poverty analysis, social intermediation, risk mitigation, and community development. International expertise will be selectively used for incorporation of best international practices. TA implementation will allow flexibility to adapt team compositions as the work progresses. Appropriate methodologies will be applied for participation of the poor and for capturing their perspectives identified by previous studies (footnote 7). The draft reports will be discussed at the national and state levels prior to finalization. For wider dissemination and participation, draft TA outputs will be posted on the web site of NABARD.

C. Cost and Financing

16. The total cost of the TA is estimated at \$1,250,000 equivalent, consisting of \$255,000 in foreign exchange cost and \$995,000 equivalent in local currency cost. The Government of the United Kingdom will finance the entire foreign exchange cost and \$745,000 equivalent of local currency cost on a grant basis. The Government will finance the remaining local currency cost of \$250,000 equivalent in kind including office space, counterpart staff, local transport, other administrative expenses, and part of the cost of workshops and surveys. The detailed cost estimates and financing plan are in Appendix 3.

D. Implementation Arrangements

17. The Ministry of Finance, Department of Economic Affairs (Banking Division) will be the Executing Agency (EA) for the TA. For TA implementation, the EA will form a TA management committee comprising representatives from the Ministry of Agriculture and Cooperation; Ministry

of Consumer Affairs, Food and Public Distribution; RBI; NABARD; and selected state governments, CCSs, RRBs, MFIs, NGOs, etc. The TA management committee, through its chairperson designate, will be responsible for overall implementation. NABARD, on behalf of the EA, will implement and coordinate the studies, analysis, and outputs under the TA. It will provide suitable office space, two full-time counterpart staff, and support services at its head office. NABARD will also provide office space at its state and district offices and seek similar facilities from the CCSs and RRBs to enable the consultants to accomplish their task.

18. The TA will be implemented over a period of 7 months, beginning in January 2004 and completed by July 2004. Tripartite review meetings involving the Government, TA consultant, and ADB will be organized by the EA twice during the TA period, to be held in conjunction with ADB missions to review implementation and resolve any outstanding issues. The Ministry of Finance will chair the meetings. Members of the TA management committee and representatives of other agencies as decided by the EA will attend the meetings. The Government will undertake a final evaluation of the TA jointly with ADB, on the basis of the final draft report of the TA.

19. The consulting services required under the TA consist of 10 person-months of international and 135 person-months of domestic consulting services. Terms of reference for consulting services are in Appendix 4. The RF and MF sector specialist (domestic) will be the team leader and will be assisted by a deputy team leader (international), financial analyst, and social and poverty specialist for coordination and consolidation of the outputs of the teams of experts constituted for the five TA components. Consulting services will be provided by an international consulting firm, which will provide both international and domestic consultants. The TA consultant will be selected and engaged in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB on the engagement of domestic consultants. For selecting the consulting firm, the quality and cost-based selection method, with simplified technical proposals, will be used.

20. The TA consultant will prepare (i) an inception report including a detailed work program, to be submitted within 3 weeks of the start of the TA and to be discussed at the initial tripartite review meeting; (ii) quarterly progress reports for reporting overall work progress during the period under review, the work program for the following quarter, and any outstanding issues; (iii) an interim report, presenting draft outputs to be submitted within 5 months of the start of the TA, and to be discussed at the interim tripartite review meeting; (iv) a draft final report compiling all TA activities and consultants' recommendations, to be submitted at least 1 month before TA completion and to be discussed at the final tripartite review meeting; and (v) a final report at the completion of the TA. The TA consultant will organize and conduct workshops to obtain stakeholder views on TA activities and outputs, and undertake surveys on an as-needed basis.

IV. THE PRESIDENT'S DECISION

21. The President, acting under the authority delegated by the Board, has approved ADB administering technical assistance not exceeding the equivalent of \$1,000,000 to the Government of India to be financed on grant basis by the Government of the United Kingdom for preparing the Rural Finance Sector Restructuring and Development Project, and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Measurable Indicators	Monitoring Mechanisms	Assumptions and Risks
Sector Goal Accelerate and enhance poverty reduction and income expansion through policy and institutional reforms in rural finance (RF) sector to enhance the access of a broad range of RF services, especially for the rural poor	Comprehensive policy, governance, regulatory, and institutional strengthening framework identified for rural finance institutions (RFIs) Reforms for mainstreaming risk mitigation and enhancing the effectiveness of commodity futures market identified	TA Steering Committee meetings, Tripartite review meetings, and reports submitted by TA consultant.	Government's commitment to pursue reforms that enables RF sector to operate autonomously within a liberalized financial policy regime
Purposes Prepare a project for Asian Development Bank (ADB) financing to initiate RF sector reforms for increasing the access to sustainable RF services	By the end of Technical Assistance (TA), sub-sector wise-reform proposals prepared and implementation plans developed	TA Steering Committee meetings, Tripartite review meetings, and reports submitted by TA consultant. Government concurrence and ADB commitment to financing the agreed reforms	Continued focus on poverty reduction in the rural sector in the Government's Five Year Plan and ADB country strategy for India
Outputs RF sub-sector wise reform priorities including cooperative credit structures (CCSs) in five states, five regional rural banks (RRB), microfinance (MF), risk mitigation, commodity markets, and National Bank for Agriculture and Rural Development (NABARD)	A consolidated project proposal based on the sub-sector analysis	Tripartite review meetings and reports submitted by TA consultant	Government and RFI commitment for the reforms
Activities (i) Review financial and operational status of CCSs and RRBs in five states and develop restructuring plans for them	Financial and diagnostic reviews and restructuring including road maps	A TA report including recommendations for comprehensive restructuring	Cooperation and proactive participation of RRBs and provincial CCSs

Design Summary	Measurable Indicators	Monitoring Mechanisms	Assumptions and Risks
(ii) Review the status of the MF sub-sector	Analysis and recommendations covering MF sub-sector reforms including policy regulations, governance, and outreach	A TA report including recommendations on MF development framework comprising policy, regulation, institutions, outreach and pilots for products and process innovations	Participatory process to ascertain the perspective of clients, especially the poor
(iii) Assess options, products, and services including financial derivatives and agriculture insurance for providing risk mitigation for the low income households	Analysis and recommendations covering possible risk mitigation measures and agricultural insurance policies as well as institutions	A TA report including recommendations for providing risk mitigation products and services for the low income households	Government's commitment to undertake measures for facilitating the establishment of a functional risk mitigation system
(iv) Develop policy and institutional framework to strengthen commodity futures market	Analysis and recommendations covering regulation and supervision, products, services, and information dissemination needs	A TA report including a strategy and road map for developing an integrated commodity futures market	Government's commitment to establish a conducive framework for sound commodity futures market operations
(v) Review of the operations of NABARD	Analysis and recommendations covering financial and operational status of NABARD	A TA report including recommendations on institutional orientation for implementing the recommendations	NABARD's proactive participation
(vi) Project coordination	Developing the overall RF development framework and providing leadership for activities (i)–(v)	Synthesis of the findings of activities (i–v) within the overall RF development framework	In-depth RF sector expertise and high level of managerial and analytical skills of the consulting team and its leader.
Inputs			
- 10 person-months of international consulting services		TA Steering Committee meetings, Tripartite review meetings, and reports submitted by TA consultants.	Qualified TA consultants are fielded in time
- 135 person-months of domestic consulting services			
Total Cost	\$1.25 million		

SUMMARY OF POVERTY REDUCTION AND SOCIAL STRATEGY

A. Linkage to the Country Poverty Analysis

Sector identified as a national priority in Country Poverty Analysis? Yes	Sector identified as a national priority in Country Poverty Partnership Agreement (PPA)? No PPA to date.
Contribution of the sector/sub sector to reduce poverty in India: India is a predominantly rural economy. Nearly three fourths of the total population and the majority of the country's 260 million poor are in rural areas. Intensity of poverty is higher among marginal farmers and landless rural laborers. Natural disasters such as droughts and floods and volatility of agricultural prices accentuate rural poverty. Inadequate access to affordable rural finance (RF) services constrains rural growth and employment. Weak RF markets depress the rate of rural economic growth and distort its income distribution consequences. The development of a sustainable RF sector with improved governance and risk mitigation mechanisms will reduce the vulnerability of the rural poor. The Project will promote rural economic growth and poverty reduction, through (i) income and employment generation in the rural sector; (ii) increased productivity of agricultural activities; (iii) private sector promotion, especially among small and microenterprises; and (iv) social protection and empowerment.	

B. Poverty Analysis

Improved Governance/ Economic Development

What type of poverty analysis is needed?

Two thirds of India's population depend on agriculture for their livelihood. However, the majority of farmers are classified as subsistence farmers and many agricultural households live below the poverty line. In terms of nonincome aspects of poverty such as the literacy rate, India has some of the lowest human development indicators in Asia, particularly in rural areas. Government poverty reduction programs have had limited impact because of ineffective targeting and leakages. Thus, the focus areas for the poverty analysis are (i) poverty assessment and mapping of the poor and vulnerable who are unable to access RF services, (ii) stocktaking of tangible and intangible productive assets of the rural poor for determining appropriate types of RF services, (iii) identifying constraints in enhancing access to RF services, and (iv) assessing the need for social intermediation support for developing skills that could be useful for generating higher returns for the rural poor from investments in income-generating activities.

India's agricultural productivity is low by international standards. A large share of public investment in agriculture is directed to subsidies for food, irrigation, fertilizer, electricity, and credit, which, in most cases, benefits large landowners rather than small farmers due to the politicization of the subsidy programs and lack of effective targeting. Smallholders, who are the majority of farm households in India, have limited access to agricultural inputs such as irrigation, fertilizer, and high-quality seeds, partly due to limited access to affordable RF services. Less than one third of farmland is irrigated and agricultural output is heavily dependent on the annual monsoon, which makes farmers vulnerable to climatic variations. The introduction of high-yielding crop varieties and improved irrigation techniques over several decades have increased productivity in some areas. However, small landholders have not been able to afford these.

The Government has initiated target group-oriented antipoverty programs since the 1960s. The major ongoing programs include the Golden Jubilee Rural Self-employment Scheme, Jawahar Rural Development Scheme, and Employment Assurance Scheme. These programs aim at higher productivity and sustainable income generation and involve subsidized credit or assets to poor households, often combined with improved technology or skill training. Experience, however, shows less than expected achievements, mainly due to the nonviability of, as well as inadequate investment in, many income-generating activities and insufficient technical and institutional capabilities in program implementation. Further, subsidized credit generates excess demand, resulting in credit rationing and capture by rural elites. Subsidized credit is perceived as a grant and encourages irregular repayment behavior.

C. Participation Process

Stakeholder analysis? Yes

The social assessment of the TA will involve consultations with various stakeholders using qualitative and quantitative methodologies. The focus of the social assessment will be on (i) cost effective RF delivery models and social intermediation services, especially to women; (ii) appropriate risk mitigation mechanisms for the rural poor; and (iii) impact of development of the commodity futures markets and agriculture insurance on small landholders. The social assessment will involve the participation of the following main stakeholders: farm and nonfarm rural households; nongovernment organizations and self-help groups; commercial banks; regional rural banks; cooperative

credit structure; formal and semiformal microfinance institutions; Ministry of Finance; provincial ministries and departments; National Bank for Agriculture and Rural Development; Reserve Bank of India; Small Industries Development Bank of India; National Cooperative Development Corporation; and selected bilateral agencies.

Participation strategy? Yes

The key aim of the project is to address rural unemployment, low agricultural productivity, and vulnerability of the rural poor. Therefore, the emphasis of the social assessment will be on participatory process aimed at rural poor and microfinance institutions to assess their needs for enhancing sustainable outreach. The assessments will also involve consultations with women groups to identify gender-related issues; the poorest and vulnerable such as female-headed households to assess their special needs; and households in geographically remote areas where rural poverty is most acute. The assessment will ensure the participation of various stakeholders through methods such as participatory stakeholder interviews, focus group discussions, and rapid appraisal. The assessment will identify monitoring and evaluation indicators.

The proposed project intends to address rural poverty through sustainable RF, therefore, the important focus of the social assessment will be the need for social intermediation as an investment in demand-side development for outreach expansion. This will include identification of systematic and cost-effective methods of borrower identification, appraisal, building social collateral, and skill development of borrowers.

D. Gender and Development

Strategy to maximize impacts on women: The social analysis includes gender analysis to identify issues and constraints for women to take and utilize RF services. A strategy of social intermediation will be prepared to assess training and skill development needs for women.

Gender plan prepared? Yes.

The poverty analysis and social assessment will include a gender plan.

E. Social Safeguards and other Social Risks

	Significant/ Nonsignificant/ None	Strategy to Address Issues	Plan Required
Resettlement	None	There will be no resettlement issues resulting from the implementation of the project.	No
Indigenous Peoples	None	No issues of indigenous people are involved.	No
Labor	None	A positive labor impact is expected as a result of extended RF outreach and expanded economic opportunities in rural area.	No
Affordability	None	There will be no affordability-related issues. In contrast, the reduced costs of production along with the productivity improvements will result in a more competitive agriculture sector that will not be dependent on government subsidies or welfare programs.	No
Other Risks/ Vulnerabilities	None	No other adverse issues are anticipated.	No

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. Government of the United Kingdom Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	200	0	200
ii. Domestic Consultants	0	540	540
b. International and Local Travel	30	60	90
c. Reports, Communications, and Translation	0	10	10
2. Equipment (Computer and Accessories) ^b	0	10	10
3. Seminars and Stakeholder Forums	0	20	20
4. Surveys	0	15	15
5. Miscellaneous Administration and Support Costs	0	10	10
6. Representative for Contract Negotiations	5	0	5
7. Contingencies	20	80	100
Subtotal (A)	255	745	1,000
B. Government Financing			
1. Office Accommodation	0	60	60
2. Remuneration and Per Diem of Counterpart Staff	0	80	80
3. Local Transport	0	40	40
4. Workshops	0	20	20
5. Surveys	0	30	30
6. Contingencies	0	20	20
Subtotal (B)	0	250	250
Total	255	995	1,250

^a Administered by the Asian Development Bank.

^b Equipment list to be approved by the technical assistance management committee.

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTING SERVICES

1. The technical assistance (TA)¹ has five components as well as project coordination. Institutional coverage includes the Reserve Bank of India (RBI); National Bank for Agriculture and Rural Development (NABARD); Small Industries Development Bank of India; Cooperative Credit Structures (CCSs); regional rural banks (RRBs); microfinance institutions (MFIs); Ministry of Finance; Ministry of Agriculture and Cooperation; Ministry of Consumer Affairs, Food and Public Distribution; provincial cooperative ministries; nongovernment organizations (NGOs); self-help groups; commercial banks; and the Forwards Markets Commission.

A. Project Coordination

2. The team of experts (domestic/international, person-months) will include a rural finance (RF) and microfinance (MF) sector specialist as project team leader (PTL) (domestic, 7); an RF and MF sector specialist as deputy team leader (DTL) (international, 4); financial analyst (domestic, 7); and a social and poverty specialist (domestic, 7). The key tasks and outputs include:

- (i) **PTL and DTL.** Monitor TA; coordinate TA activities with work undertaken by stakeholders including task forces of the Government; serve as the team leader for components 1, 2, and 5, and be overall in-charge for components 3 and 4; provide guidance for timely delivery of quality outputs² consistent with the terms of reference; ensure that work in progress is shared across the five components; liaise between the Government and the Asian Development Bank (ADB); and bring to attention all matters that need to be addressed for facilitating TA implementation.
- (ii) Assess the role of RF within the overall framework for rural sector and poverty reduction, how RF should evolve, and the factors that impact on its sustainability. This will include assessment of demand and supply gaps by economic subsectors, products and services, and gender; government policies that support and impede RF development; existing grants and subsidies and their economic and financial impact; effectiveness of ongoing programs and schemes; financial and operational status of RF institutions (RFIs); issues in loan collection; and poverty reduction impact of RF. Consolidate the findings as a strategy paper including logical framework, drawing from components 1–5, and, as required, discuss with the Government and ADB for review of scope of components 1–5.
- (iii) **Financial Analyst.** Assist the PTL in consolidation of the financial analysis of five component studies; and prepare detailed cost estimates of the project based on the five component studies, including standard cost tables and financing plan.
- (iv) **Social and Poverty Specialist.** Assist the PTL in consolidating the poverty analysis of components 1–5; establish contact with NGOs and community organizations; prepare stakeholder analysis; conduct poverty impact assessment following ADB guidelines; define, numerate, map, and target intended clients, using existing data; prepare a gender action plan; assist in the finalization of

¹ The Supplementary Appendix provides position-based terms of reference.

² One main project document on standard Asian Development Bank project format with appendixes including report on RF strategy and other outputs indicated in the components 1–5.

poverty and social design issues, and assess the overall poverty impact of the proposed project.

B. Component 1: Strengthening of Cooperative Credit Structure

3. The review, supervised by the PTL, will cover CCSs,³ including the state apex structure and a sample of district banks and societies in five states, and five RRBs, preferably in the same states. The review team for the CCS (all domestic consultants in person-months) will include two financial institution restructuring and workout specialists (3 each) and a governance and institutional development specialist (3). The review team for RRBs will have similar specialization for 3 person-months and 1 person-month, respectively, since the RRBs are relatively smaller. In addition, a team of domestic consultants comprising one each of a restructuring specialist (3 person-months), management information system specialist (2 person-months), and legal expert (1 person-month), will exercise quality control and consolidate the key outputs. The key activities and outputs will include the following:

- (i) **Financial Review.** Standard audit procedures, audit and inspection reports, sample portfolio data, and field assessment will be used to review the loan portfolio including management, pricing, classification, assets provision, and recovery procedures; assess liquidity and risk profile of assets and liabilities, including maturity, sector and client concentrations, security and collateral quality, and loan rescheduling; and determine earnings, profitability, capital and reserve adequacy, and nonperforming loans at each tier.
- (ii) **Diagnostic Review.** The review will, among others, cover laws and regulations; role of ministries, RBI, NABARD, apexes, and sponsors, scope of business and the market, and supervisory and regulatory mechanisms. In addition, the following will be analyzed: governance, autonomy, and accountability; organization and human resources; administrative systems; accounting, auditing, and reporting practices; corporate planning and budgeting; credit policies and procedures; internal controls; back-office processing; and management information system. Financial flows in the tiered CCSs will be assessed.
- (iii) **Restructuring Plan.** To be prepared in two phases, to coincide with ADB TA review missions, where Phase I will provide strategic options for policy, law, and institutional design. After a best fit selection by the stakeholders, restructuring plans will be developed (Phase II) to cover governance; organization and human resources; financial restructuring, including resolution of nonperforming loans; business processes, systems and procedures, products and services; risk management; information technology and management information system; performance benchmarking; and financial projection and business plan. The restructuring plans will aim to achieve sustainability and pro-poor orientation.

4. The outputs are financial review, diagnostic review, and restructuring plan for each CCS and RRB reviewed. The restructuring specialist, management information system specialist, and legal expert, in addition to performing quality control and consolidation, will prepare two stand-alone projects for CCS and RRB restructuring in two states based on standard Asian

³ CCS refers to the two- or three-tier short-term CCS and the unitary long-term CCS or merged long-term and short-term CCS in some states. The short-term CCS involves state-level apex, district banks, and primary agricultural credit societies. The long-term CCS is generally unitary with a state-level bank with branches.

Development Bank (ADB) sector development project format along with appendixes that include costing, financing models of representative farm and nonfarm enterprises, and drafts for proposed legal changes.

C. Component 2: Microfinance

5. The pro-poor orientation of RFIs through Component 1 will be supplemented by the microfinance (MF) subsector development aimed exclusively at the poor. The team of experts (all domestic) for this component will be headed by the PTL and will include: MFI appraisal specialist (5 person-months), MF institutional development specialist (2 person-months), MF law, supervision, and regulation specialist (2 person-months), and social intermediation specialist (2 person-months). Key activities and outputs will include the following:

- (i) Review the information and analysis contained in published reports, sector studies, and institutional diagnoses; discuss with key stakeholders to analyze the poverty situation, characteristics of poor households including socioeconomic constraints, and the volume and nature of demand for MF services; assess the policy framework for MF with specific reference to financial sector policies and ongoing reforms, policy based lending, and government programs; and review infrastructure for MF with specific reference to the legal framework, regulatory and supervisory mechanisms and standards, auditing and accounting standards, capacity building arrangements, and information systems.
- (ii) Appraise five MFIs (excluding CCSs and RRBs), based on secondary data, including NGOs, government sponsored schemes with MF components, and self-help group and bank linkage program in terms of their target clientele, outreach including depth of outreach, products and services, gender orientation, sustainability, governance, and institutional orientation.
- (iii) Assess the demand-side development interventions for empowering the poor for optimal utilization of access to MF services; the interface and sequencing of such interventions with MF services; availability of resources for demand-side development; and capacity of service providers;
- (iv) Analyze the poverty reduction impact of MF interventions and assess the role, initiatives, and policies of NABARD, Small Industries Development Bank of India, Rashtriya Mahila Kosh, major external funding agencies, and the private sector.

6. The review report will include a framework for MF development that addresses issues in prevailing policy and laws; financial infrastructure; institutional strengthening; institutional network and linkages; access to resources for outreach; public-private and private sector participation; and delivery of social intermediation support. The reports will also recommend pilots for promoting pro-poor innovations. The team will prepare a stand-alone project for MF development based on standard ADB sector development project format.

D. Component 3: Risk Mitigation

7. Risk mitigation for poor and low-income households will be studied by a team comprising risk mitigation specialists (domestic, 4 person-months, team leader; and international, 2 person-months), social protection and poverty specialist (domestic, 3 person-months), and an insurance sector specialist (domestic, 3 person-months). Key tasks and outputs include the following:

- (i) Estimate the nature and volume of demand for risk mitigation services at full price and at different levels of cost sharing and assess the extent to which such services are available and accessible in rural areas.
- (ii) Analyze risk mitigation services provided by government schemes, insurance agencies, MFIs, and other arrangements; and assess their performance, with regard to sustainability and prospects for replication.
- (iii) Assess the scope of interventions, the role of the private sector, NGOs, RFIs, and MFIs; existing and potential service delivery capacity of the Government, private sector, and self-help groups; and feasibility of linkages for lowering transaction costs and leveraging core competencies.

8. The review report will include a strategy and roadmap for mainstreaming risk mitigation services including policy, legal, and institutional arrangements; budgetary support, if any; and financial derivatives, such as for health, property, linked to ongoing poverty reduction programs. The team will prepare a stand-alone project for developing risk mitigation services in standard ADB sector development project format including estimated outreach and stream of benefits.

9. The team of experts for the review of agriculture insurance (including for crops) will comprise agriculture insurance specialists (domestic, 4 person-months, team leader; and international, 2 person-months), and insurance law specialist (domestic, 2 person-months). Key tasks and outputs include the following:

- (i) Review the insurance facilities (fully or partially actuarial-based) in rural areas along with the framework and context within which such services are provided with specific reference to policies, laws, institutions, products, and client characteristics; and analyze the demand-supply gap and assess the quality and sustainability of existing insurance services and service providers; establish whether and to what extent agriculture insurance can be sustainably provided; and determine the best possible delivery mechanism, considering the state of supporting infrastructure requirement.
- (ii) Analyze the current status and preparedness vis-à-vis elements for developing agriculture and crop insurance schemes/institutions with specific reference to the legal framework, financial and physical infrastructure, and market participants. Also, review the progress on establishing the agriculture insurance company proposed by the Government and private sector participation thereof.

10. The review report will include a strategy and roadmap for developing agriculture insurance services and institutions with an accompanying matrix of policy, legal, institutional, and capacity aspects that are appropriately sequenced; the cost of implementing thereof including subsidies, if any; and stream of expected benefits. The team will prepare a project for developing agriculture insurance services in standard ADB sector development project format.

E. Component 4: Commodity Futures

11. The team for reviewing commodity futures market will include commodity markets specialist (domestic, 4 person-months, team leader; international 2 person-months); financial derivatives specialist (domestic, 3 person-months), futures market supervision and regulation

specialist (2 person-months), and legal expert—futures market (domestic 2 person-months). Key tasks and outputs include the following.

- (i) Based on the work undertaken by the Government, review the whole gamut of initiatives for a full-fledged commodity futures market with particular reference to strengthening economic activities in the rural sector, linkages with poverty reduction, as well as major agriculture sector policies.
- (ii) Analyze the current status vis-à-vis elements of a comprehensive commodity futures market development plan with specific reference to legal and regulatory framework, financial and physical infrastructure including settlement and guarantee system, and the downstream systems including market participants.
- (iii) Assess the status, performance, and impact of the existing hedging instruments and institutional and noninstitutional arrangements operating in India; and the scope of innovative financial derivatives in the context of local market conditions.

12. The review report will include a strategy and roadmap for developing an integrated commodity futures market. This will include policy, legal, institutional aspects and support thereof; support for enhancing existing institutions; financial derivatives that enhance market penetration and participation, especially for small farmers; incentives for enhancing the private sector's role; and capacity-building needs and arrangements. The team will prepare a stand-alone project for commodity futures in standard ADB sector development project format.

F. Component 5: Sector Support

13. The domestic team of experts for this component, headed by the PTL, includes an RF institutional development specialist (3 person-months) and an RF supervision and regulation specialist (2 person-months). The key tasks and outputs include the following:

- (i) Organizational diagnosis and institutional analysis of NABARD including refinancing, supervision, and institutional development operations; role in development and implementation of RF, rural development, and agriculture policies; and projected financial status. As appropriate, recommend institutional policies and orientation for the effective implementation of the proposed reforms as well as the need for fund support for refinance operations.
- (ii) Assess the statutory and nonstatutory information requirements on RFIs from apex agencies and government; duplications thereof; and corresponding scope for rationalization and effective use of information technology. Taking inputs from components 1 and 2, recommend changes in scope and frequency of reporting.
- (iii) Review training arrangements, in consultation with RF and MF training establishments, in terms of adequacy, quality, capability, and funding status for existing and medium-term needs. Develop proposals for enhancing the effectiveness of training by drawing inputs from components 1 and 2.

14. Based on the outcome of the above, prepare three separate review reports with development framework, implementation schedule, costs, and financing plans.