BLOCK 3
MUNICIPAL FUNCTIONAL DOMAIN AND FINANCES

BLOCK 3	**Municipal Functional Domain and Finances**
Unit 7	Urban Local Government: Functions, Functionaries and Finance
Unit 8	Resource Mobilisation and Management

UNIT 7 URBAN LOCAL GOVERNMENT: FUNCTIONS, FUNCTIONARIES AND FINANCE*

Structure

7.0 Objectives

7.1 Introduction

7.2 Functions of the Urban Local Government

7.3 Functionaries of the Urban Local Government

7.4 Finances of Urban Local Government

7.5 Conclusion

7.6 Glossary

7.7 References

7.8 Answers to Check Your Progress Exercises

7.0 OBJECTIVES

After studying this Unit, you should be able to:

- Discuss the scope of activities of Urban Local Government;
- Explain, how the functions have been devolved to Local Government;
- Describe the manpower issues in discharge of functions;
- Examine the adequacy of financial resources for Urban Local Bodies to function effectively; and
- Highlight the challenges in devolution of 3 Fs- Functions, Functionaries and Finance.

7.1 INTRODUCTION

It has been widely recognised that the cities are engines of economic growth. Presently, urban areas contribute about 63 percent to the GDP of India, which is expected to reach almost 75 percent by 2030. Further, as part of structural transformation, most of the GDP from non-farm sector, which constitute around 86 percent of GDP is generated within and around cities particularly among census towns and outside the ULB areas in the urban agglomerations. This offers opportunity of employment to millions of unemployed. People migrate from rural areas to urban areas and from smaller urban areas to bigger cities and towns in search of livelihood and better standards of living. This puts pressure on the civic agencies of the cities. They face the challenge

* Contributed by Dr. Sachin Chowdhry, Associate Professor, Indian Institute of Public Administration, New Delhi

of providing basic services, at least, and more depending on their resource position.

The Urban Local Government as a nodal agency is expected to perform functions, which make life of residents comfortable. The context determines the scope of responsibilities and corresponding functions. Besides the reason of economy, the principle of subsidiary also makes Urban Local Government an automatic choice for certain functions like water supply and sewerage, waste management, horticulture etc. However, the power to assign functions to Urban Local Bodies (ULBs) is vested in the State government as per article 243X of the Constitution of India.

The 74^{th} Constitutional Amendment Act (CAA) of 1992 granted Constitutional status to the ULBs as a viable unit of Local Self-Government. As the municipal bodies in any State, they derive their powers and responsibilities from the municipal laws framed by the respective states, the legal and institutional framework in the respective state must provide for adequate and effective devolution of functions, functionaries and funds to the Urban Local Bodies for effective, efficient, responsive, transparent and accountable urban governance. However, there is no uniformity in this regard across the country, as states have resorted to varying levels of devolution.

7.2 FUNCTIONS OF THE URBAN LOCAL GOVERNMENT

Municipal functions are generally classified as:

i) Obligatory functions - The obligatory functions are those that an ULB is supposed to necessarily perform like water supply, sanitation, roads, etc.; and

ii) Discretionary functions - These are the functions that a municipality may take up, if there is demand from the citizens and resources are available like construction of community centres, public parks and gardens, organising cultural activities, etc. These functions in terms of their application have one or more of the three components investment or capital works, O&M and regulation.

The 74^{th} CAA provided 18 broad categories of functions, listed in Schedule 12(Article 243W), to be devolved to the municipal governments by the state governments for economic development and social justice, which are depicted in Unit 4.

The states have incorporated the provisions of the 74^{th} CAA in their respective state Acts, but most of them adopted a go-slow approach and many of these functions have not been given to the Local Bodies. A sizable number of states have expressed administrative or legislative constraints in devolving all functions. These functions have evolved over a period of time. They can be linked to political and administrative expediency, technological developments, and people's desire to have a wider choice in matters affecting them in their daily lives. For example, Madras Municipal Corporation was established in 1688 with the limited purpose of conservancy and to levy rates upon the inhabitants for the building of schools, a town hall and a jail. Today the activities of Greater Chennai Corporation have increased manifold in terms of scope and people's aspirations.

Similarly, Ahmedabad Municipal Corporation has a lot more obligatory and discretionary functions in the 21st century, which are mentioned below:

Functions of the Ahmedabad Municipal Corporation

Obligatory Services

- Erection of boundary of city, defining city limits
- Sewage services -watering, scavenging and cleansing of all public streets and places
- Drainage services
- Fire services
- Health & Medical services
- Street Lighting services
- Maintenance of monuments & open spaces
- Identification of streets & houses
- Regulation and abatement of offensive and dangerous trades or practices
- Maintenance of burial houses and funeral homes
- Construction or acquisition of public markets and slaughter houses Construction or acquisition of cattle-pounds
- Primary education services
- Health and hygiene services
- Construction, maintenance and alteration of bridges
- Water supply services
- Preventing and controlling the spread of dangerous diseases
- The securing or removal of unsafe buildings and places, and construction of conservancy staff quarters
- Maintenance of relief works in scarcity, floe etc.

Discretionary Services

- Construction and maintenance of maternity homes & infant welfare houses, and maintenance of central laboratories
- Tree plantation on road sides
- Construction and maintenance of public parks and gardens

- The holding of exhibition, athletics or games
- The maintenance of an ambulance services
- Construction and maintenance of theaters, community halls and museums etc.
- Maintenance of public transport facilities, construction and maintenance of educational institutes, and infirmaries and hospitals
- The destruction of animals and birds causing a nuisance.
- Construction and maintenance of factory for the disposal of sewage
- The building or purchase and maintenance of suitable dwellings for the poor and working classes
- Provision of shelter to homeless persons and poor relief
- Surveys of buildings or lands
- Measures to meet any calamity affecting the public in the city and measures to promote public safety, health, etc.

In fact, the responsibilities of the municipalities have increased further in view of the newer challenges like disaster management, climate change, water resource management etc. For example, the municipalities now are actively engaged in identifying and ranking all known and suspected emerging hazards and risks to community safety. In South Africa, the Over strand Municipal Government has been managing the process of water resource management and development, since 2001. In Canada, the amount of untreated wastewater that is, spilled into watercourses is recorded for follow up. In New Zealand, Local Governments play an important role in facilitating adaptation to climate change at the community and regional level. Manual for the Development of Municipal Energy Efficiency Projects, 2008 states that the ULBs in India can realise tremendous benefits by adopting and executing Municipal Energy Efficiency Programme.

The working group for the 12th Five-Year Plan was of the view that there was a need to have a fresh look at all the functions sought to be devolved upon the local bodies. It suggested activity mapping of the 18 functions to assess as to which functions have been easier for the states to assign to the local bodies and those that the states have found difficult to transfer.

It was recommended, “the ULBs should be empowered by different mechanisms to deliver effectively the core services and functions such as water supply, sanitation, sewage and planning and development functions”. It also suggested empowering the ULBs for effectively coordinating and controlling the role and functions of various parastatals and agencies.

Measures needed for devolution of functions

Given the importance of functions and responsibilities entrusted to the ULBs, it is necessary that political and administrative problems are taken care of. Some necessary steps are mentioned below:

i) There is overlapping in the functioning of many agencies at the city / town level. For example, development authorities and town planning departments share responsibilities with municipal authorities. Similarly parastatals like water and sanitation boards and the ULBs have shared responsibilities. In all the functions, where there is multiplicity of agencies, a proper coordination mechanism needs to be devised to ensure a coherent strategy.

ii) For long, it has been recognised that political considerations have often hampered the devolution of functions to the ULBs. Local level politicians are seen as a potential power-center and threat to political aspirations of the state and national level politicians. A political consensus needs to emerge for ensuring such devolution.

iii) Each function necessitates resources. The ULBs since beginning have been having very weak resource base. A clear line of revenue sources needs to be identified for each function. It may require innovative approaches to ensure sufficient and sustainable resources being available for each function.

iv) Increasing complexities associated with each of the 18 functions needs capable manpower to respond to the needs and challenges.

7.3 FUNCTIONARIES OF THE URBAN LOCAL GOVERNMENT

Local Government being a state subject in the Constitution, adopted after independence, gave states the power to look into the issue of manpower requirement of the municipalities. As scant attention was paid to urban areas, the personnel system in municipalities was also not properly planned, though issues were raised at several platforms. Increasing aspirations of the citizens and complexities in city management require a municipal cadre, which is capable of responding efficiently and effectively. Report of the NITI Aayog, highlights that an organisational strategy for urban capacity building at the state and ULB level is lacking. It further states that it is evident through the absence of formal structures, dedicated cadres, staffing norms, organisational procedures, job descriptions and pay scales.

Need for dedicated municipal personnel system was expressed in the first conference of the Local Self-Government Ministers held in 1948. It resolved, "there should be provincial cadres for the higher executive and technical staff employed by local bodies". The same was reiterated in 1954 in the second such conference. A Central Council of Local Self-Government was set up in 1954 under Article 263 of the Constitution of India to look into wide variety of issues concerning urban sector.

Rural-Urban Relationship Committee had been set up in 1964 with one of the references being effective and efficient functioning of the ULBs. It had noted too, "overwhelming majority of respondents wanted to have state cadres for certain categories of staff i.e. Executive Officer/Secretary, Engineers, Health/Medical Officer, Accountant/Auditor, Valuation/Taxation Officer and Education Superintendent/Officer. This was considered necessary:

i) to achieve efficiency in administration,

ii) to attract suitable persons,

ii) to have uniformity in execution, and

iv) for impartial implementation of policies.

The committee had recommended, "there should be a common cadre of class I and class II officers of all ULBs. Recruitment to the common cadres should be made through a Municipal Service Commission to be constituted for the purpose. Transfer should also be effected by Government in consultation with the Mayor and the Municipal Commissioner". Further, it added "detailed rules for recruitment, qualifications, training, promotion, disciplinary control and annual assessment of work should be framed by state governments for subordinate services''.

At the 9th meeting of the Central Council of Local Self-Government in 1963, the Himachal Pradesh government put up a note stating,"inefficiency among the staff of Local Bodies was due to the fact that qualified persons were not attracted to join service under them because of the low pay scales and disparity in the emoluments between employees of local bodies and government employees". This paved the way for consideration of municipal cadre and in the 10th meeting of the Council in 1965, a committee was set up for looking into the service conditions of the municipal employees. The committee was required to go into the following matters:

i) The question of improvement of service conditions of municipal employees; and

ii) Suggesting a pattern of organisation for state-wide municipal services.

A broad survey of the personnel policies by the Committee revealed three definite types of personnel systems in the ULBs

i) A separate personnel system in which each local authority appointed and administered personnel, who were not automatically transferable to another jurisdiction.

ii) A unified Local Government service in which all or some categories of personnel of local authorities constituted a career service for the entire state. It was administered and controlled by an agency at the state level; and the personnel were transferable between local authorities only.

iii) An integrated service in which the personnel of the state government and that of the local authorities formed part of the same service and transfers were possible not only between local authorities but also to appropriate departments of the State Government.

In some states, there was a combination of these types of systems. Some municipal Acts had the provision of appointments being made by the municipalities in consultation with the Public Service Commission in respect of posts that carried salary above a prescribed limit. The committee recommended a system of state-wide cadres, to which recruitments should be made on merit through rules for recruitment in consultation with the State Public Service Commission or a special Municipal Service Commission. At the same time, it felt that there ought to be a system of consultations with the council while posting individual officers through transfers.

The Rural-Urban Relationship Committee had recommended the division of municipal services in three grades – Special grade, grade I and grade II while grouping them as:

i) Administrative Service

ii) Engineering Service

iii) Medical and Health Service

iv) Education Service.

The Committee on service conditions had also suggested that states may move towards having integrated municipal services with corresponding categories of state service in order to ensure that the personnel available for municipal employment would have the desired competence and prestige enjoying appropriate conditions of service.

Third Five-Year Plan talked of strengthening municipal administration. It mentioned that there were no standards of ethical or occupational conduct, training, recruitment norms, qualifications, remuneration, classification and grading of staff, and service conditions. Thereafter also, as the urban sector did not receive adequate attention, the issues concerning municipalities continued to aggravate. The 74th CAA was expected to bring in necessary reforms, but personnel problem remained as it was. Thereafter, Jawaharlal Nehru National Urban Renewal Mission (JNNURM) can be said to be the first major programme for urban development. Municipal staff was entrusted with several responsibilities in planning and execution of small to large projects. Lack of capacity noticed during the implementation was attempted to be addressed in the 12th Plan.

The 12th plan had recommended creation of municipal cadre. Arun Maira Committee (Unpublished, 2013-14) observed that given the poor financial condition of ULBs, many States/ULBs may not be in a position to recruit municipal cadres. In this regard, the Committee recommended creation of appropriate municipal cadre as a mandatory reform under the JNNURM.

For the short and medium-term, it suggested, "allowing the ULBs to hire required personnel and for the long run, efforts should be made to create a professional cadre. This may also require that while undertaking the reforms of transfer of 18 functions listed in 12thschedule of the Constitution to municipal bodies, the states may transfer the personnel and posts deployed in the Departments which are currently looking after these functions".

Some states like Karnataka, Tamil Nadu, Maharashtra, Andhra Pradesh have taken measures for improving personnel system in municipalities. For example, there are three following services in Andhra Pradesh, which cater to the personnel requirement of municipalities:

i) State service to cater both for municipalities and departments of government.

ii) State Municipal Subordinate Service consisting of middle level officers on state-wide basis.

iii) Municipal Service to cater to the requirements of each municipality at the lower levels.

Andhra Pradesh has well-defined roles and responsibilities of various functionaries and also has provision for a channel of promotion from Municipal Service to State (common) Municipal Service and finally to State Service, providing career growth path to municipal employees of all sections.

The Working Group for 12^{th} plan had suggested for Recruitment Rules to provide for at least 25 percent direct recruitment in category A posts and 50 percent in category B. It had suggested separate municipal cadres- one for the Municipal Corporation and the other for the Municipal Council and Nagar Panchayat. In 2014, Report on Approach towards Establishing Municipal Cadres in India under Capacity Building for Urban Development project supported by MoHUA and the World Bank, noted the following:

i) States which do not have exclusive municipal cadres, performance in terms of reform implementation, innovations, revenues, attracting investments are lagging behind (for instance, Bihar, Assam, Odisha, etc.).

ii) Availability of functionaries is inadequate to deliver the devolved functions, and creating municipal cadres could be a strong option.

iii) Staffing norms exist in all states irrespective of having municipal cadres or not. However, there is no evidence that any scientific study of manpower requirement or work study done in any state except Assam, to assess the human resource requirement.

iv) Key leadership positions are occupied by the IAS officers followed by the State Civil Service officers. However, major critical expertise like Urban Planning, Transportation, IT and Public Finance etc. are still unavailable for the urban development. Currently states are drawing these talents from open market on consultancy, outsourcing or on Public-Private Partnership (PPP) mode.

v) Ad-hoc methods of augmenting lower-level staffing requirements are followed in states. Besides regular and deputation staff, sizable number of employees are engaged in Group C and D on daily wages in the ULBs. In all states, recruitments on compassionate grounds were the only source to fill vacancies due to ban on recruitment for decades. Compromising merit, lack of training had rendered most of these staff grossly inadequate in their competence. Staff on daily wages, outsourcing without clear guidelines, adhoc methods of engagement are prevalent in most states. There are many court cases that Karnataka, Bihar, West Bengal are facing owing to such practices.

vi) Direct recruitments to the ULB positions are done by State Public Service Commissions except for group D. Well prescribed selection methods are followed. However, enormous delays occur in the process owing to which ULBs suffer for want of manpower. Sometimes, irregularities in examinations lead to re-examination thus, causing further delay. There is no institution for exclusive recruitment of municipal cadres like railway recruitment, banking recruitment, police recruitment etc.

vii) Promotion rules are robust and well established. Eligibility criteria include seniority, passing of departmental exams, performance appraisal scores, etc. However, merit is not given due consideration as the method of performance evaluation does not provide for tracking individual performance against targets.

viii) Political interferences, corrupt practices, vested interests, lobbying etc. are prevalent in some degree in most states while posting, transfer of employees.

ix) Training is ad-hoc and inadequate. There is no mandatory induction/foundation training or in- service training for directly recruited officers.

x) There is a need to revamp the Appraisal system to make it more reflective of performance. Current Annal Confidential Report (ACR) system does not give any scope for motivation as there is no provision for quantitative assessment, self-appraisal and feedback. For group C and D, there is no system of assessing performance.

xi) Insufficient ULBs revenues including grants are the major reasons for not launching municipal cadre in its full form. Many states have over one-third positions going vacant and have no revenues commensurate to the growing employee costs. State and Central funds to the tune of 65 percent being spent on staff costs leaving only 35 percent for service delivery. It may be noted that among some states, one Executive officer is holding charge of more than one ULB.

Atal Mission for Rejuvenation and Urban Transformation (AMRUT), was launched in 2015, which emphasises on having a professional municipal cadre for better municipal governance, financial management and service delivery system. It suggests assessment for having municipal cadre to be based on the following features:

- Cost of services of cadre to be borne at the state level and not at the ULB level,
- Services of the officers/staff to be transferable among the ULBs, and

- State level Recruitment Rules for each cadre.

It puts the cadre, in following three functional groups:

i) **Municipal Administrative Service** – taking care of Executive, Social Development and Staff Services,

ii) **Municipal Technical Service** – responsible for Urban planning, Engineering, Transportation and e-Governance Services.

ii) **Municipal Finance Service –** handling Accounts, Revenue & Financial and Audit Services.

Current Situation

However, the situation still remains grim across states. It can be gauged from an example of Himachal Pradesh. In January 2020, there was an acute shortage of staff. There are 54 municipal councils in the state but there were just 12 regular Executive Officers to manage their affairs. *Tehsildars* were given the administrative charge of the municipal councils. Similarly, there were just 5 posts of Assistant Engineer in the entire state to manage the work of 54 municipal councils. The junior engineers are facing stagnancy in their careers, as there has been no promotion in their cadre in last 20 years (Mohan, 2020).

Establishing a Municipal Cadre is a necessity, but as discussed above, that needs a proper assessment of manpower requirement and also the identification of capacity gaps. This would require continuous upgradation of skills. It was in this background that JNNURM programme had been extended for two years especially focusing on capacity building of the stakeholders because it was found that necessary capacities are not available at the local level. The present programmes of Smart Cities Mission and AMRUT have component of capacity building as part of the programmes.

The government has introduced "Mission Karmyogi" in 2020. However, it is important to take measures to link performance to these capacity building programmes. The states may devise a strategy based on their socio-economic conditions. But it is equally important that there should be clear identification of sources to support manpower costs.

Check Your Progress 1

Note: i) Use the space given below for your answers.

ii) Check your answer with those given at the end of the Unit.

1) What are the measures needed for devolution of functions?

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

2) What are the functional groups of municipal functionaries suggested under AMRUT?

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

7.4 FINANCES OF THE URBAN LOCAL GOVERNMENT

The ULBs in India, in general, have always been under fiscal stress. Even after independence, their sources of revenue were limited and often meager, except in case of some big cities like Mumbai. The Taxation Enquiry Commission (1953) had recommended the following taxes for exclusive reservation and utilisation by/or for local bodies:

i) Taxes on lands and buildings

ii) Tax/ duty (octroi has been abolished by all the states)

iii) Taxes on vehicles other than those mechanically propelled

iv) Taxes on animals and boats

v) Taxes on professions, trades, callings and employments

vi) Taxes on advertisements other than advertisements published in newspapers

vii) Theatre tax or show tax

viii) Duty on transfer of immovable property (levied along with the Stamp Duty collected by the Government)

ix) Taxes on goods and passengers carried by roads or inland waterways.

The Commission had also suggested to give encouragement to municipalities to develop and expand their non-tax sources of revenue.

Reluctance to impose new taxes or increase the tax rates was another reason, which kept their revenues at low levels. It was assumed that 74th CAA would improve their fiscal health, but situation remains far from satisfactory. Mathur (2011) states that:

i) Internally generated revenue by municipalities are inadequate to meet revenue expenditures,

ii) Nature of transfers and grants-in-aid is ad-hoc and discretionary,

iii) Expenditure on establishment (wages and salaries) is very high *vis-a-vis* expenditure on operations and maintenance of services, and

iv) There is lack of adequate finance data.

To understand the resource base of ULBs, we need to examine their sources of funds and the investment requirement in the urban areas.

Sources of funds

The sources of funds for ULBs can broadly be classified as follows:

i) ***Tax Revenue***

There are some taxes that are levied by the ULBs. These include property tax, profession tax, entertainment tax, advertisement tax among others. Property tax remains major source of income for majority of the local bodies. It contributed about 60 percent to municipal tax revenue in India in 2017-18. But it was only 0.15 percent of GDP, which is far below the level of 1 percent estimated for recurrent taxes on immovable property in OECD countries (Ahluwalia et al, 2019). The tool kit of government of India (September 2020) expect states to double the property tax collection from Rs.200000 million (2019) to Rs 400000 million by 2024. Accordingly (i) PT base needs expansion with GIS mapping, cross-checking with building licenses, ration cards, mutations, electricity/gas accounts, review of exemptions and covering all government properties as per GoI circular 2009, (ii) revision in the guiding value for rent or unit area e.g.Delhi rates are fairly low, and (iii) Collection needs automation and online system, attractive concessions and incentives, Always Best Control (ABC) analysis to specially target top 10-20 percent properties and attachment of Bank account.

High Powered Expert Committee, 2011 estimated that the total municipal revenue for the country as a whole was about Rs. 1 lakh crore and bulk of this goes towards staff salaries, pensions and operational expenses. Municipal revenue as a share of GDP in India has remained stagnant at around 1 percent from 2007-08 to 2017-18. It was only 0.43 percent of GDP in 2017-18.

ii) ***Non-tax Revenue***

Rent from municipal properties, user charges for water and sanitation, etc. are the major sources of non-tax receipts for the ULBs. The share of non-tax revenue in the own sources has increased significantly from 33 percent in 2007-08 to 41 percent in 2017-18. However, it is also a fact that there is huge potential of increasing revenue through user charges.The current realisation does not cover the full cost of service delivery. The JNNURM had attempted to correct this anomaly through reforms, it could not be implemented fully across the country. Similarly, attention needs to be paid to other non-tax sources, which may increase the receipts of the ULBs.

In this regard, local fee/charges also have big potential such as (i) recovery on user charges (water etc.), which is only @ 20 percent (ii) right of way from gas/electricity and fibre optic lines, (ii) cell tower, (iii) leasing electricity poles (iv) and giving maintenance of parks to RWAs like Delhi @ Rs 8000 per park, which is much lower than having a municipal employee.

Similarly Advertisement fee need to be levied in line with Thirvananthapuram (listing the sites and plugging the leakages for 33170 unauthorised boards to double the income during 2018 to 2019. South Delhi MC has achieved three time increase with revision of rates in a ratio of 1:8 as per location and dividing city into clusters.

iii) ***Devolution of funds from the State Government*** – It is largely dependent on the recommendations of the State Finance Commission (SFC). Article 243 Y provides for the creation of Finance Commission and also review the financial position of the municipalities and make recommendation to the Governor as to:

a) the principles, which should govern:

- the distribution between the State and the Municipalities of the net proceeds of the taxes, duties, tolls and fees leviable by the State, which may be divided between them under this Part and the allocation between the Municipalities at all levels of their respective shares of such proceeds;
- the determination of the taxes, duties, tolls and fees, which may be assigned to, or appropriated by, the Municipalities; and
- the grants in aid to the Municipalities from the Consolidated Fund of the State.

b) the measures needed to improve the financial position of the Municipalities.

c) any other matter referred to the Finance Commission by the Governor in the interests of sound finance of the Municipalities.

However, there is considerable divergence between the Constitutional provisions and the working of the SFCs on the ground. The states have not paid adequate attention to this potentially important institution. Many a times they take long in submitting the report. Chakraborty et al (2018) analysed that the SFCs in 12 states took more than 30 months to submit their reports. The SFCs in general face the problems of non-availability of data, office space and technical staff. The implementation of the recommendations has also been found tardy, which affects the adequate devolution of funds to the ULBs.

iv) ***Grants from the Union Government for Development Schemes***

Since the implementation of JNNURM, there has been substantial increase in financial assistance by the Union Government to the states and the ULBs through various centrally sponsored schemes like Smart Cities Mission, AMRUT, Pradhan Mantri Awas Yojana, etc. At the same time, the states and the ULBs are expected to contribute their share for these schemes. This puts the responsibility on the ULBs to generate required quantum of funds through sources such as borrowings, municipal bonds, etc.

v) ***Grants based on the Recommendations of the Central Finance Commission***

From the Tenth National Finance Commission (NFC) onwards, due to Amendment in Article 280 after the 74th CAA, the CFCs started recommending grants to be transferred directly to the Urban Local Bodies. The 14th FC distributed the grants between the Rural and Urban Local Bodies in the ratio of 70:30. For the ULBs, the grant was in two parts – a basic grant (unconditional) and a performance grant (conditional) in proportion of 80:20. The NFC devolution, since, has gone up from Rs 1000 Corers to Rs 29000 Crores (during 1995 to 2020).

Keeping in mind the growth in urban population and the changing sectoral composition of GDP, the 15th FC has proposed the increase in the share of ULBs to 40 percent over the medium term. The inter se distribution of grants for Local Bodies has been proposed to be based on population and area in the ratio of 90:10. The 15th FC has also proposed differentiated treatment for fifty million-plus urban agglomerations/cities excluding Delhi and Srinagar and all other cities and towns with less than one million population. The grants for million-plus cities are for ambient air quality, conservation, supply and management of water, and sold waste management. In the other local bodies, the grants; are- (i) 50 percent for basic grants and (ii) 50 percent tied to drinking water and solid waste management. It has also specifically mentioned that these grants shall not be used as a substitute for either the Central Sector Schemes like Swachh Bharat Mission, AMRUT, etc. or any scheme of the State Government.

vi) ***Borrowings***

In view of the fewer sources of revenue and lower levels of receipts, the ULBs need to resort to borrowing from the capital market. But for that the ULBs need to prove their credit-worthiness. Bigger municipalities may manage this, but it is difficult for the smaller cities and towns. The Government of India had suggested reforms and handholding to improve the credit-worthiness of municipalities. Cities like Ahmedabad could issue bonds and raise Rs. 100 crores in 1998. Since then it has raised money five times through issuance of bonds. The previous was in 2019, when it raised Rs, 200 crores.

Credit rating agencies like ICRA assess the credit rating of an ULB on the basis of following factors:

- Inter-governmental fiscal relationships,

- Economy of the municipal area,
- Operational efficiency of the ULB,
- Municipal finances,
- Project pipeline and execution track record,
- Management quality and reform orientation, and
- State government's credit quality.

NITI Aayog has recommended "adequate financial accountability" requiring adhering to Fiscal Responsibility and Budget Management Act, 2003 that provides for finances and borrowings to remain within manageable limits.

Investment Requirement

Accurate municipal level data in a uniform format across the country is almost non-existent. That makes it difficult for any agency to work out approximate details of expenditure needed for works in urban areas. However, some normative estimates have been made. High Powered Expert Committee (HPEC) (2011) had estimated the investment requirement for urban infrastructure services to the tune of Rs. 31 lakh crore (at 2009-10 prices) for eight sectors of urban infrastructure for the period from 2012-2031. The HPEC had indicated that investment in urban infrastructure should increase from 0.7 percent of GDP in 2011-12 to 1.1 percent of GDP by 2031-32.

Empowering the ULBs Financially

There is a view that the "new wealth being generated by the substantive economic growth of urban areas is not being taxed effectively", which hampers providing even basic services like water supply, sanitation, transport, etc. According to Pandey (2011), "given a chance (with better financial management and devolution or powers to collect revenue from city potential) the ULBs can mobilise as high as 6 percent of city income." The following measures may augment the resources of the municipalities:

i) Property tax reforms as indicated in the Toolkit of GoI need to be given, a push to double the proceeds from 20000 Crores to 40000 crores by 2024, as it is a major source of revenue for the ULBs. The coverage of properties that are assessed for tax also needs to be increased through use of technologies like GIS and household surveys. The Ministry of Housing and Urban Affairs, Government of India has suggested the states to look into the issue of low property tax rates, which may be periodically revised. The 14th Finance Commission suggested states to do objective determination of the base and its regular revision to adjust for inflation.

ii) There is also need for devolving enough taxation powers to the Local Bodies, so that they can explore other avenues for taxation.

iii) Identifying non-land based sources of revenue can be sustainable as it would be comparatively free of politics. The 14th Finance Commission had suggested to the states to consider steps to empower the Local Bodies to impose advertisement tax and entertainment tax. NITI Aayog stated,"the ULBs are sometimes not even aware of the opportunities and avenues of generating revenues through taxes and non-tax charges. Even if they are aware, they do not have the skill to optimise tax collection".

iv) User charges for various services do not cover even the operation and maintenance costs. Under the JNNURM, the states were obliged to undertake the related reforms. However, a lot of resistance from the beneficiaries has led to very low level of realisations. The 14th Finance Commission re-emphasised the need for recovering at least O&M costs.

v) The ULBs can also augment their finances through other alternate sources such as municipal bonds, pooled financing and urban infrastructure funds.

vi) Goods & Services Tax (GST) reform has affected the already weak resource base of the ULBs. The mechanism may be devised to compensate the municipalities.

vii) E-Governance tools like online procurement, tenders and online expenditure reports may bring in efficiency in the system.

Check Your Progress 2

Note: i) Use the space given below for your answers.

ii) Check your answer with those given at the end of the Unit.

1) Enumerate the taxes recommended by Taxation Enquiry Committee?

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

2) Explain the tax revenue and non-tax revenue.

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

7.5 CONCLUSION

Habitat III (2016) UN states, "urban governance systems in most countries are currently not fit for purpose and need critical reform to enable sustainable urban development". The 74th CAA was expected to devolve sufficient powers to the Urban Local Governments to enable them to function as institutions of Self-Government. However, they continue to be plagued by the problem of 3Fs- Functions, Functionaries and Finance. The present situation and reasons thereof have been discussed above. While there is increasing realisation of the necessity of reforms to devolve adequate power to these bodies, a strong political commitment would be needed to sustain it.

7.6 GLOSSARY

Devolution: It refers to the transfer of authority to subordinate levels of the Government.

Structural Transformation: Shifting of work force from one to other sectors of economy such as Agriculture, Manufacturing and Services.

7.7 REFERENCES

Ahluwalia, I.J., Mohanty, P.K.,Mathur, O., Roy, D., Khare, A. & Mangla, S. (2019). *State of Municipal Finances in India: A Study prepared for the Fifteenth Finance Commission*. New Delhi, India: ICRIER.

Chakraborty, P., Gupta, M.& Singh, R.K. (2018). *Overview of State Finance Commission Reports*. New Delhi, India: NIPFP.

Government of India.(1953-54). *Report of the Taxation Enquiry Commission*. New Delhi, India: Ministry of Health, Family Planning and Urban Development.

Government of India. (1964). *Report of the Rural Urban Relationship Committee.* New Delhi: Ministry of Health & Family Planning.

Government of India. (1968). *Report of the Committee on the Service Conditions of Municipal Employees*. New Delhi: Ministry of Finance.

High Powered Expert Committee. (2011). *Report on Indian Urban Infrastructure and Services.*New Delhi, India: ICRIER.

ICF GHK (2014). *Approach towards Establishing Municipal Cadres in India*. New Delhi, India: MoUD and the World Bank.

ICRA.(2016). *Rating methodology for Urban Local Bodies*. New Delhi, India: ICRA.

Kamath, L & Zachariah, Y. (2015*). Impact of JNNURM and UIDSSMT/IHSDP Programmes on Infrastructure and Governance Outcomes in Cities/Towns in India: A Review of the State of Knowledge*. Working Paper- 7. Mumbai, India: TISS.

Mathur, O.P. (2011). *Municipal Finance Matters: India Municipal Finance Report*. New Delhi, India: NIPFP.

Mohan, L. (Jan 04, 2020). Only 12 Regular Executive Officers for 54 Municipal Councils. *The Tribune*. Chandigarh.

NIUA. (2015). *A Study to Qualitatively Assess the Capacity Building Needs of Urban Local Bodies (ULBs)*. New Delhi, India: NITI Aayog.

Pandey, K.K. (2012). *Administration of Urban Development and Urban Service Delivery, Theme Paper for the 56th Members' Annual Conference of IIPA*. New Delhi, India: IIPA.

Pandey, K.K. (25 December, 2020). *Financial Express*. Bolster, ULB Capacity to Raise Revenue.

Rao, G.M.(2013). *Property Tax System in India: Problems and Prospects of Reform*.Working Paper No. 2013-14. New Delhi, India: NIPFP.

7.8 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) Your answer should include the following points:

   - Overlapping in the functioning of many agencies.
   - A political consensus needs to emerge for ensuring such devolution.
   - Innovative approaches to ensure sufficient and sustainable resources being available for each function.
   - Increasing complexities associated with each of the 18 functions need capable manpower to respond to the needs and challenges.

2) Your answer should include the following points:

   - Municipal Administrative Service — taking care of Executive, Social Development and Staff Services;
   - Municipal Technical Service — responsible for Urban planning, Engineering, Transportation and e-Governance Services; and
   - Municipal Finance Service — handling Accounts, Revenue & Financial and Audit Services.

Check Your Progress 2

1) Your answer should include the following points:

   - Taxes on lands and buildings
   - Tax/ duty
   - Taxes on vehicles

- Taxes on animals and boats
- Taxes on professions, trades, callings and employments
- Taxes on advertisements other than advertisements published in newspapers
- Theatre tax or show tax
- Duty on transfer of immovable property
- Taxes on goods and passengers carried by roads or inland waterways.

2) Your answer should include the following points:

- Tax revenues include property tax, profession tax, entertainment tax, advertisement tax among others.
- Property tax remains major source of income for majority of the local bodies.
- Rent from municipal properties, user charges for water and sanitation, etc. are the major sources of non-tax receipts for the ULBs.

UNIT 8 RESOURCE MOBILISATION AND MANAGEMENT*

Structure

8.0 Objectives

8.1 Introduction

8.2 Urban Local Bodies: Need for resources

8.3 Urban Local Bodies: Sources of Revenue and Resource Mobilisation Avenues

8.4 Urban Local Bodies: Resource Mobilisation practices and financial innovation in India

8.5 State of Municipal Finance in India

8.6 Strengthening Resources of Urban Local Bodies: Options and suggested Municipal Finance Reforms

8.7 Conclusion

8.8 Glossary

8.9 References

8.10 Answers to Check Your Progress Exercises

8.0 OBJECTIVES

After studying this Unit, you should be able to:

- Explain the need of resources for Urban Local Government;
- Describe the different sources of resource mobilisation available to urban local bodies;
- Discuss resource mobilisation practices and financial innovations adopted in some of the Indian Urban Local Bodies to raise resources; and
- Examine the state of municipal finance in India; and
- Suggest the options and municipal finance reforms required to Strengthen the resources of Urban Local Bodies.

8.1 INTRODUCTION

As we all know, the world is urbanising rapidly and the pace of urbanisation is going to increase in years to come. In line with the global trend, the rising pace of urbanisation in India, where 377 million or 31 percent of population live in urban areas (as per 2011 Census) and that is 35 percent in 2021 , the need for housing and urban services has also been increasing manifold. In order for Urban Local Bodies to keep pace with this rate of urbanisation and provide residents the basic services including water, sewerage, drainage,

* Contributed by Dr. Akshaya Sen, Joint General Manager, HUDCO Ltd., New Delhi

roads, waste management, etc., the provision of municipal finance becomes one of the key aspects for sustainable development of cities and towns.

In fact, financing urban development is perhaps the most demanding of all the challenges that countries across the globe, including India, face in managing urbanisation. India, in particular, faces daunting challenges of urban infrastructure due to the widening gap between needs of urbanisation and resources available with Urban Local Bodies (ULBs) and infrastructure authorities. Though the urban sector contributes about two-third of Gross Domestic Product of India, the resources available to Urban Local Government are inadequate even to serve their present population. In this Unit, we will discuss why urban local bodies need resources; different sources of resource mobilisation available to ULBs in general and how Indian ULBs are raising resources including some of the key financial innovations adopted in some of the Indian ULBs. This Unit will also provide a glimpse of the state of municipal finance in India, and suggest options and municipal finance reforms required to strengthen the resources of ULB for effectively discharging the assigned functions.

8.2 URBAN LOCAL BODIES: NEED FOR RESOURCES

Municipal finances play a catalytic role in the development and growth of urban economy, as availability of adequate revenue results in better urban governance and management of the city. Local Governments need financial resources in order to finance various urban services and activities, which are assigned to them - both obligatory and discretionary functions. For effectively discharging all these functions, Urban Local Governments or ULBs need adequate and regular sources of revenue. However, the reality is that local revenue sources meet only a small part of local expenditure needs, primarily because of inadequate and/or unclear division of jurisdiction of taxes between different tiers of the government – central, state and local (vertical imbalance); and the tax base is unevenly distributed within cities (horizontal imbalance). While large cities may be able to generate substantial tax revenues, smaller, more remote and rural jurisdictions may have little scope for levying taxes. Further, the fiscal transfers from the Centre to States to ULBs are not adequate to carry out their mandated functions.

In case of India, the need for resource mobilisation by ULBs is all the more important in view of the huge investment requirements for urban infrastructure services estimated by the High-Powered Expert Committee (HPEC), set up by the Government of India. As per the HPEC (2011) Report, an investment of Rs. 39.2 trillion (2009–10 prices) will be needed to both eliminate the deficits and meet the requirements of the incremental population until 2031 for urban infrastructure services, covering the requirements for water supply, sewerage, storm-water drain, solid waste management, street lighting, urban roads, urban transport, traffic-support infrastructure, renewal and redevelopment including slums, and capacity building. The percapita expenditure requirements of the ULBs in India are suggested to have eight time jump as per McKinsey Report for the period of

2010-30. The requirements are phenomenally large and increasing in direct proportion to the scale and level of urbanisation. Thus, raising resources through strengthening and augmenting local revenue sources as well as borrowings assume much more significance.

8.3 URBAN LOCAL BODIES: SOURCES OF REVENUE AND RESOURCE MOBILISATION AVENUES

Most Urban Local Governments around the world have adopted a mix of instruments to finance their activities including urban infrastructure and services, which include local taxes such as property tax, user charges, central and state government capital grants, debt financing, land-based instruments, public-private partnerships, and emerging financial market instruments such as structured bonds and infrastructure investment funds. Borrowing has been a major instrument to finance lumpy infrastructure projects during the urban transition of developed countries. Table 8.1 provides various sources of revenue and resource mobilisation avenues of the Urban Local Bodies across the world with variations in nature, composition and scale of each source as per the local specifications. These sources are discussed briefly in the following sections.

i) **Local taxation**: Local taxes are the main source of revenue for the ULBs with the choice about tax rates, tax bases and tax assessment and collection decided by them. The common types of local taxes include: taxes on land and buildings (commonly called Property Tax); taxes on luxuries including those on entertainment, amusement, betting, and gambling; taxes on advertisement; taxes on non-motorised vehicles; tolls, taxes on professions, trades, employment; etc. In India, the ULBs levy around 25 different kinds of tax instruments. Of these, property tax is the most important individual revenue source for municipalities. Over the years, local governments are expanding the tax base using innovative methods such as application of Geographic Information System (GIS) to expand the property tax base as well as innovative valuation of property tax to increase revenues.

ii) **User Charges and Fees:** User charges are the charges for services provided by the ULB directly and exclusively to the payer. The charges are normally related to the cost of providing the service. User charges can be of two types: consumption related and benefit related. For urban services such as water supply, sewers, electricity, garbage disposal, public transit, and recreation – user charges are consumption related, levied by the Local Government based on costs of providing these urban services. These charges provide proper signals to consumers of the scarcity value of the services; and to providers about the demands that need to be met through service provision. A major benefit-related charge is the development charge or "betterment tax": a lump sum charge designed to recover the cost of infrastructure development from beneficiaries. A development charge may cover only a limited project, for example, construction of a metro corridor or it may cover the full development of a new area. Other sources of non-tax revenue of the ULBs are municipal fees for permits and licenses, sale and hire charges, lease amounts, etc. where the costs are normally limited to the cost of administration/enforcement.

Table 8.1: Revenue Sources of Municipal Corporations in India

Revenue Head/Category	Sources of Revenue
Tax revenue	Property Tax on land and/or buildings, Professional Tax, Entertainment Tax, Advertisement Tax, Tax on Animals, Vacant Land Tax, Taxes on Carriages and Carts, Tax on motorised and non-motorised vehicles, Tax/Stamp duty on the transfer/sale/ registration of immovable property, Local sales tax and/or tax on sale of local products, Tax on local businesses and services, Tax on tourism, hotels, restaurants.
Non-Tax revenue	User Charges, Municipal Fees for different activities such as building plan approval, licenses, permits, advertisement, Sale & Hire Charges, and Lease amounts.
Other receipts	Sundry receipts, Law charges costs recovered, Lapsed deposits, Fees, Fines & Forfeitures, Rent on Tools & Plants, Miscellaneous Sales *etc.*
Assigned (Shared) revenue	Entertainment Tax, Surcharge on Stamp duty, Profession Tax, and Motor Vehicles Tax.
Grants-in-aid	i) Plan Grants made available through planned transfers from the upper tier of Government under various projects, programmes and schemes. ii) Non-Plan Grants made available to compensate against the loss of income and some specific transfers.
Loans	Loans borrowed by the local authorities for capital works *etc.* – HUDCO, LIC, State and Central Governments, Banks, PPP and Municipal Bonds.

iii) **Assigned (shared) revenue:** Another important source of revenue for the Local Government is the shares of taxes (and other revenues) collected by the Central/State government and allocated (partly or wholly) to the Local Government, either based on their origin (where they were collected) or by formula. Some of the important revenue sharing taxes include entertainment tax, surcharge on stamp duty, profession tax, motor vehicles tax, etc. Shared tax revenue varies in terms of composition and nature across regions/states, also forms significant proportion of municipal resources.

iv) **Inter-governmental grants and transfers:** Apart from their own revenue sources, i.e., tax and non-tax revenue sources, the Local Government also depends upon grants-in-aid and transfers from the higher levels of government such as Central and State governments. Inter-governmental transfers and grants to Local Bodies are necessary to meet a number of objectives such as mismatch of functions and finance, correction of vertical and horizontal imbalances between tiers of government; internalisation of inter-governmental externalities and addressing inter-jurisdictional spill-overs of benefits and costs, encouragement of activities of national importance, establishment of an efficient and equitable tax system with centralisation of tax collection to exploit scale economies in administration and revenue sharing. Most of the ULBs receive financial support in the form of revenue grants from the State governments to meet current expenses. Similarly, capital grants are also provided for meeting project related expenditure. Most countries have developed a well-designed system of grants and transfers to the ULBs from the higher levels of government. They allocate some portion of inter-governmental transfers to municipalities on the basis of a formula to ensure objectivity, transparency and predictability of funds being made available to recipients. Fiscal capacity, fiscal needs and fiscal efforts are the key ingredients of such a formula.

v) **Borrowings through Debt financing from Financial Institutions and Banks:**The Urban Local Bodies resort to borrowings from various sources – financial institutions, commercial banks, municipal banks, government, donors, bonds, etc. as a key resource mobilisation strategy to finance large capital expenditure for undertaking infrastructure projects. When the benefits from infrastructure projects flow over a period of time, it may be both fair and efficient to finance such projects by borrowings. For debt financing of large capital projects, the local governments generally borrow from domestic financial institutions and development banks, accessing capital markets or soliciting private sector participation through contracts, leases and concessions.

vi) **Borrowing through accessing Capital Market:**For accessing capital market, municipal bonds are seen as a popular long-term resource mobilisation instrument for many urban local bodies across the world, particularly large urban local bodies like Municipal Corporations in India. A Municipal Bond is a debt obligation issued by a Local Government or entity on its behalf, with the undertaking to repay the bond principal with interest at a specified payment schedule. A typical model structure of Municipal Bond is given in figure 8.1. A key feature of Municipal Bonds is the tax-free status of their interest payments, which helped attract wealthy individual savers in addition to institutional investors. There may be several variants of Municipal Bonds developed using ingenious financial engineering. The two most common categories of Bonds are Revenue and General Obligation (GO) Bonds. Revenue

Bonds are serviced by the revenues of the particular investment, for example, toll roads or water utilities. On the other hand, GO bonds are serviced from the general revenues – taxes and other income – of the Municipality. Often, a portion of the general revenues of the ULB is "ring fenced" in a dedicated account to ensure the timely servicing of the Bonds, for example, through escrow mechanism. Because of their nature, Revenue Bonds typically finance "bankable" projects that have some charging mechanisms for cost recovery, while GO bonds may be used for investments that are not revenue generating.

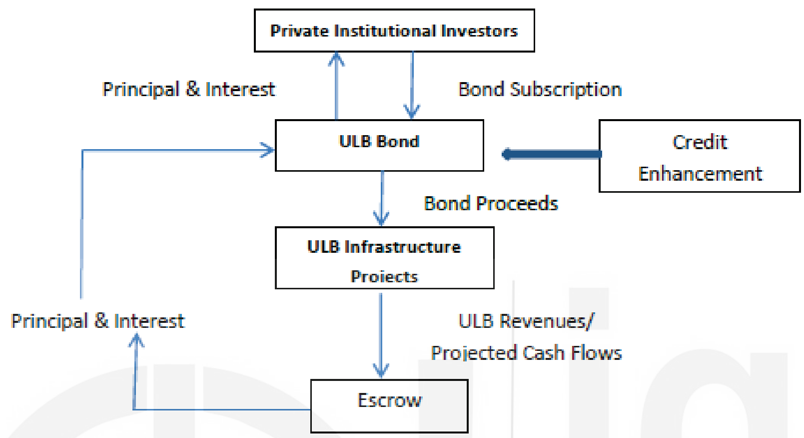

Figure 8.1: Municipal Bond Model Structure

Another variant of the Municipal Bond currently being explored by the small and medium ULBs is known as "Pooled Financing Bonds" (Figure 8.2) in which a number of small and medium Municipalities combine their funding requirements for different projects, so as to improve their credit worthiness, cost effectiveness and risk-sharing. Municipalities in the Indian states of Tamil Nadu and Karnataka have experienced floating such Bonds.

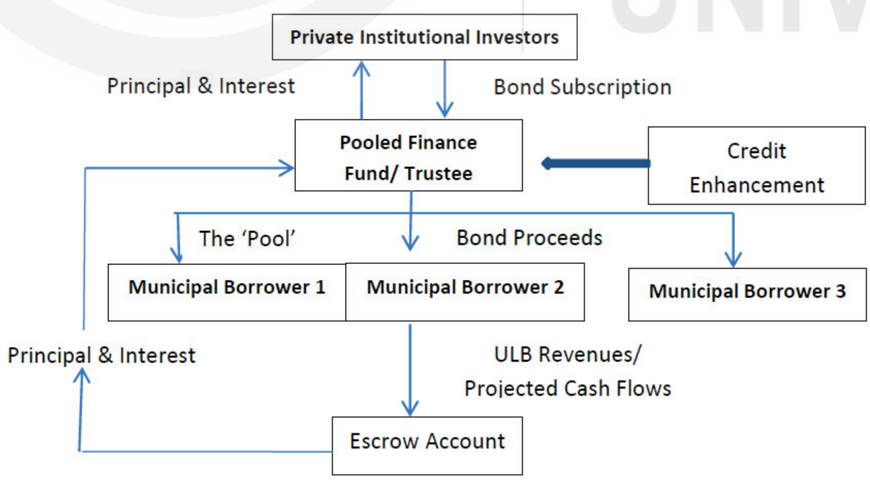

Figure 8.2: Pool Financing Bond Model Structure

vii) **Financing through Public-Private Partnerships:** Local governments are increasingly resorting to Public-Private Partnerships (PPPs) for financing range of municipal projects. The PPPs are defined as risk-sharing relationships between the public and private sectors, based on a shared aspiration to bring about a particular public policy outcome. The PPPs can be understood along a spectrum ranging from simple service contract awarded to the private operator, right up to joint ventures and full privatisations. Depending upon the nature and specifications of the contract, the private sector is roped in as the provider of services in addition to sharing of risk in terms of delivery (costs and benefits) and in some cases, also responsible for financing.

Check Your Progress 1

Note: i) Use the space given below for your answers.

ii)Check your answer with those given at the end of the Unit.

1) Why Urban Local Government needs resources?

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

2) What are the different sources of revenue and resource mobilisaton avenues available to ULBs?

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

……………………………………………………………………………

8.4 URBAN LOCAL BODIES: RESOURCE MOBILISATION PRACTICES AND FINANCIAL INNOVATION IN INDIA

Like other Local governments in the world, the revenue base of the ULBs in India can be broadly categorised into: (a) tax revenues, (b) non-tax revenues including user charges and fees, (c) assigned (shared) revenue, d) grants-in-aid, e) loans, and (f) other receipts. It may be mentioned that composition as well as relative importance of the revenue sources of the ULBs varies across the states. With octroi abolished in all cities in view of the new Goods and Services Tax (GST) regime, property tax remains the only major "own" tax revenue source with municipal authorities in India. However, property tax remains grossly under-exploited. Over the years, the municipal financing in India have seen a substantial evolution from a grant and soft loan-based infrastructure creation programme to increasing use of innovative and market-based mechanisms that bring in private capital for Municipal Bodies.

This section, brings together the resource mobilisation practices and some of the key financial innovations adopted by the ULBs in India.

i) **Tax Revenues**: Studies on municipal finance indicate that close to 25 different kinds of tax instruments are being levied by the Local Bodies in India, many of them are showing growing the irrelevance to the contemporary socio-economic realities and the changing economy of cities. Property taxes are the most important individual revenue source for municipalities in India, constituting around 62 percent of the total own revenues of all the Urban Local Bodies in India in 2012-13 (14^{th} Finance Commission, 2015). Property Tax (PT) is the mainstay of Municipal Finance in India. However, it is highly underutilised. The share of PT in India is only point 15 percent of GDP as againt the developing countries average of point 62 and global average of 1.04 (ICRIER:2019). Recently, initiatives in some Municipal Corporations have shown that revenues from property tax can be substantially increased with proper reforms of the tax system. Bruhat Bangalore Mahanagar Palike (BBMP), which is now known as Bruhat Bengaluru Mahanagar palike, for example, reformed its property tax by revising the area-based values, introducing a self-assessment system and enabling online payment of the tax with the result that revenue increased from Rs. 440 crore in 2007-08 to Rs. 1210 crore in 2011-12. Box 8.1 depicts the property tax reforms undertaken by the BBMP in Bangalore.

Box 8.1: Property Tax Reforms: BBMP

- The Bruhat Bangalore Mahanagar Palike (BBMP) launched the optional Self-Assessment Scheme (SAS) in 2000. The city was divided into six zones, A, B, C, D, E and F based on the guidance values notified by the Stamps and Registration Department of Karnataka Government.
- For each zone, rental rates per square foot were determined linking buildings to location, type of construction, built-up area, use and age.
- Tax was levied at 20% of Annual Rental Value (ARV) for residential use and 25% for non-residential use.
- A cess of 34% was levied, covering education cess, health cess, beggary cess and library cess.
- To facilitate political acceptability, a cap on the property tax increase was set at 2.5 times the existing liability.
- Due to the SAS, property tax collection in Bengaluru increased by 33 % during 2000-01.

Source: Vaidya, 2006

Presently, Unit Area Method of calculating property tax is being followed by some large ULBs for assessment of property tax. Similarly, Greater Hyderabad Municipal Corporation (GHMC) has undertaken property tax reforms with Self-assessment of Property Tax Scheme in 1999-2000, assigning unique Property Tax Identification Number (PTIN) to taxable properties, resulting in increased tax base as well as tax revenue for the GHMC. These need to be widely adapted. In this regard, Government of

India has issued a toolkit in September 2020 expecting that PT revenue will undergo a twofold increase during 2020 to 2024 and suggested reforms in the tax base (wider coverage and cross checking through ration cards, voter lists, gas connection etc. and GIS mapping), Revision of rates particularly upward fixation of Guiding Value for base, and streamlining collection system through automation, online collections etc.

ii) **Non-tax Revenues**: Non-tax revenues in India include user charges, municipal fees for different activities such as building plan approval, licenses, permits, advertisement, sale and hire charges, lease amounts, etc. At present, urban fees is not significant in India, with the proceeds from non-tax revenues from all Urban Local Bodies amounting to a mere 0.18 percent of GDP. As per the 14th Finance Commission, non-tax revenue constituted around 38 percent of the total own revenues of all the Urban Local Bodies in India in 2012-13. User charges as a percentage of own revenues of the ULBs have increased, but the third tier of government needs to be given more autonomy in deciding and fixing the charges, which are currently under the state control. Resource mobilisation efforts of Indore Municipal Corporation (Box 8.2) are worth mentioning for its efforts in increasing in non-tax revenue through reforms in user charges (e.g. water supply) in addition to the property tax reforms.

Box 8.2: Resource Mobilisation Efforts of Indore Municipal Corporation

In 1999-00, the Indore Municipal Corporation (IMC) embarked on a modernisation plan, developed with extensive citizen participation, to improve urban services and increase revenues to do so. In addition to Property Tax reforms through self-assessment of properties by taxpayers, and widening tax base, IMC brought in reforms in user charges for water. Indore had approximately 80,000 illegal water connections, and only 120,000 legal connections. The IMC launched a drive to identify legal/illegal water connections during the physical survey of properties. It compared its water charges and property database to identify residences that were not receiving or paying water bills, and calculated arrears owed. These measures increased revenue in water supply from Rs. 340 million in 1999-00 to Rs. 750 million in 2003-2004. Total revenue increased correspondingly from Rs. 101 million to Rs. 184 million.

Source: Vaidya, 2006

iii) **Inter-governmental grants and transfers:**In India, state governments are constitutionally required to regularly appoint the State Finance Commissions (SFCs) every five years to determine the measures needed to improve the financial position of the municipalities, including assignments and sharing of state taxes and grants and the grants-in-aid to be given to them from state funds. Since the 74th Constituent Amendment Act of 1992, the Central Finance Commission (CFC), which reports every 5 years, has also been obligated [as per article 280(3)(c)]to make recommendations on measures needed to augment state funds to supplement municipal resources as recommended by the respective SFC.

Fiscal transfers to the ULBs in India come from the state and the centre. Fiscal transfers from the central government sources accounted for 9.5 percent of the municipal revenues and transfers from the state government sources, 34.5 percent on an All-India basis in 2012-13. The pattern of fiscal transfers, however, varies drastically between states and cities.

iv) **Borrowing through Debt financing from Financial Institutions and Banks:** In India, with the permission from their respective states, the Urban Local Bodies have been borrowing from established Development Financial Institutions and non-banking financial companies such as Housing & Urban Development Corporation Ltd. (HUDCO), Life Insurance Corporation (LIC) and Infrastructure Development Finance Company (IDFC), for long-term credit needs for infrastructure projects, both at the national and sub-national/state levels. However, loans from banks and financial institutions are usually of shorter tenure – 5-7 year; and may require sovereign guarantee, which in most of the cases may not be available. Hence, larger ULBs are mobilising resources from the capital markets to mobilise private savings for urban infrastructure involving lengthier payback periods.

Box 8.3: Municipal Bonds in India

The Ahmadabad Municipal Corporation (AMC) was the first ULB to access the capital market in January 1998. It issued Rs. 1,000 million bonds to public. This was a remarkable achievement since it was the first Municipal Bond issued in India without a state guarantee and represented the first step toward a fully market-based system of Local Government finance. Several ULBS and utility organisations have issued Bonds thereafter and have so far mobilised over Rs. 12,240 million through taxable Bonds, tax-free Bonds and pooled financing. Ratings of Local Governments establish a transparent credit record, and a reference framework for current and future performance of local finances and debt management. It the last 12 years, all major rating agencies have provided ratings for municipal and municipal enterprise Bond offerings. More than 80 ULBS had received ratings. Several states have made it mandatory for the ULBs to undergo rating in case they want to borrow money from financial institutions or from capital market.

Source: ChetanVaidya and Hitesh Vaidya, 2010

v) **Direct borrowing from Capital Markets – Municipal Bonds, Pool financing, etc.:** As the resource requirements for Urban Local Bodies are high and the own resources through taxes and non-tax revenues are not adequate to meet the investment needs in urban areas, the ULBs are using innovative financing like direct borrowings from capital markets through issue of "Municipal Bonds" and "Pool Finance Development Funds" (PFDF). After the Credit Rating Information Services of India Limited (CRISIL) began rating the Municipal Corporations (MCs) in 1996, the groundwork necessary for the Municipal Bond Market was established. Ahmedabad MC was the first municipal entity to issue Rs. 1 billon Municipal Bond with the credit rating of A+ in 1998. This is followed by Municipal Bonds issued by some of the large Municipal Corporations like Bangalore, Indore, Ludhiana, Hyderabad, Nagpur, etc. (Box 8.3) amounting to Rs. 12. 24 billion (for 22 Municipal Bonds till 2010).

Though the Municipal Bond market has seen limited off take since its initiation in 1997, resource mobilisation through this route has again launched by some of the ULBs. Pune Municipal Corporation (PMC) launched India's largest Municipal Bonds Programme of Rs. 2264 Crore on 22nd June 2017 at Bombay Stock Exchange, Mumbai out of which Rs. 200 Crore has already been raised during the first tranche of its 5-year Bond programme. Similarly, the Greater Hyderabad Municipal Corporation (GHMC) has successfully raised Rs. 200 crore with a coupon rate of 8.90 percent through Municipal Bond issuance in February 2018. Hyderabad and Lucknow city governments have also issued Bonds in 2019 and 2020.

v) **Pooled Financing Bonds:** Pooled Financing Bonds are being thought off by the small and medium municipalities for raising resources from the capital markets. The government has enhanced the funding available under the Pooled Finance Development Fund (PFDF) to catalyse Municipal Bond market for the ULBs. Pooled Municipal Debt Obligation (PMDO) credit facility was also enhanced to Rs. 500 billion. Municipalities in the Indian states of Tamil Nadu and Karnataka have experienced floating such bonds to raise market-finance for infrastructure projects like water and sanitation. The first case of successful pooled financing in the developing world is the case of the Water and Sanitation Pooled Fund (WSPF) in the Indian state of Tamil Nadu in 2002 under which Rs. 304.1 million with a tenure of 15 years was mobilised from the Capital Market in December 2002. The Bond proceeds were lent back-to-back to the 13 ULBs in the pool at 9.2 percent per annum, resulting in substantial savings vs. their individual borrowing rate of 12 percent. This followed by a similar Fund called "Karnataka Water and Sanitation Pooled Fund" (KWSPF) in Karnataka was floated in 2006, which raised Rs. 1 billion from the Capital Market.

vi) **Public-Private Partnerships:** In India, resource mobilisation and financing of capital projects through the Public-Private Partnership (PPP) has been emerging as one of the key means of financing urban service delivery. A number of PPP options have emerged since the late 1990s in urban infrastructure projects: roads, sewerage, water supply and solid waste management. Some of the examples of good practices developed through PPP include: provision of 24X7 water supply in three cities of Karnataka (Belgaum, Gulbarga, Hubli-Dharwad), Tirupur as well as in Nagpur; sewerage project with citizen participation in Alandur; and solid waste management in Greater Mumbai. At the policy level, there has been a focused effort on creating national legal framework for PPPs as well as capacity building efforts at the national, state and local levels. A PPP cell has been set up in the Ministry of Finance which provides access to detailed model documents, guidelines, databases and toolkits for use by states and cities as they undertake PPP projects. Provisions of fiscal incentives such as Increased/ additional FAR/FSI/TDR; tax incentives; Single Window Clearance, etc. have been initiated in order to incentivize the private sector for financing the ULBs.

vii) **Land-based instruments:** Towards improving municipal finance, wide varieties of land-based instruments for financing urban infrastructure are currently in use in many Indian cities, which can be classified into three groups: monetary exactions (e.g., betterment charges, impact fees, Mass Rapid Transit-related Cesses in Bengaluru; and land-based Charges and fees in Andhra Pradesh and Telengana), land exactions (e.g., Town Planning Schemes of Gujarat), and monetisation of underutilised public land assets (e.g. land monetisation model of Mumbai by MMRDA to develop 553-acre site from marshland and industrial slums). Conversion charges, betterment charges, impact fees, and development charges are the most frequently used levies in India. The Greater Hyderabad Municipal Corporation (GHMC) has introduced a number of innovative instruments to collect land-related charges and fees through the town planning process. It has made effort to use urban land as a resource.

8.5 STATE OF MUNICIPAL FINANCE IN INDIA

With an aim to strengthen the third tier of governance, the 74th Constitutional Amendment Act (CAA) has mandated the devolution of funds, functions and functionaries to the ULBs in 1992, its implementation picked pace only after 2005. As per the Fourteenth Finance Commission, in 2012–13, municipal revenue constituted just over one per cent of GDP in India (Table 8.2), while municipal revenues in other emerging economies such as Brazil and South Africa are five percent and six percent of their GDP, respectively, indicating significant scope for the ULBs in India to grow and contribute.

As indicated in Table 8.2, share of revenues from own sources in total municipal revenues went down from 55.7 percent in 2007-08 to 51.6 percent in 2012-13, although own sources have increased 81 percent, from Rs. 275.01 billion in 2007–08 to Rs. 499.13 billion in 2012-13. The share of tax revenues decreased from 37.2 percent to 32 percent between 2007-08 and 2012-13, while the share of non-tax revenues increased from 18.5 percent to 19.7 percent between the same period. User charges as a percentage of own revenues of ULBs have increased, but the third tier of government needs to be given more autonomy in deciding and fixing the charges, which are currently under the state control. The share of transfers in total municipal revenues went up from 44.1 percent to 48.4 percent during the same period due to increased state devolutions/ grants-in-aid and finance commission transfers. Recent data suggests that the share of own sources has further declined from 56 to 44 percent during 2010 to 2018 (Economic Survey 2018)

Table 8.2: State of Municipal Finances of all States

	2007-08		2012-13	
Own Sources				
	Rs. (Billion)	Per-cent	Rs. (Billion)	Percent
Tax Revenue	183.66	37.20	309.12	32.00
Non -Tax Revenue	91.34	18.50	190.02	19.70
Sub Total	275.01	55.70	499.13	51.60
Transfers				
Government of India	35.15	7.10	53.87	5.60
Finance Commission	9.86	2.00	37.60	3.90
State Devolution and Assignments	93.42	18.00	185.37	19.20
State Grant-in-aid	66.53	13.50	148.09	15.30
Others	13.55	2.70	42.32	4.40
Sub total	218.51	44.10	467.27	48.40
(Percentage of GDP at market price)				
Total Revenue		1.08		1.03
Own Revenue		0.60		0.48
Total Expenditure		1.00		

Source: Fourteenth Central Finance Commission, 2015

In view of the inadequate municipal resources available to meet its revenue and capital expenditure requirements, the ULBs in India are resorting to borrowings, which are regulated by the Local Authorities Loan Act, 1914.

8.6 STRENGTHENING RESOURCES OF URBAN LOCAL BODIES: OPTIONS AND SUGGESTED MUNICIPAL FINANCE REFORMS

i) **Strengthening Own Tax Revenues:** Urban Local Bodies need to augment their existing own tax revenue sources through periodic revision in the tax rates; right assessment of the tax base; improving collection efficiency through innovative tax reform models; and management innovations within the existing revenue structures (GIS mapping, capital value method, Unit Area Method, on-line systems). There is also a need to minimise unnecessary exemptions on property taxes. Taxation powers of the ULBs should also be enhanced through amendments in the Municipal Acts, State/Central Acts.

ii) **Strengthening Non-tax Revenues:** Currently, user charges are very low leading to poor cost recovery of urban basic services. The ULBs should revise the user charges periodically to realistic levels e.g. covering at least O&M, revision of user charges linked to inflation. There is also a need to update inventory of assets through listing, classification along with valuation followed by asset management strategy.

iii) **Reforms in devolution from state /central governments:**Inter-governmental transfers should not build the culture of dependency in the local bodies. The underperforming ULBs should be punished in appropriate manner. Most countries allocate some portion of inter-governmental transfers to municipalities on the basis of a formula to ensure objectivity, transparency and predictability of funds being made available to recipients. In India, such a formula-based transfer is required.

iv) **Improving Municipal Finance**: Reforms to bridge the urban fiscal gap must address the issues of expenditure assignment, revenue assignment, finance-function matching and municipal management to raise revenues and cut costs. The policy environment must actively support the deployment of debt capital for public infrastructure creation. A Revenue Mobilisation Incentive Fund (RMIF) needs to be created to motivate the ULBs to prepare revenue mobilisation action plan to stimulate revenue potential from city economy, value added role of municipal services and sale, use, transfer of municipal assets.

v) **Financial Management Reforms**: In line with the national focus on municipal reforms, Financial Management System of some ULBs is undergoing appreciable change covering Double Entry Accounting System (DEAS), Normative and Performance linked Budgeting, etc. These reforms are at different levels of implementation and only a few ULBs are performing relatively better. Therefore, scaling up and sustainability of these reforms needs to be promoted in a wider context of the ULBs.

vi) **Unlocking Land Value:** Land monetisation is a useful source of finances for the ULBs. Proper inventory of assets and its regular updating through computer database of properties using of GIS will help in unlocking the land values. Land can be used as a resource for ULBs through various land based instruments such as Vacant Land Tax; Land Transfer Tax; Land Gains Tax; Purchasable/Transferable Development Right; Development charges; Betterment charges and Impact fee; Additional FSI; TDR etc.

Check Your Progress 2

Note: i) Use the space given below for your answers.

ii) Check your answers with those given at the end of the Unit.

1) Examine the resource mobilisation practices and financial innovation by Urban Local Bodies.

………………………………………………………………………………

………………………………………………………………………………

………………………………………………………………………………

………………………………………………………………………………

………………………………………………………………………………

2) Suggest the necessary methods to strengthen the resources of ULBs?

………………………………………………………………………………

………………………………………………………………………………

………………………………………………………………………………

………………………………………………………………………………

………………………………………………………………………………

8.7 CONCLUSION

In practice, Local governments around the world have adopted a mix of instruments to finance their urban services and infrastructure needs such as local taxes, user charges and non-tax revenue, land-based instruments, inter-governmental grants and transfers, and borrowings from domestic financial institutions, banks as well as accessing capital market. Over the years, the municipal financing in India have seen a substantial evolution from a grant and soft loan-based infrastructure creation programme to increasing use of innovative and market-based mechanisms such as municipal bonds, pool financing bonds, etc. that bring in private capital for municipal bodies. In the emerging context of rapid urbanisation and need for more resources by the Local governments for performing their assigned functions, it is imperative that municipal finance reforms are undertaken in the right earnest so as to enable the local bodies to stimulate, strengthen and augment their resource base as well as enhance their resource mobilisation power from the market.

8.8 GLOSSARY

Escrow Mechanism:It refers the use of a third party capable of holding assets on behalf of two parties who are involved in the process of completing a transaction. In this regard, asset could be money, funds, stocks etc. Thus, it can be stated that an escrow account is the third-party account that holds the asset until the conclusion of a specific time or until a particular condition has been fulfilled.

8.9 REFERENCES

Ahluwalia, I.J., Kanbur, R & Mohanty, P.K. (Eds.) (2014).*Urbanisation in India-Challenges, Opportunities and the Way Forward*. New Delhi, India: Sage Publications Ltd.

Alam, M. (ed.) (2010). *Municipal Infrastructure Financing – Innovative Practices from Developing Countries*. London: Commonwealth Secretariat Local Government Reforms Series.

Devas, N., Alam, M., Delay, S., Koranteng, R.O. & Venkatachalam, P. (2008). *Financing Local Government*. London: Commonwealth Secretariat Local Government Reforms Series.

Government of India, Economic Survey, 2018.

Government of India. (2011). *The High-Powered Expert Committee (HPEC) Report on Indian Urban Infrastructure and Services*. Retrieved from https://icrier.org/pdf/FinalReport-hpec.pdf

Government of India. (September,2020) Toolkit on Property Taxes.

Government of India. (2015). *Report of the Fourteenth Finance Commission, India Public Finance Statistics*. New Delhi, India: Ministry of Finance.

Government of India. (2016). *India Habitat III National Report 2016*. New Delhi, India: Ministry of Housing and Urban Poverty Alleviation.

Ahluwalia, I. J., Mohanty, P.K., Mathur, O, Roy, D., Khare, A & Mangla, S. (March 2019) ICRIER, *State of Municipal Finances in India: A study proposed the Fifteenth Finance Commission* Retrieved fromhttps://fincomindia.nic.in/writereaddata/html_en_files/fincom15/StudyReports/State%20of%20Municipal%20Finances%20in%20India.pdf

Mckinsey (April 2010). *India's urban Awakening: Building inclusive cities sustaining economic growths*. Retrieved from https://www.mckinsey.com/featured-insights/urbanization/urban-awakening-in-india

Pandey, K. K. (2012). *Stimulating Revenue base of Urban Local Bodies.*New Delhi, India: Indian Institute of Public Administration.

Vaidya, C. & Vaidya, H. (2010). Market-Based Financing of Urban Infrastructure in India. In S. Kochar and M. Ramachandran (Ed.), *Building from the Bottom*. New Delhi, India: Academic Foundation.

Vaidya, C. (2006). *Successful Municipal Resource Mobilization in Indore, in India Infrastructure Report 2006*. New Delhi, India: 3-I Network.

8.10 ANSWEWRS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) Your answer should include the following points:
   - Refer Section 8.2
2) Your answer should include the following points:
   - Refer Section 8.3

Check Your Progress 2

1) Your answer should include the following points:
   - Refer Section 8.4
2) Your answer should include the following points:
   - Refer Section 8.6