Urban Sector Reform Agenda: Financing Civic Services and Development

by

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April 2005

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1. India's Urbanisation Scenario

1.1 According to the Census 2001, out of total population of 1028.6 millions in India about 286 millions live in urban areas. Thus, around 28 out of every 100 persons in the country reside in cities and towns. The percentage of people living in urban areas in the country increased from 11 in 1901 to 28 in 2001. Table 1 provides data on the number of urban agglomerations/towns, total population, urban population and urban population as a percentage of total population for these units in India for various census years from 1901 to 2001.

Table 1
India: Number and Population (in Million) of Urban Agglomerations (UAs) and Towns (1901-2001)

Census Year	Number of UAs/Towns	Total Population	Urban Population	Urban Population as % of Total Population
1901	1,830	238,396,327	25,851,873	10.8
1911	1,815	252,093,390	25,941,633	10.3
1921	1,944	251,321,213	28,086,167	11.2
1931	2,066	278,977,238	33,455,989	12.0
1941	2,253	318,660,580	44,153,297	13.9
1951	2,822	361,088,090	62,443,934	17.3
1961	2,334	439,234,771	78,936,603	18.0
1971	2,567	548,159,652	109,113,977	19.9
1981	3,347	683,329,097	159,462,547	23.3
1991	3,769	846,387,888	217,551,812	25.7
2001	4,378	1,028,610,328	286,119,689	27.8

Note: 1. Urban Agglomerations, which constitute a number of towns and their outgrowths, have been treated as one unit.

2. The total population and urban population of India for the year 2001 includes estimated population of those areas of Gujarat and Himachal Pradesh where census could not be conducted due to natural calamities.

3. The total population and urban population of India for the year 1991 includes interpolated population of Jammu & Kashmir where census could not be conducted.

4. The total population and urban population of India for the year 1981 includes interpolated population of Assam where census could not be conducted.

Source: Census of India 2001

1.2 Notwithstanding, the difference in definitions of constituents of urban areas in various countries, the degree of urbanisation in India is amongst the lowest in the world. As per United Nations estimates, 47 per cent of total population of the world lived in urban areas in 2000. The percentage of urban population in Asia was 36.7 while that for Europe, South America and North America was 74.8, 79.8 and 77.2 respectively. With less than 28 percent of the total population living in cities and towns, India is less urbanized compared to many countries. The pace of urbanisation in India has also been slower as compared to other countries. United Nations estimates show that while the degree of urbanisation in the world increased from 30 per cent in 1950 to 47 per cent in 2000, that for India went up from 17.3 in 1951 to 27.8 in 2001. China and Indonesia, which had lower levels of urbanisation in 1950, have now overtaken India with the percentage of urban population being 32.1 and 40.9 respectively.

1.3 Urban growth rate in India has been relatively low compared to many developing countries. The decadal growth rate of urban population in India increased at a fast pace from 1921-1931 until 1951. Subsequently it registered a sharp decline during 1951-1961. This drop was largely due to declassification of a very large number of towns during 1951-1961. The decades 1961-1971 and 1971-1981 witnessed significant improvements in urban growth rate which thereafter steadily dropped to the present level of about 31.2 per cent for decadal growth and 2.7 per cent for annual average exponential growth. As against the average annual growth rate of urban population of 3.27 per cent during 1961-71 and 3.86 per cent during 1971-81, the urban population growth rate was 3.13 per cent for 1981-91 and 3.12 per cent for 1991-2001. Although the rural population growth rate has been fluctuating from the first decade of the previous century, it fluctuated within a small band during 1951-61 and 1991-2001 (see Table 2).

Table 2
Growth in Population of Urban Agglomerations/Towns: 1901-2001

Census Decade	Percentage Decadal Growth in Population of UAs/Towns			Average Annual Exponential Growth in Population of UAs/Towns		
	Total	Rural	Urban	Total	Rural	Urban
1901-11	5.7	6.4	0.3	0.6	0.6	0.0
1911-21	-0.3	-1.3	8.3	0.0	-0.1	0.8
1921-31	11.0	10.0	19.1	1.0	1.0	1.7
1931-41	14.2	11.8	32.0	1.3	1.1	2.8
1941-51	13.3	8.8	41.4	1.2	0.8	3.5
1951-61	21.6	20.6	26.4	2.0	1.9	2.3
1961-71	24.8	21.9	38.2	2.2	2.0	3.2
1971-81	24.7	19.3	46.1	2.2	1.8	3.8
1981-91	23.9	20.0	36.4	2.1	1.8	3.1
1991-2001	21.3	17.9	31.2	1.9	1.7	2.7

Source: Census of India 2001

1.4 The Census of India delineated as many as 5161 towns in 2001, which was 472 more than the number at the 1991 Census (4689). The number of towns at the 1981 Census was 4609. Out of the total 5161 towns in 2001, 3800 are statutory towns and 1361 are census towns. The number of statutory towns and census towns in 1991 was 2987 and 1702 respectively. The number of Urban Agglomerations (UAs) in the country increased from 381 at the 1991Census to 384 at the 2001 Census. The corresponding number in 1981 was 276. If an urban agglomeration is counted as one urban unit then the number of Urban Agglomerations/Towns is 4378 as compared to 3768 in 1991.

1.5 The Indian urbanisation scenario is characterised by two significant features. First, there has been a massive growth in the absolute number of people living in urban areas. During 1951-2001 the country's urban population increased from 62.4 million in 1951 to 286.1 million in 2001. Second, there has been an increasing concentration of urban population in the Class I towns or 'cities' (with 100,000 or more). In 1991, about two-thirds of the urban population lived in 300 Class I UAs/Towns, which constituted less than 8 per cent of the total of 3,768 urban agglomerations in the country. While the census figures are not yet available for various size classes of towns in 2001, data on metropolitan population reveal that 32.5 per cent of the urban population lived in metropolitan urban agglomeration/towns in 1991 and by 2001 the figure went up to 38.6 per cent. Table 3 shows the distribution of urban population by size class of urban agglomeration/town based on the available data. Table 4 shows the trends in the growth of population of metropolitan urban agglomerations/towns from 1901 to 2001.

Table 3
Growth of Various Classes of Towns and Percentage of Urban Population to Total Population: 1961-2001

Class of Town	**No. of Towns**					**Percentage of Urban Population to Total Population (%)**				
	1961	**1971**	**1981**	**1991**	**2001**	**1961**	**1971**	**1981**	**1991**	**2001**
> 100,000	113	148	216	300	393	9.22	11.28	14.04	16.44	-
50,000 to 99,999	138	183	270	345	401	1.97	2.20	2.66	2.79	-
20,000 to 49,999	484	582	739	947	1151	2.99	3.12	3.11	3.42	-
10,000 to 19,999	748	874	1048	1167	1344	2.26	2.10	2.13	2.02	-
5,000 to 9,999	761	678	742	740	888	1.20	0.88	0.79	0.67	-
Below 5,000	218	178	230	197	191	0.14	0.09	0.11	007	-
Unclassified					10	-	-	-	-	-
All classes	2462	2643	3245	3696	4378*	17.98	19.92	23.39	25.71	27.80

* includes 10 unclassified towns

Source: Office of the Registrar General, India.

1.6 Calcutta was the only metropolitan city in the country in 1901. The number of metropolitan cities increased to 5 in 1951, 12 in 1981, 23 in 1991 and 35 in 2001. The 35 million-plus cities together had a population of about 108 million at the 2001 Census, accounting for about 39 per cent of urban population of the country. Table 4 shows a steady growth in the number and percentage of urban population living in million-plus cities from

1931 onwards. Appendix 1 provides data on growth in population of the urban agglomerations/towns delineated as ‘metropolitan’ at the 2001Census

Table 4
Number and Percentage of Urban Population in Million-plus Cities in India 1901-2001

Census Year	Number	Population (in million)	Population per Million Plus City (in million)	% to Urban Population
1901	1	1.51	1.51	5.84
1911	2	2.76	1.38	10.65
1921	2	3.13	1.56	11.14
1931	2	3.41	1.70	10.18
1941	2	5.31	2.65	12.23
1951	5	11.75	2.35	18.81
1961	7	18.10	2.58	22.93
1971	9	27.83	3.09	25.51
1981	12	42.12	3.51	26.41
1991	23	70.66	3.07	32.54
2001	35	107.88	3.08	38.60

Source: Census of India 2001

1.7 The trends of urbanisation in India in recent decades indicate the following key features: (i) continued concentration of urban population in large cities and existing city agglomerations; (ii) slowing down of urbanisation during 1981-1991 and 1991-2001 as compared to 1971-1981 and 1961-1971; and (iii) large variations in the spatial patterns of urbanisation across states and cities. The pattern of population concentration in large cities reflects the spatial polarisation of employment opportunities. This phenomenon has led to a tremendous pressure on civic infrastructure systems: water supply, sewerage and drainage, solid waste management, parks and open spaces, transport, etc. It has also led to deterioration in the quality of city environments. In several cities, the problems of traffic congestion, pollution, poverty, slums, crime, and social unrest are assuming alarming proportions. However, there is also another side of population concentration in cities. Large cities are the engines of economic growth and generators of resources for national economic development.

2. Cities & Economic Development

2.1 Research in urban economics suggests that cities have played a key role in the development of national economies of the developed world during their days of fast urbanisation. The National Commission on Urbanisation Report 1988 stressed the role of Indian cities as reservoirs of capital and skills, centres of knowledge and innovation, sources of service sector employment, generators of public financial resources for development and hopes of millions of rural migrants. It is estimated that Urban India contributes to more than 60 per cent of the country’s Gross Domestic Product (GDP). Within Urban India, it is large cities that generate the bulk of the GDP. While city or district level estimates of GDP and resource mobilization are not readily available, it is well-established that cities contribute significantly to the exchequers of State Governments and Government of India. For example, the share of two districts containing Hyderabad city and 10 surrounding Municipalities in Andhra Pradesh, namely Hyderabad and Ranga Reddy Districts, had only 9.5 per cent share in the population of the State comprising 23 districts in 2001. However, the percentage shares of these two districts in the total collection of key state taxes: Commercial Tax, Excise, Stamp Duty and Registration and Motor Vehicles Tax were many times more than their demographic shares as illustrated in Tables 5-9.

Table 5
Collection in Key State Taxes 2001-02:
Importance of Hyderabad and Ranga Reddy Districts

Name of District	Population as per 2001 Census	Commercial Taxes	Prohibition and Excise Taxes	Registration and Stamps Revenues	Transport and Motor Vehicles-related Revenues
	(Persons)	Figures for 2001-02 in Rs. Crores			
Hyderabad	3686460	5140.57	657.45	180.57	32.93
% Share in State Total	4.87%	67.44%	39.80%	18.48%	6.21%
Ranga Reddy	3506670	412.59	383.78	172.81	114.47
% Share in State Total	4.63%	5.41%	23.23%	17.69%	21.59%
Hyderabad and Ranga Reddy Combined	7193130	5553.16	1041	353.38	147.40
% Share in State Total	9.50%	72.85%	63.03%	36.18%	27.80%
Total Collection for State	75727541	7622.60	1651.90	976.86	530.20

Source: Centre for Good Governance (compiled from Census of India, 2001, Series 29, Andhra Pradesh, and data from Finance Department, Government of Andhra Pradesh)

Table 6
Commercial Taxes Collection: 1997-98 to 2001-02
Hyderabad and Ranga Reddy Districts vs. Andhra Pradesh

(Rs. Crores)

Name of District	1997-98	1998-99	1999-00	2000-01	2001-02
Hyderabad	2369.27	3249.25	3892.68	4758.22	5140.57
% Share in State Total	52.78%	63.23%	64.51%	66.86%	67.44%
Ranga Reddy	250.95	282.93	321.65	369.02	412.59
% Share in State Total	5.59%	5.51%	5.33%	5.18%	5.41%

Name of District	1997-98	1998-99	1999-00	2000-01	2001-02
Hyderabad and Ranga Reddy Combined	2620.22	3532.18	4214.33	5127.24	5553.16
% Share in State Total	58.37%	68.73%	69.84%	72.04%	72.85%
Total Collection for State	4488.84	5138.96	6034.65	7117.07	7622.60

Source: Centre for Good Governance (compiled from Census of India, 2001, Series 29, Andhra Pradesh, and data from Finance Department, Govt. of Andhra Pradesh)

Table 7
Prohibition & Excise Taxes Collection: 1997-98 to 2001-02
Hyderabad and Ranga Reddy Districts vs. Andhra Pradesh

(Rs. Crores)

Name of District	1997 - 98	1998 - 99	1999 - 00	2000 – 01	2001-02
Hyderabad	185.12	216.31	306.60	366.76	657.45
% Share in State Total	20.86%	23.41%	29.53%	29.51%	39.80%
Ranga Reddy	288.22	278.33	308.10	339.69	383.78
% Share in State Total	32.48%	30.12%	29.67%	27.33%	23.23%
Hyderabad & Ranga Reddy Combined	473	495	615	706	1041
% Share in State Total	53.34%	53.53%	59.20%	56.84%	63.03%
Total Collection for State	887.46	924.01	1038.41	1242.96	1651.90

Source: Centre for Good Governance (compiled from Census of India, 2001, Series 29, Andhra Pradesh, and data from Finance Department, Govt. of Andhra Pradesh)

Table 8
Revenue Receipts from Registration and Stamps, 1997-98 to 2001-02
Hyderabad and Ranga Reddy Districts vs. Andhra Pradesh

(Rs. Crores)

Name of District	1997-98	1998-99	1999-00	2000-01	2001-02
Hyderabad	91.76	107.58	123.66	150.70	180.57
% Share in State Total	16.36%	17.14%	17.12%	17.49%	18.48%
Ranga Reddy	91.87	105.62	128.27	154.86	172.81
% Share in State Total	16.38%	16.82%	17.76%	17.97%	17.69%

Hyderabad & Ranga Reddy Combined	183.63	213.20	251.93	305.56	353.38
% Share in State Total	32.75%	33.96%	34.88%	35.45%	36.18%
Total Collection for State	560.73	627.80	722.30	861.88	976.86

Source: Centre for Good Governance (compiled from Census of India, 2001, Series 29, Andhra Pradesh, and data from Finance Department, Govt. of Andhra Pradesh)

Table 9
Revenue Receipts from Transport and Motor Vehicles: 1997-98 to 2001-02
Hyderabad and Ranga Reddy Districts vs. Andhra Pradesh

(Rs. Crores)

Name of District	1997-98	1998-99	1999-00	2000-01	2001-02
Hyderabad	13.29	15.77	21.73	26.57	32.93
% Share in State Total	4.09%	4.55%	5.36%	6.04%	6.21%
Ranga Reddy	74.37	77.12	91.58	97.83	114.47
% Share in State Total	22.90%	22.25%	22.57%	22.23%	21.59%
Hyderabad & Ranga Reddy Combined	87.66	92.89	113.31	124.40	147.40
% Share in State Total	27.00%	26.80%	27.93%	28.27%	27.80%
Total Collection for State	324.70	346.58	405.69	440.05	530.20

Source: Centre for Good Governance (compiled from Census of India, 2001, Series 29, Andhra Pradesh, and data from Finance Department, Govt. of Andhra Pradesh)

2.2 It is generally agreed that the proximity of firms, individuals and institutions, made possible by urbanisation, gives rise to economies of scale, scope and agglomeration. Agglomeration economies play an important role in reducing the costs of firms as they enter the manufacturing and services worlds. Urban economists distinguish between two types of agglomeration economies: localisation and urbanisation. Localisation economies arise from the co-location of firms in the same industry or local concentration of a particular activity. They are external to firms but internal to the industries concerned. Urbanisation economies occur from the increased scale of the entire urban economy. They are external to both firms and industries.

2.3 Localisation economies in urban areas result from the backward and forward linkages between economic activities. When the scale of an activity expands, the production of many intermediate services: financial, legal, consultancy, repairs and parts, advertising, etc., which feed on such activity, become profitable. Activities like banking and insurance are known for economies of scale. One obvious advantage of agglomeration is the reduction in transportation and communication costs due to geographical proximity. There are many other important economies associated with urbanisation. For example, the concentration of workers with a variety of special skills may lead to labour market economies to firms through a reduction in recruitment and training costs. Similarly, the costs of collection and dissemination of information can go down significantly when different types of people work and live together. Pooled availability of capital, skill and knowledge, ease of contact and informational spillovers between firms, institutions and individuals make cities the centres of technological innovation and diffusion.

2.4 Urbanisation economies result due to the spatial concentration of population leading to larger, nearer and more diverse markets, enabling greater division of labour. These economies occur to all firms located in an urban area and not limited to any particular group. A large concentration of firms and individuals results in the reduction of transaction costs, benefits of face-to-face contact, sharing of risks and access to wider choices. Larger urban areas provide better matching of skills to jobs and reduce job search costs. The provision of civic infrastructure and services: water supply, sewerage, solid waste management, transport etc. involves economies of scale and these facilities become financially viable only if the tax-sharing population exceeds a certain threshold. Cities offer returns to scale, scope, agglomeration and sharing.

3. Some Urban Policy Issues

3.1 The discussions in the previous section suggest that urban policies cannot be viewed in isolation from broader economic and social policies for national development. The latter policies lead to unintended spatial consequences which may sometimes be more profound than those actually intended. Much of urban policy, as Brian Berry observes, is actually "unconscious, partial, uncoordinated and negative. It is unconscious in the sense that those who effect it are largely unaware of its proportions and features. It is partial in the sense that a few of the points at which governments might act to manage urbanisation and affect its course are in fact utilised. It is uncoordinated in that national planning tends to be economic and urban planning tends to be physical, and the disjunction often produces competing policies. It is negative in that the ideological perspective of the planners leads them to try to divert, retard or stop urban growth, and in particular to inhibit the expansion of metropolitan and primate cities" [quoted in Mohan (1996)]. This general statement almost entirely applies to India.

3.2 One of the main reasons why national policy makers living in large cities tend to be averse to the growth of these cities is the implicit assumption that there is ‘excessive' migration from rural areas. However, the question as to from whose point of view migration is judged ‘excessive' is seldom analysed meaningfully. The value judgement whether migration is ‘too much’ or ‘too little' ought to be primarily based on an analysis of who gains and who loses from migration. Evidence indicates that the rural-urban migrants eventually consider themselves better off in their new locations. Further, considering the diminishing returns to agriculture due to overcrowding and the observed trends in urban-rural remittances, it is likely that the non-migrants remaining in villages benefit from migration of relatives. On the urban side, the capitalists gain due to the influx of cheap unskilled labour from rural areas to complement the factors of production in capital- and skill-rich cities. Migration is an exercise of free choice and in essence, it should be beneficial to the economy as a whole.

3.3 It is worth noting that in 1961 Rural India contained 82 per cent of the total population and the contribution of agriculture to GDP was 46 per cent. The figures for 1991 stood at 74 per cent and 28 per cent respectively. In 2001, agriculture contributed to less than 25 per cent of GDP in India while engaging 72 per cent of population. Judging by international experiences (see Tables 10 and 11), employment is bound to shift from agriculture to manufacturing and service sectors as the inevitable structural transformation of the economy takes place. Apparently, the inadequate infrastructure support for the creation of secondary and tertiary jobs has led to a delay in the release of labour force from rural areas to cities in India in spite of the overcrowding in agriculture.

Table 10
Gross Domestic Product by Economic Activity at Constant: 1993-94 Prices: Percentage Share

(%)

	Economic Activity	1950-51	1960-61	1970-71	1980-81	1990-91	2000-01
1	**Agriculture, Forestry and Fishing**	**57.71%**	**53.01%**	**46.35%**	**39.71%**	**32.20%**	**24.62%**
	Agriculture	50.16%	47.26%	40.96%	35.76%	29.50%	22.26%
	Forestry and Logging	6.73%	4.71%	4.42%	2.97%	1.70%	1.18%
	Fishing	0.89%	1.03%	1.01%	0.99%	1.00%	1.18%
2	**Mining and Quarrying**	**1.48%**	**1.74%**	**1.78%**	**2.11%**	**2.73%**	**2.39%**
3	**Manufacturing**	**8.89%**	**10.90%**	**12.62%**	**13.82%**	**16.64%**	**15.85%**
	Registered	4.36%	5.88%	7.57%	8.07%	10.52%	10.32%
	Unregistered	4.51%	5.00%	5.06%	5.75%	6.12%	5.53%
4	**Electricity, Gas & Water Supply**	**0.33%**	**0.59%**	**1.18%**	**1.69%**	**2.34%**	**2.26%**
5	**Construction**	**4.07%**	**5.12%**	**6.11%**	**6.08%**	**5.52%**	**6.11%**
6	**Trade, Hotels and Restaurants**	**8.64%**	**9.83%**	**10.91%**	**12.19%**	**12.54%**	**14.27%**
	Trade	8.20%	9.25%	10.29%	11.51%	11.81%	13.26%
	Hotels and Restaurants	0.48%	0.54%	0.60%	0.68%	0.73%	1.01%
7	**Transport, Storage & Communication**	**3.31%**	**3.91%**	**4.64%**	**6.22%**	**6.19%**	**7.40%**
	Railways	1.29%	1.38%	1.45%	1.48%	1.35%	0.86%
	Transport by Other Means	1.64%	2.02%	2.49%	3.67%	3.75%	4.92%
	Storage	0.08%	0.07%	0.06%	0.11%	0.09%	0.07%
	Communication	0.39%	0.50%	0.70%	0.96%	1.00%	1.55%
8	**Financing, Insurance, Real Estate and Business Services**	**6.68%**	**6.10%**	**5.94%**	**6.52%**	**9.67%**	**12.55%**
	Banking and Insurance	0.95%	1.28%	1.67%	2.31%	4.16%	6.23%
	Real Estate, Ownership of Dwellings and Business Services	5.52%	4.68%	4.21%	4.21%	5.51%	6.33%
9	**Community, Social and Personal Services**	**9.41%**	**9.17%**	**10.69%**	**11.65%**	**12.18%**	**14.56%**
	Public Administration and Defence	2.55%	2.86%	4.25%	5.30%	5.73%	6.50%
	Other Services	6.84%	6.30%	6.43%	6.36%	6.45%	8.06%

Source: Compiled from National Accounts Statistics 2004, Central Statistical Organisation, Government of India, Ministry of Statistics and Programme Implementation

Table 11
Sectoral Contributions in
Selected OECD and Non-OECD Countries, 1995

	Contribution to Civilian Employment (%)			Contribution to GDP (%)		
OECD Countries	Agri-culture	Industry	Service	Agri-culture	Industry	Service
Australia	5.1	23.5	71.4	2.9	27.5	69.5
Austria	7.2	33.2	59.6	2.2	34.3	63.5
Belgium	2.6	27.7	69.7	1.3	28.5	70.2
Canada	4.1	22.6	73.3	2.1	25.7	72.1
Denmark	5.1	26.8	68.1	3.3	23.9	72.8
Finland	8.3	26.8	64.9	3.7	31.4	64.9
France	4.9	26.7	68.4	2.4	26.5	71.1
Germany	3.3	37.6	59.1	1.1	30.9	68.1
Italy	7.7	32.1	60.2	2.9	31.6	65.5
Japan	5.8	34.0	60.2	2.1	38.2	59.6
Korea	12.5	33.2	54.3	6.6	43.6	49,8
Netherlands	4.0	23.0	73.0	3.4	26.9	69.7
New Zealand	10.4	24.9	64.6	8.7	25.5	65.8
Norway	5.3	23.4	71.3	2.4	30.1	67.5
Spain	9.8	30.1	60.2	3.5	32.7	63.8
Sweden	3.4	25.0	71.6	2.0	27.5	70.5
Switzerland	4.0	28.8	67.3	3.0	33.5	63.5
United Kingdom	2.1	27.7	70.2	1.7	27.1	71.1
United States	2.9	24.0	73.1	1.7	26.1	72.1
Non-OECD Countries	Agri-culture	Industry	Service	Agri-culture	Industry	Service
Bangla Desh	65.0	16.0	19.0	33.8	20.2	46.0
India	64.0	16.0	20.0	27.8	30.7	41.5
Indonesia	54.9	11.1	31.1	16.1	41.9	42.0
Malaysia	18.0	35.6	46.3	13.5	47.4	39.1
Philippines	44.7	15.8	39.5	21.5	35.5	43.0
Thailand	41.6	23.7	34.7	10.8	42.4	46.8
China	72.0	15.0	13.0	18.9	53.0	28.1

Sources: OECD in Figures : Statistics on the Member Countries, OECD, Paris, 1997.
Economic and Social Survey of Asia and the Pacific, United Nations, New York, 1997.

3.4 Tables 10 and 11 suggest that as the structural transformation of the Indian Economy matures into a modern service sector-dominated developed country, urbanisation is bound to get a push. First, the positive correlation between income and migration is well-known in the research literature on rural-urban migration. It is most likely that as rural areas develop, they would eventually release population to cities. Second, the agricultural sector still employs about seventy per cent of the country's labour force, although its share in the Gross Domestic Product is about twenty-five per cent. On the contrary, in countries like USA and UK only about 2 per cent of the population is engaged in agriculture. The process of rural-urban migration and in situ transformation of rural areas into towns and cities cannot be stopped and any attempt to control migration is bound to fail. Experiences of some developing countries reveal that policies to check migration to cities are enormously costly and difficult to administer. Further, globalisation, information technology revolution, economic reforms and liberalisation are bound to give a push to urbanisation as cities are the preferred destinations of foreign direct investment and business process outsourcing. Thus, instead of concentrating energy and resources on impractical and sub-optimal policies, it would perhaps be prudent to work out and pursue strategies to promote healthy and orderly urban growth. The agglomeration of economic activities and people, i.e. urbanisation, can be visualised as a positive force in economic development. It should be explicitly recognised that urbanisation is a natural consequence of economic development and cities contribute far more to national economic growth than their share in total population. They contribute significantly to the country's national income and exchequer.

3.5 The economies of agglomeration offered by cities are, however, not without limits. The disadvantages of agglomeration - known as congestion diseconomies - include overcrowding, shortage and high cost of housing, traffic congestion, environmental pollution, deterioration in civic services, poverty, crime, social unrest, etc. Appropriate polices are required to minimise and effectively manage these congestion diseconomies. These would include planned spatial development, regulation and management of urban growth, deconcentration and decongestion programmes including provision of urban amenities in rural areas, slum improvement and upgradation, family planning to reduce natural increase, and provision of high quality and cost-effective municipal services. The key is the sound management of cities and towns and their adjoining areas to deal with the positive and negative forces of urbanisation for development. Unless urban areas develop and create enough job opportunities, they will not be in a position to absorb the surplus and disguisedly employed labour of rural areas.

3.6 Some experts are of the view that the slowdown in urban growth in the recent decades provides a disturbing signal which reflects the failure of governments to cope with the demands of industrialisation and urbanisation in adequate fashion. The fact that our urban economies have not been able to support job creation in manufacturing and tertiary sector to absorb rural migrants is considered as a cause of grave concern. Mohan (1996) surmises that inadequate infrastructure investments might have inhibited industrial and tertiary sector growth in cities leading to too few jobs being generated in the non-agricultural economy, particularly in manufacturing during 1981-91. The lack of job opportunities, compounded by worsening of the quality of life in urban areas, might have discouraged the prospective rural migrants to search for jobs in cities. Mohan (1996) further observes: "The deceleration of urban growth could as well be contributing to greater immiserisation rather than caused by greater rural prosperity" [Mohan (1996)]. These observations apply to the trends in urbanisation during 1991-2001 and call for policies to address the serious infrastructure bottlenecks in our cities and towns – for both backlog and growth needs and to exploit the full potential of cities and towns to contribute to national economic development.

3.7 The discussions in the foregoing paragraphs suggest that the main planks of urban policy should be the exploitation of agglomeration economies, augmentation and sustaining of the high productivity of cities, minimisation of congestion diseconomies and effective management of the problems of urban growth, environment and poverty which accompany urbanisation. The problem of urbanisation can thus be viewed as one of management. In this regard, the role of integrated regional and urban planning, strategy to facilitate housing and infrastructure development, participatory municipal management, environmental protection and urban poverty alleviation are of critical importance. Unless urban development and environment are absolutely incompatible, urban policy should aim at coping with the growth of cities and towns rather than avoiding or thwarting this growth. The forces of agglomeration do contain hidden resources to meet the demands of economic growth and population concentration. Urbanisation poses both challenges and opportunities. Urban policy is needed to convert these challenges into opportunities. Provision of infrastructure base for city economic growth and services for city residents is critically important for exploiting agglomeration economies and minimising the negative impacts of population concentration.

3.8 The discussions in the foregoing sections call for an urban agenda that considers cities as solutions, not problems. This agenda must take both the positive and negative sides of city growth, the realities of rural economy and the opportunities that urban sector could provide if cities and towns are enabled to have adequate infrastructure and to provide effective civic services. The urban agenda for the country, among other things, may include the following:

- Harnessing the advantages of globalisation and information and communication revolution, supporting economic reforms, industrialisation, productivity growth, expansion of financial and other services, and promoting economic activity and job growth in both formal and informal sectors;

- Creating an enabling legal-institutional framework for the planning, financing, management and regulation of urban development with the objective of sustainable augmentation of housing, infrastructure and civic services to the people without detriment to the living environment;

- Undertaking sustainable expansion of urban infrastructure facilities: water supply, sewerage, storm water drainage, solid waste management, transport, recreation, health care, education etc. through suitable financing systems with a view to building the basic foundation for city productivity and economic growth;

- Facilitating commercialisation of urban infrastructure and alternate forms of public service provision, including privatisation, public-private-community and inter-governmental partnerships;

- Assisting the urban poor in income generation activities, improving the quality of their physical environment and enhancing their access to employment and basic services like safe drinking water, sanitation, primary health care and primary education;

- Protecting the urban environment and ensuring harmonious development of rural and urban areas with due regard to the conservation of ecology, water, forests and other natural resources;

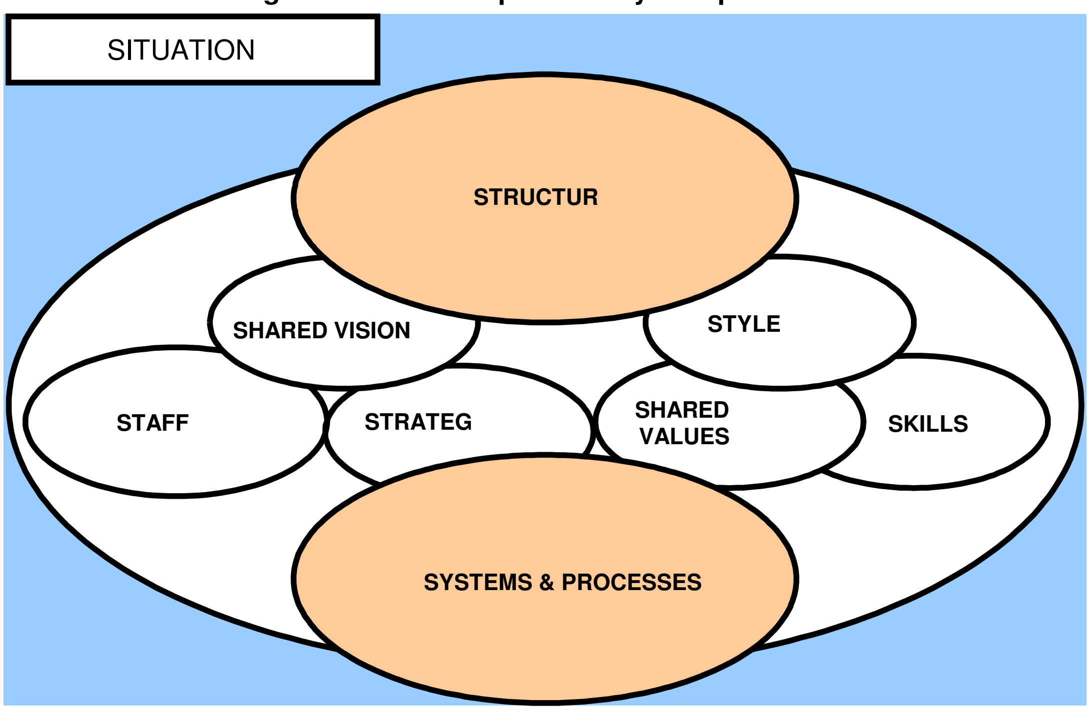
- Installing and sustaining people-friendly and clean urban government based on empowered elected local bodies, committed leadership, partnerships with civic society, participatory planning, and accountable service delivery in accordance with the Constitution (74th Amendment) Act;

- Harnessing the power of information and communication technologies to re-engineer and simplify complicated administrative processes, spread a performance-oriented, result-focused work culture and ensure transparency in all local government operations; and

- Instituting systems of continuous capacity building for all civic stakeholders - covering both systemic and individual capacity - to carry forward governance reform process and address the issues of rapid change confronting cities and towns.

3.9 The implementation of the urban agenda requires a re-engineering of urban management structures, systems, processes, legal framework, rules and procedures, human resource management, financial management, performance management, change management in city governments etc. Particular emphasis is required to be placed on reforming the structure of municipal governance as called for by the 74th Amendment Act. Figure 1 displays the model of organisational development from management research to highlight the different areas that need to be addressed to develop an effective system of public service delivery in an urban area. As identified in the figure, structure, systems and processes, staff, skills and strategy form key elements of an organisation which determine the efficiency and effectiveness of that organisation. Structure here refers mainly to the way in which the activities and tasks are divided and lines of reporting are drawn. Systems are the formal processes of business, which are specific and unique to the organization. Processes here refer to the internal business processes to achieve the desired outcomes and strategic priorities. In all, staff working with a shared vision of the structure, systems and internal business processes with appropriate skills specific to the organization form the bed-rock for developing effective organizations. This is particularly true in the case of urban administration, which involves multiple institutions and structures with overlapping responsibilities.

Figure 1
Organization Development: Key Components



3.10 Building an appropriate institutional structure or framework is the hardest part of the strategy for urban sector reforms. Reforming the structural aspects of any governmental organisation, be it secretariat, district machinery or local self-government, requires the following:

- There must be a mechanism through which strategic goals and objectives of the institution or administration are clearly spelt out, articulated and understood;
- Functions, aligned to strategic goals and objectives, must be clearly defined at various levels;
- Finances must be clear and commensurate with the functions required to be performed;
- Functionaries must be aligned to functions and the requirement of skills demanded for the discharge of those functions;
- Functional outputs must be commensurate with finances, i.e. the funds allocated for such functions;
- Incentive structure must be conducive to the delivery of performance in operation in terms of 3 E's: economy, efficiency and effectiveness; and
- Accountability channels must be clear: to the top and to the bottom – public at large.

The Constitution (74^{th} Amendment) Act, 1992 is an initiative aimed at reforming the structure of municipal governance in the country to make the same accountable, efficient and result-oriented.

4. Constitution (74th Amendment) Act, 1992

4.1 The Constitution (74th Amendment) Act, 1992 envisages a 'systemic change' in the pattern of municipal government in the country with a view to enabling cities and to towns to play a critical role in economic and social development. It signifies the beginning of a historic reform to decentralise power to the people. The Act prescribes a common legal-institutional framework for the efficient and effective delivery of municipal services. This framework comprises a number of mandatory institutions:

- State Election Commission (Article 243K);
- Elected Municipalities: Municipal Corporations, Municipal Councils and Nagar Panchayats (Article 243Q);
- Ward Committees and other Committees (Article 243R);
- State Finance Commission (Article 243I);
- District Planning Committee (Article 243ZD); and
- Metropolitan Planning Committee (Article 243ZE).

4.2 The mandates of various local government institutions as prescribed by the Constitution (74th Amendment) Act are as follows:

- State Election Commission to superintend, direct and control the preparation of electoral rolls, and conduct all elections to the rural and urban local bodies [Article 243K(1)];
- Municipalities to function as "institutions of self-government" - prepare "plans for economic development and social justice", perform functions and implement schemes as may be entrusted to them by the State Government including those related to the

Twelfth Schedule [Article 243W(a)];

- Ward Committees and Special Committees to take municipal government physically closer to the people and carry out the responsibilities conferred upon them including those in relation to the Twelfth Schedule [Article 243W(b)];
- State Finance Commission to review the financial position of the rural and urban local bodies, and make recommendations regarding the "principles" of devolution of resources from the State to the local bodies and the "measures" needed to improve their finances and functioning [Article 243I(1)];
- District Planning Committee to "consolidate" the plans prepared by the Panchayats and the Municipalities in the district and to prepare a draft development plan for the district as a whole [Article 243ZD(1)];
- Metropolitan Planning Committee to prepare draft development plan for the Metropolitan area as a whole [Article 243ZE(1)].

4.3 The Constitution (74th Amendment) Act, 1992 assigns a critical role to 'elected' local representatives of the people in matters relating to local public service delivery, urban planning including town planning and district and metropolitan planning. It prescribes urban planning including town planning and planning for economic and social development as legitimate functions of elected urban local bodies. It also mandates that not less than four-fifth of the total members of a District Planning Committee are elected by, and from amongst, the members of the panchayat at the district level and municipalities in proportion to the ratio of rural and urban population in the district. Similarly, it is mandatory that not less than two-third of the members of a Metropolitan Planning Committee are elected by, and from amongst, members of the municipalities and chairpersons of the panchayats in the metropolitan area in proportion to the ratio of the population of municipalities and panchayats in that area.

4.4 The 74th Amendment Act provides for three types of municipal authorities: Nagar Panchayats for transitional areas (in transition from rural to urban), Municipal Councils for smaller towns, and Municipal Corporations for larger urban areas (Article 243Q). The Act inserted the Twelfth Schedule (Article 243W) to the Constitution of India providing for an illustrative list of legitimate municipal functions. These functions include:

- Urban planning including town planning;
- Regulation of land-use and construction of buildings;
- Planning for economic and social development;
- Roads and bridges;
- Water supply for domestic, industrial and commercial purposes;
- Public health, sanitation, conservancy and solid waste management;
- Fire services;
- Urban forestry, protection of the environment and promotion of ecological aspects;
- Safeguarding the interests of weaker sections of society, including the handicapped and the mentally retarded;
- Slum improvement and upgradation;
- Urban poverty alleviation;
- Provision of urban amenities and facilities such as parks, gardens, playgrounds;
- Promotion of cultural, educational and aesthetic aspects;
- Burials and burial grounds; cremations, cremation ghats/grounds and electric crematoria;
- Cattle pounds; prevention of cruelty to animals;
- Vital statistics including registration of births and deaths;

- Public amenities including street lighting, parking lots, bus stops and public conveniences;
- Regulation of slaughter houses and tanneries.

4.5 Functions require finances. However, without assigning a list of local taxes to the municipal authorities, the Constitution (74th Amendment) Act, 1992 left the matter to the State Governments. It inserted Article 243X, which provides that a State Legislature may, by law,

(a) authorise a Municipality to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedure and subject to such limit;
(b) assign to a Municipality such taxes, duties, tolls and fees levied and collected by the State Government for such purposes and subject to such conditions and limits;
(c) provide for making such grants-in-aid to the Municipalities from the Consolidated Fund of the State; and
(d) provide for the constitution of such Funds for crediting all moneys received, respectively, by or on behalf of the Municipalities and also for the withdrawal of such moneys therefrom,
as may be prescribed by law.

4.6 Article 243Y inserted into the Constitution through the 74th Amendment Act makes it is mandatory on part of the Governor of a State for the constitution of State Finance Commission to review:

(a) the principles which should govern –
i) 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 and the allocation between the Municipalities at all levels of their respective shares of such proceeds;
ii) the determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by the Municipalities;
iii) 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; and
(c) any other matter referred to the Finance Commission by the Governor in the interest of sound finance of the Municipalities.

4.7 While the 74th Amendment Act aims at ushering in a strong local democracy through the establishment of key institutions, it leaves the issues of their empowerment and operationalisation to the wisdom of the State Governments. In fact, even in mandatory matters such as the establishment of District and Metropolitan Planning Committees, the 74th Amendment does not prescribe any time limit. This is presumably due to the fact that under the country's Constitution, India is a Union of States and it is under state laws that Municipalities are constituted. However, the spirit of the Constitution (74th Amendment) Act calls for a critical role on the part of State Governments to create a conducive environment to steer the decentralization process, facilitate municipal reforms and enable the elected municipal councils to function effectively, undertaking planning for economic and social development and being the custodians and champions of local socio-economic development plans. This requires, among other things, reforms in the municipal finance system in the country, starting first within the civic systems.

5. Reforming Municipal Finances

5.1 The following simplistic model, borrowed from local public finance literature, provides an analytical approach to study the municipal finance issues and it broadly applies to individual as well as total municipal services in a city:

Required Expenditures	=	Unit Cost X Quantity of Service required to be provided per capita as per adopted Norms X Population
Municipal Revenues	=	Own Taxes + User Charges and Fees + Transfers (Shared or Assigned Revenues & Grants) + Loans
Own Taxes	=	Collection Rate X Legal Tax Rate X Base-to-Income Ratio X Per Capita Income X Population
Legal Tax Rate	=	Legal Liability of Tax/Base of Tax
User Charges	=	Unit User Charge for Service X Quantity of Service provided per capita X Population
Shared Revenues	=	Rate of Sharing X State Taxes
Grants	=	Per capita Grant X Population
Municipal Fiscal Gap	=	Required Expenditure - Municipal Revenues

Budget deficit is the difference between budgeted expenditures and budgeted revenues. The ratio: actual revenues/potential revenues represents the municipal collection efficiency. A measure of municipal autonomy can be defined as: municipal 'own' revenues/total municipal expenditures. A measure of inter-governmental control is: total municipal revenues/total government expenditures (in case of India, the appropriate denominator is Municipal + State expenditures).

5.2 As may be seen from the above analytical framework, the expenditures required to be met by a municipality depend on service cost, service norm and population parameters. This applies to all categories of services. The revenues raised depend on the size of revenue base, extent of access to the base, the tax rate and the collection efficiency. This is true for all collectible resources. The municipal fiscal gap can be redressed in the following broad ways: (a) reducing municipal responsibilities; (b) scaling down municipal service norms; (c) cutting costs and unnecessary expenditures; (d) enhancing municipal power to raise revenues; (e) increasing transfers from higher levels of government; and/or (f) stepping up local effort to raise revenues. Reforms to correct the municipal fiscal gap will need to address all or some of these factors. This implies that municipal finance reforms ought to address both municipal revenues and municipal expenditures.

5.3 As regards reforming municipal revenues, the following simplistic model may be adopted for analytical purposes. The revenues from a tax (revenue) source can be enhanced in several ways as seen from the following formula:

$$T = r \times t \times (B - L)$$

where T = Total Tax Collection, r = Collection Efficiency or the Collection Rate, t = Legal Tax Rate, B = Potential Tax Base and L = Leakages i.e. part of Tax Base including Exemptions, which has not been brought to Tax Net. T is positively related to r, t and B and negatively related to L. The above formula applies to all sources of municipal revenues: taxes and non-taxes. Municipal revenue reforms need to address all the above parameters comprehensively.

5.4 An analysis of the structure of municipal revenues - mix of taxes, user charges and fees, transfers and loans – in the country suggests that it varies considerably between States and suffers from the following problems:

(a) Vertical Imbalance: Most urban local governments suffer from inadequate 'own' resources leading to heavy dependence on transfers from State Governments as is the case with Anglo-Saxon countries.
(b) Horizontal Imbalance: Municipalities suffer from uneven access to resources. This gives rise to imbalances between Municipalities of various population sizes and even within the same population size, with similar tax base / rates.
(c) State Government Control: Generally, the State Governments control the municipal authority to levy taxes and user charges, set rates, grant exemptions, borrow funds, etc. and also determine the pattern of transfers to Municipalities. Mostly high-yielding and buoyant sources of revenue are not with the local governments, excepting in the case Octroi-levying states. Grants-in-aid are often discretionary.
(d) Municipal Revenue Mix: Taxes and transfers constitute the predominant sources of municipal revenues. Property tax is the most common and often the singlemost important municipal tax. User charges, though becoming increasingly popular, are yet to dominate the municipal scene. Borrowing constitutes a relatively small source.
(e) Systemic Inefficiency: Municipalities generally suffer from under-exploitation of "own" revenue sources and high administrative and revenue collection costs.

The above issues need to be addressed carefully as part of a holistic municipal revenue reform programme.

5.5 Municipal revenue reforms are complex and depend on a number of factors most of which are specific the situations obtaining in the Municipalities and States concerned. However, some general lessons can be drawn from tax reforms in developed and developing countries. These include:

(a) There is no optimal tax structure. What is optimal from the point of view of one level of government may be sub-optimal for the other levels. However, useful principles can guide tax reforms in a given situation.
(b) Broadening the tax base or tax net should be given a high priority so as to avoid reliance on relatively high tax rates which are opposed by the tax-payers.
(c) Tax preferences and exemptions in order to promote specific economic and social objectives - the so-called tax expenditures - need to be eliminated or reduced.
(d) Tax rates should be moderate to ensure better tax compliance and to prevent tax evasion.
(e) A systematic view of taxes and their institutional and political contexts is important. Reforms in the tax structure and tax administration should go together.
(f) Involvement in and ownership of tax reforms by the political powers and the public in general and taxpayers, in particular are essential for the success of tax reforms.

Directions for Reforms

5.6 The key directions for municipal revenue reforms include: clarifying the functions for which revenues are required; clarifying the sources of revenues available to discharge the functions; matching expenditures and revenues; effectively managing municipal revenues and expenditures and enhancing accountability in resource use. Clearly delineating the functional domain of the urban local bodies is critically important. Only after a clear assignment of the responsibilities of municipal government vis-a-vis other tiers of government is achieved, can any meaningful decision be taken regarding how to finance them.

Expenditure Assignment

5.7 Urban Local Bodies (ULBs) in India have been incurring expenditures for the provision of the following civic services and infrastructural facilities to citizens and business:

- Conservancy Services and Solid Waste Management
- Water supply
- Surface and Underground Drainage
- Storm-water Drainage and Flood Control
- Roads, Bridges, Flyovers, Subways, Walkways etc.
- Street Lighting
- Pre-school and Primary Education
- Preventive Health Care and Control of Epidemics
- Malaria Control
- Prevention of Food Adulteration
- Maternal and Child Health Care Services
- Parks and Playgrounds
- Avenue and Block Plantations
- Town Planning – Zoning and Building Regulations
- Slum Improvement and Urban Community Development
- Licensing of Dangerous and Offensive Trades
- Regulation of Markets and Slaughter Houses
- Maintenance of Cattle Pounds
- Registration of Births and Deaths
- Maintenance of Cremetoria and Burial Grounds.
- Rainwater Harvesting and Conservation.

The 74th Amendment Act envisages that functions such as protection of the environment and promotion of ecological aspects, safeguarding the interests of weaker sections of society, including the handicapped and the mentally retarded, urban poverty alleviation, promotion of cultural, educational and aesthetic aspects and prevention of cruelty to animals are legitimate local functions to be discharged by elected municipal councils. Some states in the country have not assigned to the urban local bodies all the 18 functions envisaged in the Constitution (74th Amendment) Act 1992. Municipal Acts of some states even mention "functions as may be entrusted to by State Government from time to time". This kind of ambiguity needs to be eliminated. Clear assignment of municipal functions is the first step towards building a good municipal governance system. The second step is to ensure that the assigned functions are matched by adequate resources.

5.8 International best practices as well as the theory of fiscal federalism in public finance suggest that public sector activities should, to the extent possible, be performed by the lowest level of government. As Oates (1972) observes:

“Each public service should be provided by the jurisdiction having control over the minimum geographical area that would internalise benefits and costs of such provision”.

This rule, known as the “Subsidiarity Principle”, facilitates the efficient mobilisation and allocation of resources through the use of local knowledge, administrative effectiveness, financial autonomy and accountability. If we follow the subsidiarity principle, which is accepted by many countries, the functions of urban forestry, protection of the environment and promotion of ecological aspects, safeguarding the interests of weaker sections of society, including the physically handicapped and the mentally retarded and promotion of cultural and aesthetic aspects, poverty alleviation and slum upgradation need to be devolved on the urban local bodies. There is a need for state governments to clearly demarcate the functions to be performed by urban local bodies without any duplication with other authorities.

Revenue Assignment

5.9 As regards the assignment of revenue sources to urban local bodies, the areas of reforms include: devolution of tax and non-tax revenue sources, including user charges by State Government to ULBs, sharing of State revenues, grants-in-aid system, borrowing etc., effective exploitation of revenue sources and prudent financial management. Most common revenue sources available to the Municipalities to discharge various local government functions in India can be divided into the following broad categories: Taxes; Non-taxes - User Charges and Fees and Sale and Hire Charges; Assigned Revenues; Grants and Contributions; Debt and other revenues as follows:

Taxes:	Property Tax, Advertisement Tax, Tax on Animals, Vacant Land Tax, Taxes on Carriages & Carts, Octroi.
Non-Taxes:	
User Charges & Fees:	Water Charges & Water Supply Donations, Trade Licensing Fee, Building Permit Fee, Development Charges/Betterment Charges, Mutation Fee, Magisterial Fines, Market Fee, Slaughter House Fee, Encroachment Fee, Parking Fee, etc.
Sale & Hire Charges:	Sale of Rubbish, Certificate Fees, Sale of Forms, Staff Quarters Rents, Shop Room Rents.
Assigned Revenues:	Entertainment Tax, Surcharge on Stamp Duty, Profession Tax, Motor Vehicles Tax, Entry Tax.
Grants & Contributions:	
(a) Non-Plan Grants	Animal and Vehicle Tax Compensation, Toll Compensation (Octroi Compensation), Property Tax Compensation, Per Capita Grant.
(b) Plan Grants	Road Grants, School Building Grants, Master Plan Grants, Integrated Development of Small and Medium Towns (IDSMT), Swarna Jayanthi Shahri Rozgar Yojana (SJSRY), National Slum Development Scheme (NSDP), Integrated Low Cost Sanitation (ILCS), Environmental Improvement of Urban Slums (EIUS), Urban Basic Services for the Poor (UBSP), etc.

Debt:	Water Supply Schemes, Sewerage Schemes, Roads, Integrated Low Cost Sanitation (ILCS), Integrated Development of Small and Medium Towns (IDSMT), other Civic Infrastructure Projects and Capital Works.

5.10 Property tax is the most important source of taxation in majority of the urban local bodies in the country. A few States like Maharashtra and Gujarat do still have Octroi, considered to be an obnoxious tax and needed to be phased out. The major sources of municipal user charges and fees levied by selected Municipal Corporations in the country are shown in Table 12.

Table 12
Major Sources of User Charges and Fees of Municipal Corporations in India: 2001-2002

Name of State	Name of Municipal Corporation	User Charges and Fees
Maharashtra	Greater Mumbai	Water Charges, Sewerage Charges, Building Licence Fees
West Bengal	Kolkata	Planning Fees, Car Parking Fees, Mutation Fees
Karnataka	Bangalore	Betterment Charges, Building Licence Fees, Penalty for Late Tax payment
Orissa	Bhubaneswar	Building Licence Fees, Market Fees
Gujarat	Surat	Water Charges, Building-related Fees, Betterment Charges
Tamil Nadu	Chennai	Building Licence Fees, Market Fees, Other Licence Fees, Parking Fees
Andhra Pradesh	Hyderabad	Dangerous and Offensive Trade Licence Fees, Market Fees, Slaughter House Fees
Uttar Pradesh	Kanpur	Building Licence Fees, Market Fees

Source: Municipal Budgets for 2001-2002

Table 13 shows the major sources of assigned or shared revenues in selected Municipal Corporations in the country.

Table 13
Major Sources of 'Shared' Municipal Revenues in India: 2001-2002

Name of State	Name of Municipal Corporation	Shared Municipal Taxes
Maharashtra	Greater Mumbai	Non-agricultural Assessment Tax, Entertainment Tax
West Bengal	Kolkata	Motor Vehicles Tax, Entertainment Tax
Karnataka	Bangalore	Entertainment Tax, Surcharge on Stamp Duty
Orissa	Bhubaneswar	-
Gujarat	Surat	Entertainment Tax
Tamil Nadu	Chennai	Surcharge on Sales Tax, Duty on Transfer of Property, Entertainment Tax

Andhra Pradesh	Hyderabad	Transfer of Immovable Property Tax, Profession Tax, Entertainment Tax
Uttar Pradesh	Kanpur	-

Source: Municipal Budgets for 2001-2002

Table 14
Major Sources of Grants-in-Aid to Municipal Corporations in India: 2001-2002

Name of State	Name of Municipal Corporation	Grants-in-Aid provided to Municipal Corporations
Maharashtra	Greater Mumbai	Primary Education Grant, Secondary Education Grant
West Bengal	Kolkata	Dearness Allowance Grant, Grant to Implement Recommendations of Pay Commission, Water Supply, Sewerage and Drainage Grants
Karnataka	Bangalore	Octroi Compensation, Motor-Vehicle Tax Compensation, Family Planning Schemes Grants
Orissa	Bhubaneswar	Salary and Dearness Allowance Grants, Road Development Grant, Primary Education Grant, Secondary Education Grant
Gujarat	Surat	Education Grant, Family Planning Grant, Small Savings Grant
Tamil Nadu	Chennai	Revenue Grant, Contributions, Compensation for Toll
Andhra Pradesh	Hyderabad	Dearness Allowance Grant, Property Tax Compensation, Octroi Compensation, Per Capita Grant, Motor Vehicle Tax Compensation, Road Grant, Education Grant (Primary & Secondary)
Uttar Pradesh	Kanpur	Octroi Compensation, Salary Grant, Education Grant (Primary & Secondary Education), Medical Grant, Road Grant

Source: Municipal Budgets for 2001-2002

5.11 In the State of Andhra Pradesh the contributions of various sources of municipal revenues (117 urban local bodies combined) in 2002-2003 were as follows:

	%
Tax Revenues	26.54
Assigned Revenues	23.78
Fees & User Charges	24.49
Sale & Hire Charges	1.27
Revenue Grants	4.88
Capital Grants	18.34
Municipal Debt	0.70
Total	100.00

5.12 The broad heads of municipal expenditure as adopted in municipal budgets and accounts include Salaries, Maintenance Works, Capital Works and Loan Repayment. In Andhra Pradesh the contributions of various sources of municipal revenues (all 117 urban local bodies) in 2002-2003 were as follows:

		%
A. Revenue Expenditure:		
	Establishment Expenditure	24.87
	Maintenance Expenditure	22.82
	Management, Loan Repayment & Others	31.08
B. Capital Expenditure:		21.23
	Total	100.00

5.13 In general, revenues of ULBs in India fall short of the requirements of rapid urban growth and development. However, municipal authorities are required under law to maintain a revenue surplus or zero deficit. Accordingly, municipal capital expenditures become the casualty in municipal budgets.

Matching Functions and Finances

5.14 Bahl and Linn (1992) provide some general principles for identifying the revenue sources appropriate to financing particular types of municipal expenditures:

(1) Where the benefits of public services are measurable and accrue to readily identified individuals in a jurisdiction, user charges are the appropriate financing instruments;

(2) Local public services such as administration, traffic control, street lighting and security, which are services to the general public in the sense that identification of beneficiaries and measurement of benefits and costs to individuals is difficult, are most appropriately financed by taxes on local residents;

(3) The cost of services for which significant spillovers to neighbouring jurisdictions occur e.g., health, education and welfare, should be financed by substantial state or national inter-governmental transfers;

(4) Borrowing is an appropriate source to finance capital outlays on infrastructure services particularly, public utilities and roads.

The above principles may be kept in view when the State Governments consider reforming the assignment of municipal revenue sources to match municipal expenditures.

Revenue Assignment Principles

5.15 Using the criteria of equity (consistency of revenue sources with expenditure needs) and efficiency (minimising resource cost), Musgrave (1984) suggests the following broad principles of tax assignment in a federal system of government like India:

(1) Taxes suitable for economic stabilisation should be central;
(2) Progressive redistributive taxes should be assigned to central governments;
(3) Tax bases distributed highly unequally between jurisdictions should centralised;
(4) Taxes on mobile factors of production are best handled centrally;
(5.) Residence-based taxes such as tax on sale of consumption goods to consumers and excises are suited for states;
(6) Taxes on completely immobile factors of production are best suited for local levels;
(7) Taxes of lower levels of government should be cyclically stable;
(8) Benefit taxes and user charges are to be used appropriately at all levels;
(9) Resource taxes and value-added tax (VAT) are appropriate for sharing between governments.

In terms of the Congruence Principle of Public Finance the less mobile and the stronger the spatial concentration of a tax base the lower the level of government to which those taxes should be assigned. Thus, all land-based taxes are considered suitable for local governments.

Choice of Municipal Taxes

5.16 Known principles and best practices of local public finance point to the following desirable characteristics of a municipal tax:

(1) Immobility: The tax base should be immobile to allow the local authority some freedom to vary the tax rates without eroding the tax base;

(2) Adequacy: The tax yield should be adequate to meet essential local needs;

(3) Buoyancy: The tax base must be sufficiently buoyant, i.e., expand in response to such forces as inflation, increase in population and economic growth;

(4) Stability: The tax yield should be stable and predictable and it should not be susceptible to cyclical fluctuations;

(5) Equity: The tax should be perceived to be reasonably fair (in terms of progressivity) by tax-payers;

(6) Administrative Ease: The tax should be easy to administer efficiently (at minimum resource costs) and effectively;

(7) Non-exportability: It should not be possible to export much, if any, of the tax burden to non-residents;

(8) Visibility: The tax base should be visible, to ensure accountability on part of the municipal government.

For growing cities, buoyancy ought to be the critical dimension of municipal finance and other considerations can be regarded as secondary.

5.17 Research on assignment of finances to the Municipalities in the context of the Constitution (74th Amendment) Act suggests that the following sources may be appropriate for devolution to urban local bodies in India:

(1) Property Tax including Vacant Land Tax

(2) Advertisement Tax;

(3) Entertainment Tax;

(4) Profession Tax;

(5) Stamp Duty on Registration (or a share of it);

(6) A 'major' tax in lieu of the abolished Octroi or a formula-based share in some high-yielding and buoyant state taxes or in general state revenues;

(7) Business Licensing Fees;

(8) Planning Permission Fees/Development Charges.

It may be noted that Municipalities in many developed countries are endowed with the powers of levying local option income tax, local option sales tax, payroll tax, tax on petrol and gasoline etc. in addition to property tax. A broadening of the municipal taxation power is required in India. A possible ‘local finance list’ may perhaps be considered under the Constitution of India with suitable amendments to the Union List, State List and Concurrent List.

Property Tax Rationalisation

5.18 It is widely accepted that property taxes can provide the municipal governments an access to a broad and expanding base while promoting efficiency through the linking of provision of municipal services closely to their financing. They are indirect user charges for civic services whose benefits are collective and not confined to identifiable individuals. Experience with property tax reforms in India suggests that there are several problems that need to be addressed simultaneously. These include: (1) simplification of tax laws, (2) coverage of tax net, (3) valuation accuracy, (4) collection efficiency, (5) rate setting, (6) administrative incentives and (7) policy and institutional reforms. The Self Assessment Scheme introduced by the Municipal Corporation of Hyderabad in 1999 provides a good example of property tax reforms on account of which the Corporation's revenues went up from Rs. 48 crores to Rs.130 crores in two years while the effective tax rate was reduced almost by two-thirds. Similar self-assessment schemes are practiced in Bangalore and Chennai.

User Charges and Benefit Taxes

5.19 When beneficiaries are identifiable and benefits can be measured, user charges are the first best instruments of financing public services. They promote efficiency by providing information on demand to the providers of public service and also ensure that what the public sector supplies is valued (at the margin) by citizens. They act as instruments to ensure the accountability of public functionaries. In the case of 'collective' services where beneficiaries are not identifiable or services are not measurable and levying user charge is not possible, benefit taxes are the appropriate instruments of financing. When clear linkages exist between the taxes levied and the expenditures financed, earmarked benefit taxes constitute indirect user charges or surrogate prices for services [Buchanan (1963)]. Earmarking then facilitates the rational choice by tax payers.

5.20 The theory of public finance suggests the following guiding principles for levying user charges and benefit taxes:

(I) Wherever possible, user charges may be levied for the services provided as the first resort;
(2) For achieving efficiency, user charges should be levied on the direct recipients of benefits;
(3) The poor may be subsidised directly if needed, rather than through reduced prices and distortions in the entire market for services;
(4) Where charging is impracticable, specific benefit taxes should be levied on local residents;
(5) Inter-governmental transfers may be used to finance services only if user charges and benefit taxes are not adequate.

There is a lot of scope for improving municipal finances in India through the levy user charges and benefit taxes. "Users pay", "Beneficiaries pay" and "Polluters pay" are the cornerstones of local public finance.

Inter-Governmental Transfers

5.21 Appropriately designed inter-governmental transfers can play an important role in promoting effective municipal service delivery. They bridge the fiscal gap between rich and poor municipalities and act as instruments to direct municipal resources to desired directions – infrastructure building, in particular. Municipal activities are unlikely to provide efficiency unless financial accountability is clearly established. Municipal governments can be made accountable to the higher levels of government for expenditures financed out of inter-governmental transfers.

5.22 The theory of public finance suggests the following principles for the designing of inter-governmental transfers:

(1) The quantum and frequency of inter-governmental transfers must be predictable;
(2) They must be transparent through explicit and identifiable entries in government budgets;
(3) They must imply a hard budget constraint for the municipalities and there should be no soft options at the margin;
(4) They must be predetermined rather than being open-ended or discretionary;
(5) They must have in-built incentives/penalties for promoting local resource mobilisation and performance.

5.23 Keeping in view the above principles an appropriate system of inter-governmental transfers may be designed on the following lines:

(1) An annual distributional pool may be created at the state level consisting of a predetermined percentage of certain shared taxes or general state revenues;
(2) The formula for the distribution of funds out of the pool may take into account both the need and fiscal capacity of municipal bodies;
(3) The following could be the break-up of grants to be given out of this pool:

(a) Specific transfers:
(i) Per capita health grant to meet the primary health care costs based on stipulated state standards;
(ii) Per capita education grant to meet the primary education expenditures based on predetermined state norms;
(iii) General per capita grant for discharging other designated functions of state government;
(iv) Slum upgradation grant (on a per capita basis) subject to local matching.
(slum upgradation activities may include: widening and paving of pathways, street lighting, drinking water supply, sewerage, drainage works, community baths and toilets, etc.)

(b) Municipal Equalisation Fund
The Equalisation Fund may be designed to take care of the fiscal disparities between the municipalities on account of various exogenous factors. The formal distribution of municipal equalisation fund may be based on a composite index linked to both the fiscal needs and capacities of municipalities.

(c) Municipal Development (Capital) Fund
This fund may consist of grants to a state nodal agency such as Urban Infrastructure Finance Corporation or a Municipal Urban Development Fund which could use the funds as base capital or equity to 'leverage' market resources. This institution can assist municipalities in the development of financially viable infrastructure projects and secure loans for implementing them. These projects may be based on long-range Municipal Development Plans and linked to cost recovery and municipal

revenue reforms.

There is a need for State Governments to develop an objective, principle-based and performance-oriented intergovernmental transfer system

Financing Municipal Capital Works

5.24 The capital needs of cities on account of backlog, current and growth needs are enormous. In view of the massive demands on urban infrastructure, there is a need to explore alternative institutional innovations for mobilising resources to build civic infrastructure. Although the institutional and funding arrangements in different countries vary a great deal in structure and operations (e.g., development funds, municipal banks, cooperatives, limited companies, rediscount facilities, etc.), certain fundamental principles underlie the approaches adopted. When capital markets are underdeveloped or shallow, the smaller local bodies cannot have easy access to market funds. Larger and viable institutions which can pool risks and borrow with ease and at a lower cost can approach the capital market, national level financial intermediaries and bilateral and multilateral lending institutions on behalf of these smaller entities. They can also assist the eligible municipalities in project formulation, preparation of capital development plans, finance and operating plans and projects and in designing suitable cost recovery instruments.

5.25 Recognising the need for financial intermediation, the Government of Tamil Nadu established the Municipal Development Fund in the past. This Fund, which operated successfully for years, has been translated into a Trust Fund-Asset Management Company set up with the involvement of private sector infrastructure financing agencies. The Government of Karnataka has also established the Karnataka Urban Infrastructure Development Finance Corporation. The Government of Andhra Pradesh has recently restructured the Andhra Pradesh Urban Finance and Infrastructure Development Corporation. These types of financial intermediaries, if properly designed, could achieve the following objectives:

(I) Facilitate the supply of capital to municipal authorities for infrastructure projects at a reasonable cost;

(2) Assist small and medium-sized towns to provide adequate urban services by providing them long-term finance;

(3) Help in costing of services and streamlining the financial and accounting systems so as to enable them to approach external funding sources;

(4) Promote full cost recovery and internal resource mobilisation, and improve financial management;

(5) Identify and assist in the development of projects with a good potential for tapping market funds;

(6) Promote joint sector or pooled financing of urban infrastructure by participating in both public and private sector projects;

(7) Eventually issue infrastructure bonds on behalf of the municipalities.

Accessing Municipal Bonds Market

5.26 Borrowing is an appropriate instrument to finance long-gestation capital works whose benefits spread over generations. Accessing the debt market requires actions to remove restrictions to borrowing powers of municipalities, municipal intermediaries, urban infrastructure financing institutions and special purpose vehicles; steps to improve cost recovery and resource mobilisation on the part of borrower-municipalities; development and deepening of municipal bonds market; and creation of credit enhancement mechanisms. Municipal bonds are of recent origin in India although the system is well-established in many developed countries including the United States.

During 1997-2002, eight municipal corporations in the country have raised funds from the market through the issuance of municipal bonds. Table 15 describes the salient features of these bonds.

Table 15
Issuance of Municipal Bonds in India: 1997-2002

Year	Municipal Corporation	Amount (in Rs. Crores)	Bond Tenor (Years)	Interest Payable Per Annum (%)	With State Guarantee or No State Guarantee	Rating
December 1997	Bangalore	100	7	13.00%	SG	CRISIL A (SO)
January 1998	Ahmeda-bad	100	7	14.00%	NSG	CRISIL AA (SO)
May 1999	Nashik	100	7	14.75%	NSG	CRISIL AA (SO)
September 1999	Ludhiana	10		13.5% - 14.00%	NSG	ICRA LAA - (SO)
November 2000	Nagpur	50	7	13.00%	NSG	ICRA LAA - (SO)
April 2001	Madurai	30	15	12.25%	NSG	ICRA LA + (SO)
July 2001	Indore	10	7	11.50%	SG	
March 2002	Ahmeda-bad	100	10	9.00%	NSG	CRISIL AA (SO)
March 2002	Hyderabad	82.50	7	8.50%	NSG	CRISIL AA + (SO) ICRA LAA+(SO)

5.27 The tax-free City Development Bond issued by the Municipal Corporation of Hyderabad to the tune of Rs.82.5 crores during March 2002 is based on a sound theory of city development practiced in many developed countries. The bond issue was assigned CRISIL rating AA+(SO) and ICRA rating LAA+(SO). The bond proceeds are dedicated to the financing of development projects of regional and city-wide importance including traffic and transportation projects to decongest the city – road widening, junction improvement, development of parallel roads, slip roads and link roads, signalisation of intersections, construction of road over-bridges, road under-bridges, storm-water drainage, sewerage and solid waste management, modern lighting and slum upgradation, etc. Hyderabad City Development Bond is by far the best-rated municipal bond in the country. The bond presumes that the development of regional or city-wide infrastructure would capitalise into land values and other tax bases and that tapping the associated tax increments and escrowing the same to service the bonds would fuel a process of self-financed city development spiral.

5.28 The development of a full-fledged municipal bonds market in India would require a number of key initiatives by the Central and State Governments. The following are some suggestions by experts which would serve to position municipal bonds favourably with commercial investors.

(1) The bonds issued by the municipalities and other agencies for urban infrastructure projects should be exempt from income tax.
(2) Municipal bonds may be regarded as eligible securities for the purpose of investment by public trusts, banks (SLR status) and public sector units. The Government of India may regard municipal bonds as eligible instruments for money and treasury markets.
(3) Municipal obligations to Central and State Governments may be made subordinate to the bondholder servicing obligations.
(4) The Government of India may formulate and administer a bond assurance or guarantee programme that serves to extend tenor, generate liquidity and provide a mechanism to equate risks across municipal bond issues.
(5) Municipalities may be allowed to issue municipal bonds on the basis of credit rating by independent agencies such as CRISIL, ICRA and CARE. As these bonds are not likely to be guaranteed by State Governments, the debts should not form a part of the allocations made by the Reserve Bank of India under its public debt account. The issue of municipal bonds may, therefore, be governed by specific guidelines to be formulated by the Security Exchange Board of India (SEBI).
(6) The borrowing powers of municipalities and infrastructure agencies in the country are limited at present on account of restrictions under municipal and other laws. Such restrictions may be removed.
(7) Municipalities should be allowed to establish escrow accounts in order to provide transparent appropriation mechanisms to investors. Escrow accounts are special accounts in which revenue streams for debt-servicing are collected and only after meeting the debt-servicing requirements does the bond issuer have a lien on the account.

Credit Enhancement Mechanisms

5.29 Credit enhancement mechanisms enable the issuer of debt to obtain a higher credit quality than would have been possible on a stand-alone basis. Superior credit rating in the case of a debt instrument benefits the issuer in terms of lower interest rates and easier marketability due to high safety of the instruments. The credit quality of municipal bonds can be enhanced by the following mechanisms:

(1) Some clearly identified sources of revenues of a municipal body can be captured in an escrow account. This account can act as collateral for bond-servicing and also meet the debt-servicing obligations directly at the direction of the trustees of the bonds.
(2) The State Government can provide security by pledging to meet debt obligations in case of the inability of the municipal borrower to meet them. State-municipal transfers in the form of shared taxes and grants constitute a major source of municipal finance in many states. An agreement between the State Government and the bond-issuing municipality which stipulates that the annual transfers could be captured in an escrow account on a pre-determined schedule for debt servicing and act as a collateral to municipal bond issue may be worked out.
(3) A portion of the funds raised through bond issue can be kept in an escrow account or invested in marketable securities and provide credit-cum-liquidity support to the

instrument. Similarly, the amounts kept in the sinking fund could be invested in liquid securities and earn interest which could cover part of the debt-servicing obligations.

(4) The escrow accounts should be monitored by an independent trustee of the bonds and any shortfalls may be compensated by the State Government.

(5) Project revenues may be suitably earmarked for the purpose of bond-servicing in addition to general obligation.

Government of India: New Initiatives

5.30 To catalyse urban sector reforms to enhance investment flows for urban infrastructure, the following initiatives have been launched by the Ministry of Urban Development and Poverty Alleviation, Government of India:

- Urban Reform Incentive Fund (URIF)
- City Challenge Fund (CCF)
- Pooled Finance Development Scheme (PFDS)

The Government of India Budget this year has also proposed a National Urban Renewal Mission/Fund.

Urban Reform Incentive Fund (URIF)

5.31 In order accelerate and incentivise the process of urban reforms, the Government of India has embarked on a scheme to provide reform-linked assistance to States. The 2002-2003 Budget called for setting up an Urban Reform Incentive Fund (URIF) with an initial outlay of Rs.500 crore per annum during the 10th Five Year Plan. The URIF provides incentives to state governments to carry out the following reforms identified:

- Repeal of Urban Land Ceiling Act
- Rationalisation of high stamp duty regimes to no more than 5% by end of 10th Plan period
- Reform of Rent Laws to remove rent control
- Introduction of computerized registration of properties
- Reform of Property Tax
- Levy of realistic user charges by Urban Local Bodies
- Introduction of double entry system of accounting in ULBs.

The allocation of URIF to States is based on the share of each State in the country's urban population. The incentive fund is provided to States as Additional Central Assistance (ACA) in installments. A Memorandum of Agreement (MoA) has to be executed by the recipient State with the Ministry of Urban Development and Poverty Alleviation.

City Challenge Fund (CCF)

5.32 In response to the emerging urban challenge and in the context of the 74th Constitutional Amendment, the Ministry of Urban Development and Poverty Alleviation, Government of India, has introduced a new fiscal incentive - the City Challenge Fund (CCF). Announced in the Budget speech of the Finance Minister for 2002-03, the objectives of the CCF are:

- Catalyzing institutional, fiscal and financial reforms of cities
- Creating credit-worthy cities
- Improving service delivery

In order to meet the requirement of funds to meet transition and transaction costs, an amount of Rs.500 crores has been proposed in the 10^{th} Five Year Plan. Support from external funding agencies has also been envisaged.

The basis for access to CCF include:

- Competition
- Cities with population above 5 lakhs
- Commitment and capacity to implement city-wide reforms
- Submission of urban reforms plan
- 75% of the expenditure to be borne by the Centre and 25% by the States/ULBs.

Under the CCF the following reforms items have been identified:

- Improving municipal financial capacity
- Reducing wasteful expenditure
- Improving financial accounting system
- Formation of separate entity for delivery of urban services
- Public-private partnerships
- Capacity building and restructuring including voluntary retirement scheme for surplus staff.

The applications for CCF assistance have to originate from eligible municipalities and routed through their respective State Governments. Applications have to be forwarded by the State Governments to the Ministry of Urban Development and Poverty Alleviation addressing the following issues:

- Analysis of existing financial situation
- Need for Government support
- Evidence of remedial measures taken
- Preparation of restructuring plans
- Commitment for restructuring.

The procedure for approval and review of restructuring plans includes:

- Independent evaluation committee of experts to be constituted by Ministry to examine proposals and recommend amount of assistance, phasing, etc.
- Grant negotiation and ratification by municipalities
- Execution of Memorandum of Agreement.

The implementation and monitoring of CCF will comprise the following:

- Monitoring of implementation of restructuring plans by the Ministry
- Reporting requirements to be agreed with each municipality
- Independent progress assessment
- Monitoring by the Steering Committee and Project Review Committee at regular interval
- Provision for mid-term correction and remedies.

The sanction of grant under CCF would be done by the Ministry directly to Municipality under intimation to State Government. Release of grants would be in two or three installments and limited to 75% of the eligible costs. Downstream monitoring by Municipality, State and Ministry will be continued over a period of 5 years to ensure sustainability.

Pooled Finance Development Scheme (PFDS)

5.33 The objectives of the Pooled Finance Development Scheme (PFDS) include:

- Enabling Small and Medium-size Urban Local Bodies to access capital markets
- Facilitating development of bankable urban infrastructure projects
- Introduction of necessary reforms (e.g. tariff and financial) and
- Development of Municipal Bond Market.

Under the PFDS, a State entity (existing or newly created) will be responsible for raising funds from the market on behalf of select ULBs. Repayment of loan by the ULBs would be ensured through mechanisms such as escrowing of resources, interception of State grants and Debt Service Reserve Fund (DSRF). The Central and State Governments will contribute at the rate of 7% to the DSRF. 75% of the reform costs will be borne by the Central Government and 25% by the State Government. A Memorandum of Agreement (MoA) will be signed with the State entity. As part of the 10th Five Year Plan, Rs. 400 crores have been sanctioned for PFDS out of which 25% funds have been earmarked for reforms and 75% for contribution to DSRF.

National Urban Renewal Mission/Fund

5.34 The Budget of the Government of India this year has announced the National Urban Renewal Mission/Fund designed to meet the challenge of urban renewal. The Fund will cover the seven mega cities, all cities with a population of over a million, and some other towns. An outlay of Rs.5,500 crore in 2005-06, has been proposed in the budget which includes a grant component of Rs.1,650 crore for the Mission.

The Mumbai Metro Rail Project, the Mumbai Trans Harbour Link, the Mumbai Western Expressway Sealink and the Bangalore Metro Rail Project are examples of projects which could be supported through the Mission.

Budgeting, Accounting and Auditing Reforms

5.35 Budgeting practices in most municipalities suffer from the following drawbacks:

(1) Budget heads or categorizations are not fully useful for expenditure planning and control;

(2) Budget formats do not focus on the goals and programmes as a result of which it is not possible to hold the various municipal heads of departments accountable for their functions;

(3) Feedback mechanisms from operational to decision-making levels and accountability mechanisms are generally weak;

(4) There is no integration between budgeting, accounting and management functions;

(5) The distinction between recurrent and capital expenditures is not clear.

There is a need to reform the budgeting process in municipalities so that the budget is made to play the following roles effectively:

(1) A policy-making role in allocating resources between various categories of infrastructure and services;
(2) A management role in allocating resources to particular agencies/ departments and estimating the inputs - personnel, equipment required to achieve specific outputs;
(3) A control role in giving authority to local officials to collect and spend money and in prescribing who can spend how much and on what.

5.36 Typically, all capital transactions of municipalities are booked under a separate head called 'Extraordinary and Debt'. This is not desirable. There is a need for separation of Revenue from Capital accounts on account of the following reasons:

(1) It will assist in the integration of infrastructure planning and financing;
(2) It will facilitate the development of institutional finance for infrastructure;
(3) The economic and accounting basis for the formulation and levy charges will improve;
(4) The financial discipline of municipalities will greatly improve, move to a more rational system where capital creation is commensurate with the income necessary to operate and maintain the investments.

Further, municipal budgets classify all types of public works into one category. This classification mixes functions like roads which are amenable to tax-financing with functions such as water supply which are eminently suitable for user charges. There is a need to re-orient the municipal budgets with fund-based principles so that they can facilitate financial planning and accountability.

5.37 Most municipalities follow a system of cash-based accounting as against accrual-based accounting used by the private sector. Under cash-based accounting, receipts and payments are posted as and when cash is received or paid. This often leads to serious off-budget/book liabilities being incurred but not recorded. In the case of accrual-based accounting, the financial effects of transactions are recognised in the period in which they occur, irrespective of whether the cash is received or paid. This enables transactions to be reported in the financial statements for the relevant period. Municipal accounts adopt the cash-based system on the ground that the primary objective of accounting is to maintain budgetary control over activities. However, it is being widely recognised that a combination of cash and accrual-based accounting may be more appropriate for municipalities. Under this Modified Accrual basis, revenue is recorded only when cash is received, while expenses and related liabilities are recorded when incurred. Recently a National Municipal Accounting Manual has been released by the Government of India to guide ULBs to switchover to accrual-based accounting. Computerisation of municipal budgets and accounts following the Manual is of prime importance.

5.38 Regarding auditing of municipal accounts, in most states they are audited by the Local Fund Audit Department. Sometimes these audits do not take place for years and the extent to which auditors are unbiased is itself questionable. There is a need to upgrade the audit standards in respect of municipalities to the levels fixed by the Accountant General with the involvement of chartered accountants. It may be desirable to establish an Audit Commission as in some developed countries to set local fund audit standards, introduce competition, procure auditors, fix auditor's fee and exercise quality control in audit.

5.39 While structural and systemic reforms as described in the foregoing sections are critically important for long-term results, even more important are the reforms that need to be undertaken at the city level by Municipalities and Municipal Corporations to introduce a reform and result culture. Charity begins at home. There are enormous opportunities for reforms in every city or town in view of years of reform backlogs and the fact that several obvious loopholes exist in the present systems. Benchmarking with the ‘best in the class” or international and national best practices can provide clear directions as to how reform is to be pursued. The case study of municipal reforms in Hyderabad Municipal Corporation in Andhra Pradesh during 1998-2002 amply demonstrates this position.

6. A Case Study of Hyderabad

6.1 Hyderabad Municipal Corporation has undertaken a series of municipal reforms including reforms in municipal finances during 1998-2002 with the objective of improving governance, finance and provision of infrastructure and basic amenities to the citizens. These reforms have enabled the city to bag the Clean City Award at the national level for 4 consecutive years: 1999 to 2002 – a unique distinction unmatched by any city in the country. Hyderabad has also been the recipient of the Green City award from the Government of Andhra Pradesh and the prestigious Indira Priyadarshini Vrikshamitra Award from the Prime Minister of India for commendable work on urban forestry. The International Lighting Society of North America selected Hyderabad for an international award in recognition of the significant effort made by the city to improve street lighting. The city was able to obtain credit ratings of AA+(SO) from CRISIL and LAA+(SO) from ICRA for its Municipal Bond 2002 issue. These ratings are higher than those accorded to any other Municipal Corporation in the country for similar issues. Interestingly, 90 per cent of the Hyderabad City Development Bond was sold within hours after issue in the last week of March 2002. The city also bagged two out of 10 CRISIL Awards for Excellence in Municipal Initiatives in India in 2001-02.

6.2 The key reforms initiated by Hyderabad City during 1998-2002 include: rationalization of municipal functions, preparation of clear job charts for functionaries, development of performance indicators and management information systems, all-out use of information technology to foster e-governance, simplification of budgeting, adoption of commercial (modified accrual-based) accounting, creation of geographical and functional cost centres, prioritization of developmental and regulatory measures based on impact studies, integrated infrastructure planning and capital budgeting, regular enforcement of basic town planning, public health and environmental regulations, adoption of the principles of local public finance: ‘users pay’, ‘beneficiaries pay’ and ‘polluters pay’ to strengthen resource mobilization, introduction of schemes of self-assessment of taxes and fees, community-based environmental management and slum development programmes, free availability of information to the public, transparency at all levels, etc.

6.3 The steps taken by the Municipal Corporation to improve its resources and recover costs include: property tax reforms, including the introduction of the scheme of Self-Assessment of Property Tax, re-vamping of advertisement fee and trade licensing fee with emphasis on self-declaration and self-filing of returns, use of land as a resource and levy of user and polluter charges. The Corporation made all-out effort to identify direct and indirect users of services/beneficiaries and levy user charges and benefit taxes. Polluters were also identified and made to pay for pollution mitigation and prevention measures. For the first time in the history of the Municipal Corporation, City Development Bonds were issued in

March 2002 to raise a sum of Rs.820 million for development projects.

6.4 The reforms on the municipal expenditure side in Hyderabad include: budgeting and accounting reforms, rationalization of expenditures, outsourcing of sanitation, cost reduction, mechanisms to ensure accountability in public expenditures, etc.

6.5 Due to the various reforms initiated by the Corporation, municipal revenues went up significantly. Property tax increased by 70 per cent during 1999-2000. The period 1998-2000 witnessed an unprecedented rise in advertisement fee collection by more 230 per cent. Trade licensing fee went up by 63 per cent during 1999-2000. The effective tax rate in the case of property tax was reduced and the correction of historic inequities – vertical as well as horizontal – was tapped as the key source of revenue improvements. Town planning-related charges registered more than 100 per cent growth during 1999-2000. Buoyancy in revenues resulted in a significant rise in the expenditure on public infrastructure facilities and lowering of the ratio of salaries as percentage of total expenditure: revenue + capital. Visibility in the delivery of public services and establishment of linkages between local taxes and local services enhanced the image of the Municipal Corporation of Hyderabad in the eyes of the public.

Figures 2-10 demonstrate some of the conspicuous results of municipal reforms undertaken by the Municipal Corporation of Hyderabad during 1998-2002 pictorially.

Figure 2
Municipal Corporation of Hyderabad
Property Tax Collected: 1991-92 - 2001-02

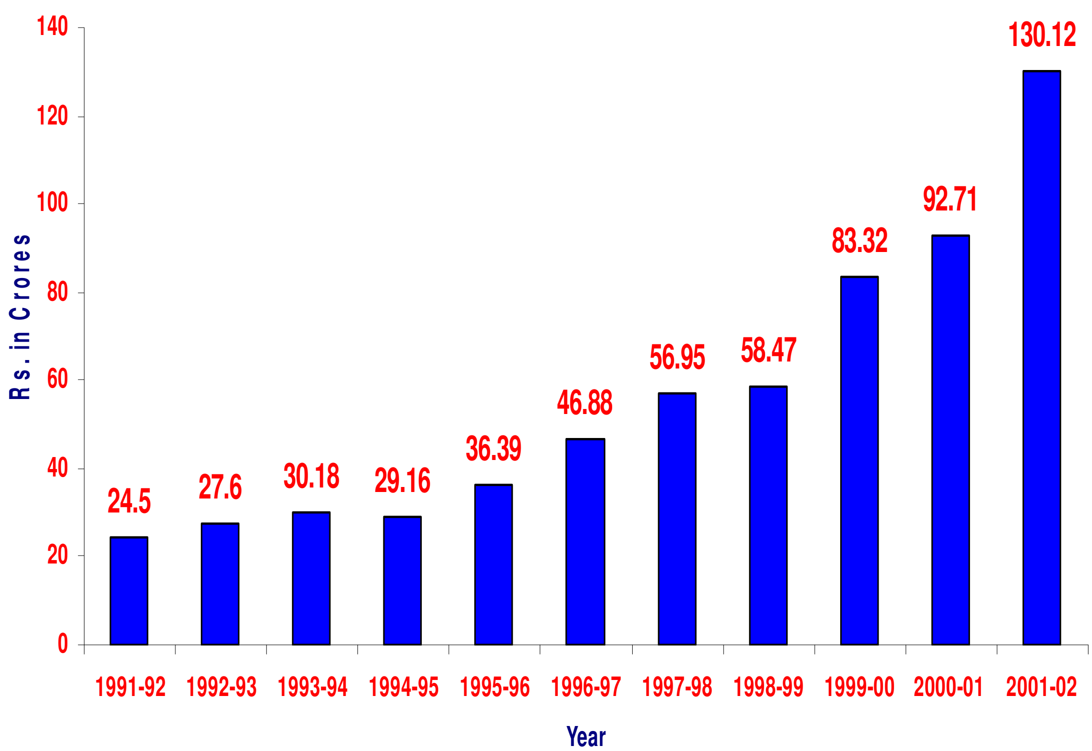


Figure 3
Municipal Corporation of Hyderabad
Trade Licensing Fee Collected: 1991-92 - 2001-02

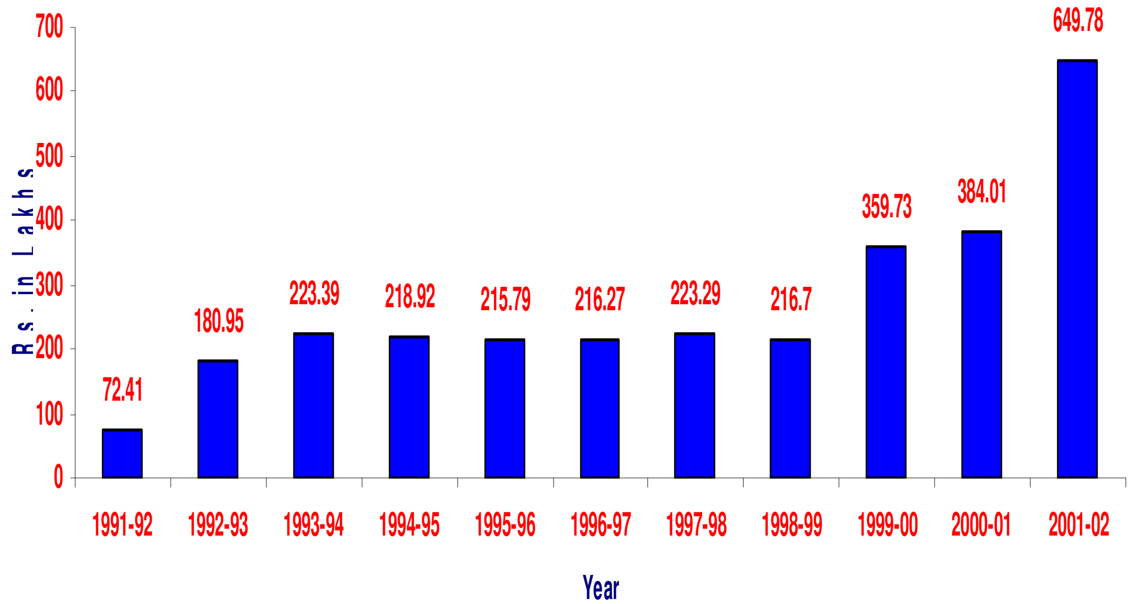


Figure 4
Municipal Corporation of Hyderabad
Advertisement Fee Collected: 1991-92 - 2001-02

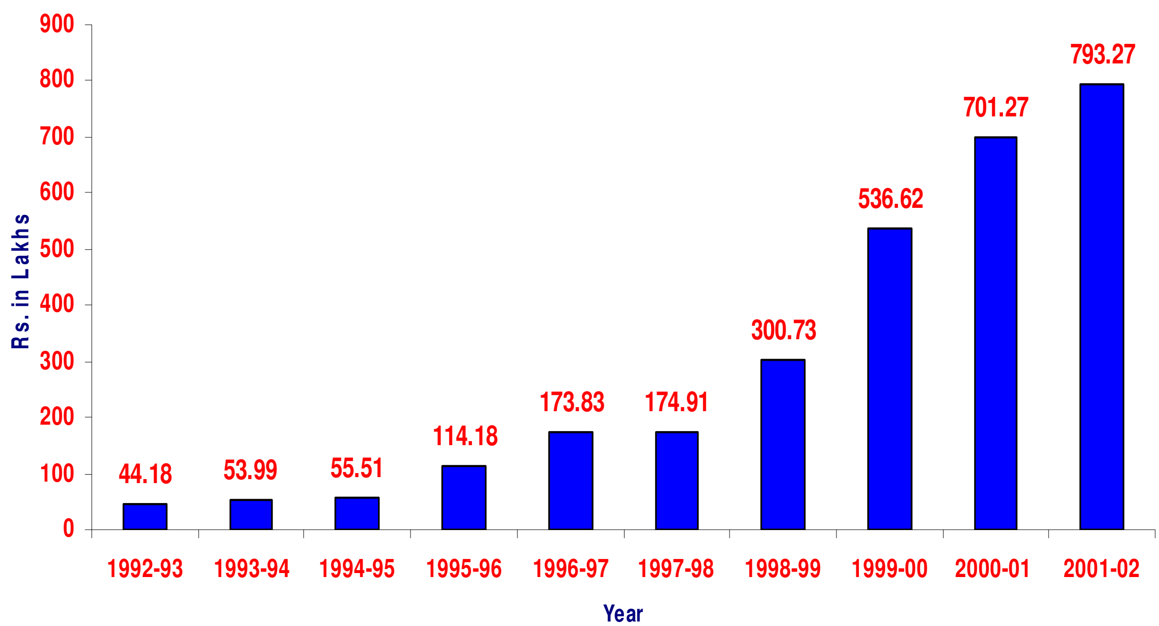


Figure 5
Municipal Corporation of Hyderabad
Public Works Department Charges: 1994-95-2001-02

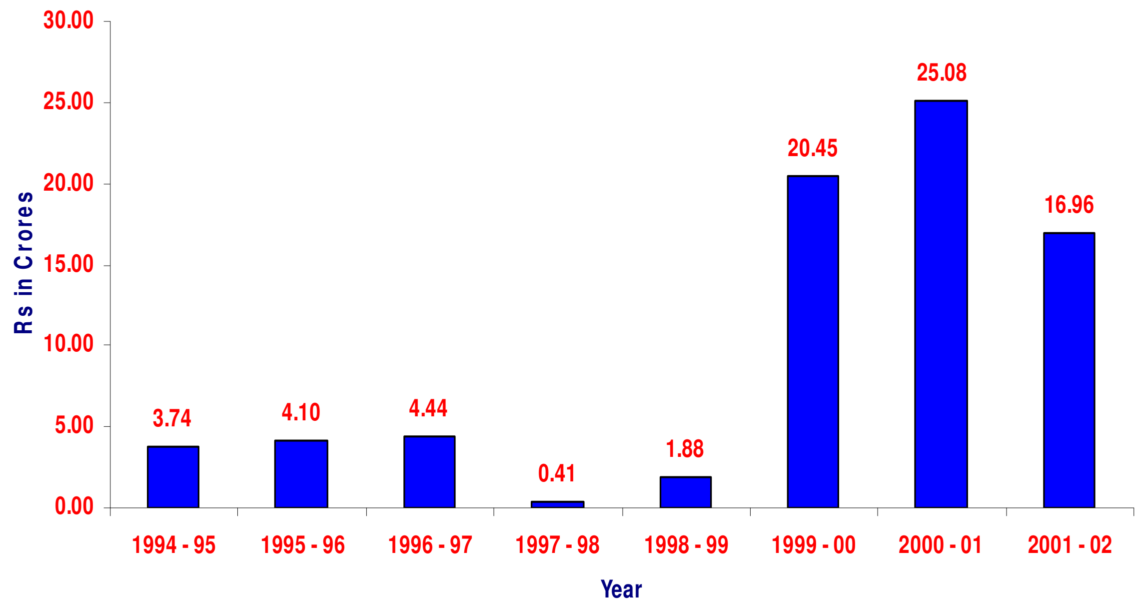


Figure 6
Municipal Corporation of Hyderabad
Parks & Plantation Charges: 1994-95 - 2001-02

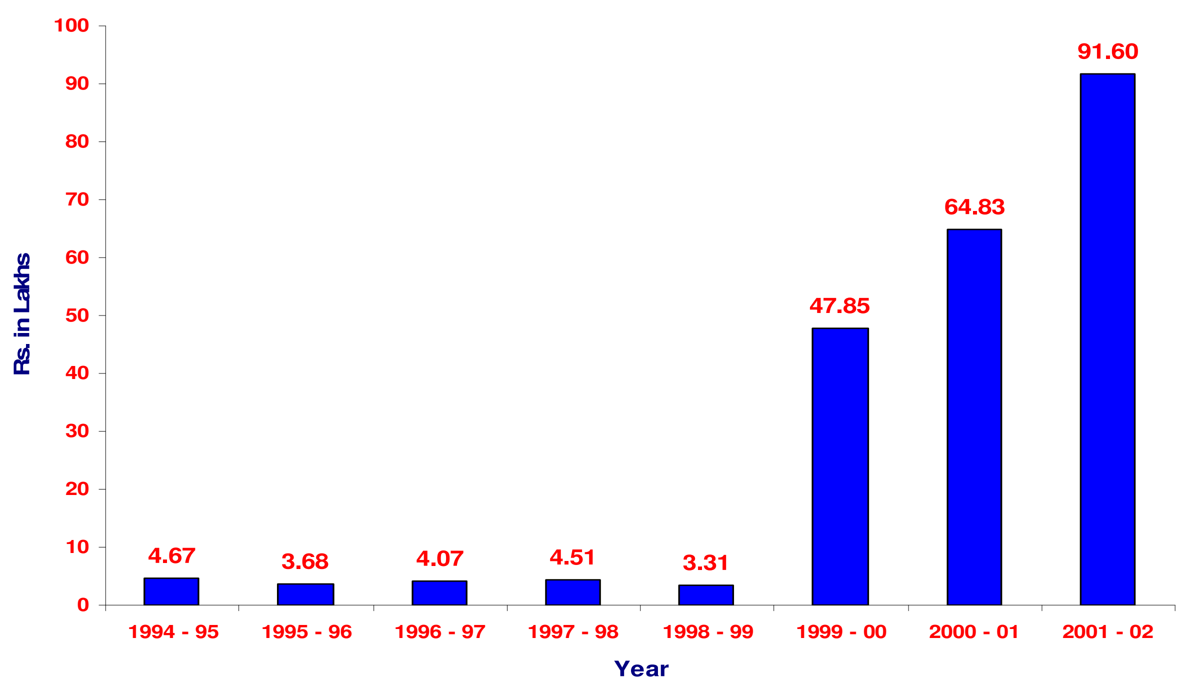


Figure 7
Municipal Corporation of Hyderabad
Town Planning Charges: 1992-93 - 2001-02

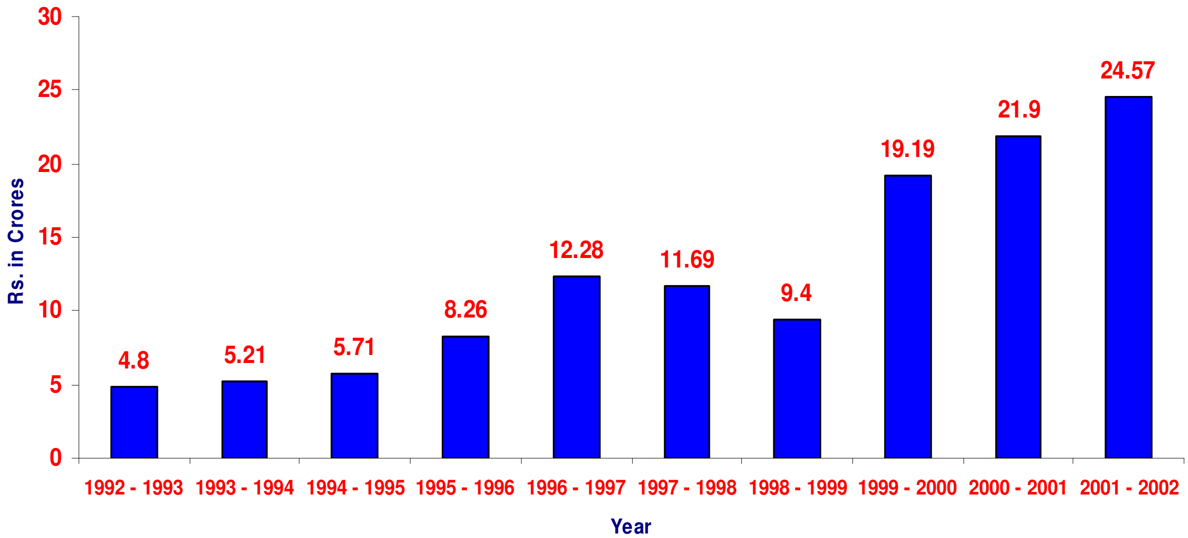


Figure 8
Municipal Corporation of Hyderabad
Betterment (including External Betterment) Charges 1992-93 - 2001-02

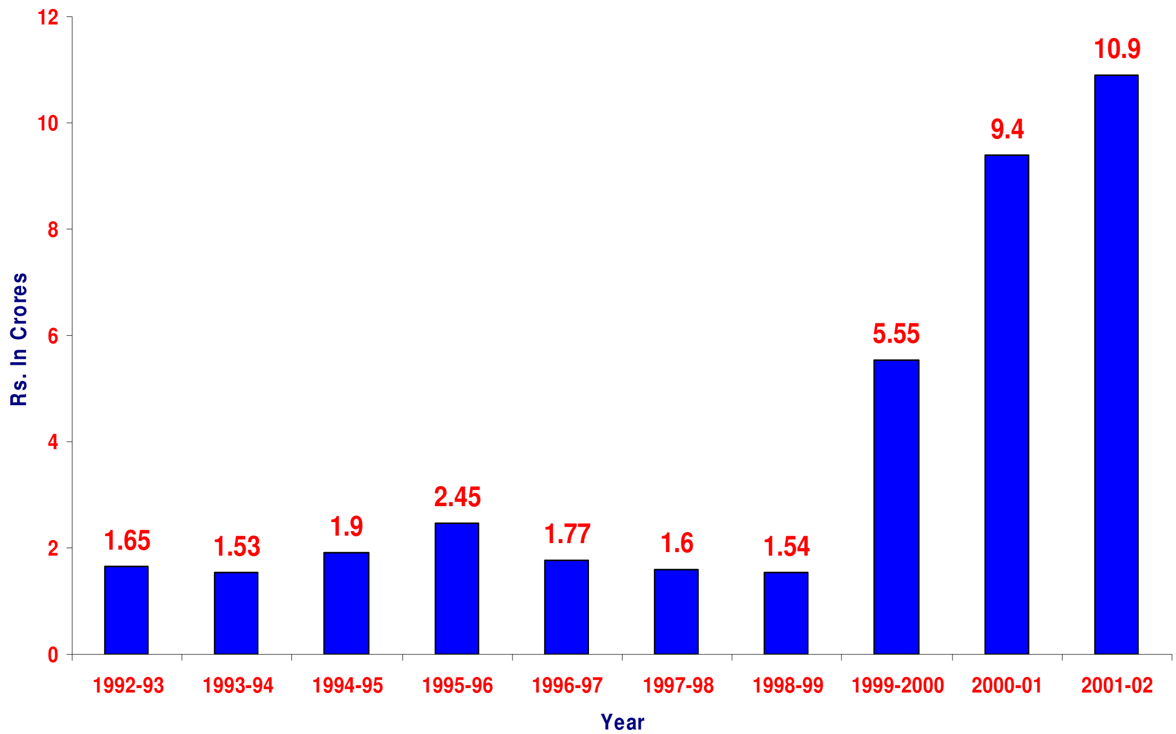


Figure 9
Municipal Corporation of Hyderabad
Capital Expenditure 1994-95 - 2001-02

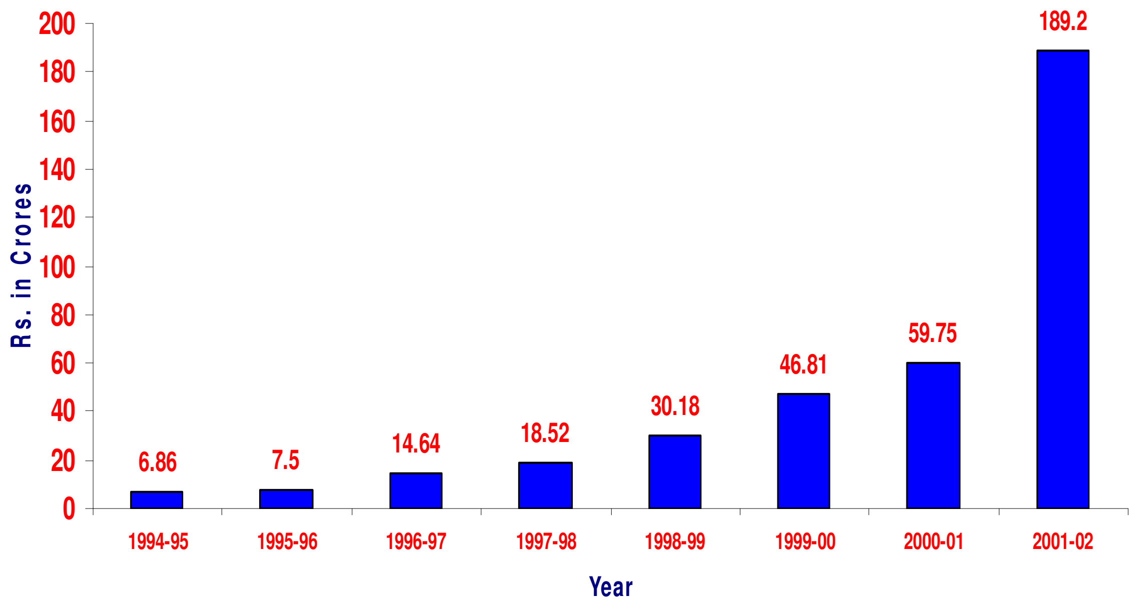
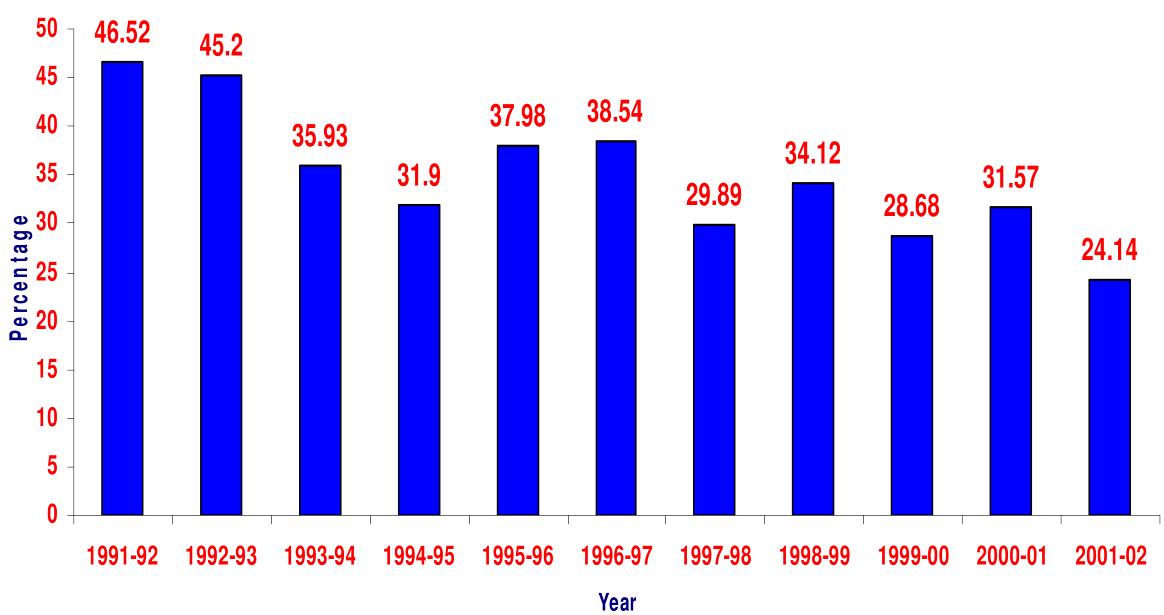


Figure 10
Municipal Corporation of Hyderabad
Trends in Salary Ratio as % of Expenditure:
1991-92 - 2001-02



6.6 How municipal revenue reforms were instrumental for a quantum jump in the provision of civic amenities in Hyderabad city is well-illustrated in Table 16 which compares the achievement under modern lighting programme prior to 1999-2000 with that for the period 1999-2002.

Table 16
Municipal Corporation of Hyderabad
Modern Lighting Programme - No of Points

	Pre - 1999 - 2000	1999 -2000	2000-2001	2001 -2002
Modern Lighting	6416	700	2000	9000
High Masts (Concrete)	64	-	-	-
High Masts (M.S./Galvanised)	107	30	21	79
Conversion of Tubes To SV Lamps	10326	11114	27100	15680
Lighting in Slums	6000	4714	5500	6720
Modern Lighting	6.04	1.75	1.58	22.87
High Mast Lighting	1.88	0.32	1.15	4.34
Conversion of Tube Lights to Sv Lamps	2.58	3.89	10.84	7.95
Lighting In Slums	0.6	1.65	2.20	3.40

6.7 Some key reforms in municipal revenues and expenditures undertaken by the Municipal Corporation of Hyderabad during 1998-2002 are described below:

Self-Assessment of Property Tax

6.8 The Self-Assessment of Property Tax Scheme of Hyderabad Municipal Corporation, introduced in 1999, took advantage of the existing legal provisions under the Hyderabad Municipal Corporation Act, 1955. Section 213 of the Hyderabad Municipal Corporation Act, 1955 stipulates:

"Commissioner may call for information or returns from owner or occupier or enter and inspect assessable premises:-

(1) To enable the determination of rateable value of any building or land and the person primarily liable for the payment of any property tax leviable in respect thereof the Commissioner may require the owner or occupier of such building or land, or of any portion thereof, to furnish him, within such reasonable period as the Commissioner specifies in his behalf, with information or with a written return signed by such owner or occupier-

(a) as to the name and place of abode of the owner or occupier, or of both the owner and occupier of such building or land; and

(b) as to the dimensions of such building or land, or of portion thereof, and rent, if any, obtained for such building, or land, or any portion thereof.

(2) Every owner or occupier on whom any such requisition is made shall be bound to comply with the same and to give true information or to make a true return to the best of his knowledge or belief.

(3) The Commissioner may also for the purposes aforesaid make an inspection of any such building or land".

6.9 While calling for mandatory information under Section 213, the Municipal Corporation of Hyderabad gave tax-payers the opportunity of calculating their own tax under the Self-Assessment Scheme, keeping in view the relevant legal provisions. One month's honest rent in the event a property is let out was considered the benchmark for accepting tax returns although the legally stipulated rate was up to rent for 3 months. Every property tax-payer was assigned a unique property tax identification number (PTIN). The tax records were classified by property category and fully computerised. Correction in the historical tax inequity was the source of mobilisation of a significant increase in property tax despite the lowered tax rate. Simple tax payer-friendly process, lack of discretion on the part of bill collectors and tax inspectors, tax-service linkage, tax education, involvement of resident welfare associations in both service provision and tax payment, scientific classification of properties and computerisation of tax records were the other contributing factors. Appendix 2 describes the salient features of the Self-Assessment of Property Tax Scheme of Hyderabad.

Similar self-assessment schemes were introduced for advertisement fees and trade licensing fee during 1998-2002.

Use of FSI as a Resource

6.10 With a transparent policy of according planning permission and keeping in view the need for road widening, the Government of Andhra Pradesh has permitted the Municipal Corporation of Hyderabad to undertake widening of roads by using Floor Space Index (FSI) as a resource. The Commissioner is authorised to grant building permissions for additional construction area over and above that permitted by the Zoning/Building/FSI Regulations. Land surrendered horizontally is compensated by additionally permitted construction vertically. The Corporation rebuilds the demolished compound walls/other structures and grants permission to land-owners to go up vertically. The extent to which vertical construction is to be permitted depends on the extent of land surrendered by parties and the prevailing FSI in the area. If there is no scope for going vertical, the landowners can avail Transferable Development Rights (TDR) for using the same elsewhere or selling to other builders. In some cases even construction of buildings for non-residential use (commercial/ institutional) is permitted to induce the landowners to part with valuable residential land for road widening.

6.11 Through the process of using FSI as a resource the Municipal Corporation of Hyderabad has been able to acquire 821,253 square yards of lands costing more than Rs.811crores free of cost for the widening of 65 roads during 1996-2002. Table 17 shows the achievements under the Road Widening Scheme during the same period.

Table 17
Floor Space Index as a Resource: Road Widening Scheme – Achievements

Year	No. of Roads Widened	Amount Spent (Rs. In Crore)
1996 - 1997	7	4.16
1997 - 1998	7	1.63
1998 - 1999	8	9.74
1999 - 2000	7	11.20
2000 - 2001	16	10.09
2001 - 2002	23	20.00

Hyderabad City Development Bond

6.12 The Municipal Corporation of Hyderabad floated tax-free bonds (to the tune of Rs.820 million) during March 2002. The issue was assigned CRISIL rating AA+(SO) and ICRA rating LAA+(SO). These ratings have been by far the highest ever credit ratings accorded to a municipal bond in the country. The features of the Hyderabad City Development Bond are as follows:

Issue amount	Rs. 82.50 crores
Offer Opening Date	March 21, 2002
Offer Closing Date	March 27, 2002
Date of Allotment	March 31, 2002
Instrument	Un-secured , non-convertible redeemable tax free bonds in the nature of debentures
Face Value	Rs. 1,00,000/- per Bond
Minimum Application	Five Bonds and in multiples of one Bond thereafter
Credit rating	AA+ (SO) by CRISIL and LAA + (SO) by ICRA
Coupon rate	8.50% p.a. payable semi-annually
Tenor	7 years
Put/call option	At the end of 5th year from deemed date of allotment
Redemption	In two equal installments at the end of 6^{th} and 7th year from the deemed date of allotment.
Interest on application money	8.50 % p.a.
Escrow mechanism	Escrow account of Non-Residential property tax, professional tax, advertisement tax, entertainment tax, stamp duty and town planning charges
Interest payment dates	Semi-Annually - Payable on 01 March and 01 September of each year during the tenor of the Bond.
Tax benefits to the investors	The municipal bonds are eligible for tax exemption under Section 10(15)(vii) of Income Tax Act, 1961.
Trustee	State Bank of Hyderabad, Hybank Towers, Gunfoundry, Hyderabad – 500 001.
Issue Open to:	Companies and Body Corporate including Public Sector Undertakings, Commercial Banks, Regional Rural Banks, Co operative Banks, Financial Institutions Insurance Companies, Any other investor authorised to invest in the Bonds

6.13 The proceeds from the Hyderabad City Development Bond are earmarked to be used only for development projects of regional/city-wide importance. The important project components include: traffic and transportation projects to decongest the city, storm water drainage, sewerage and solid waste management, modern lighting and slum upgradation. In view of the priority for decongesting the city, MCH intended to spend a large chunk of the bond proceeds for road widening, junction improvement, parallel roads, slip roads and link roads, signalisation of intersections, construction of Road Over-bridges, Road Under-bridges, etc. to improve commuting in the MCH area.

6.14 The Hyderabad City Development Bond 2002 is based on an economic theory that suggests the earmarking and linking of development-related taxes and other revenue sources to development works that benefit business and property. When bond proceeds are utilized for development projects which facilitate trade, commerce and economic growth, they enhance land values and tax base. The result is greater mobilization of taxes and charges like non-residential property tax, trade licensing fee, advertisement fee, entertainment tax, professional tax etc. These sources can be pooled together to serve the bonds and as resources grow with the pace of development they generate additional debt-raising and debt-servicing capacity. Thus, a spiral of revenue mobilization through bonds – development works – enhancement in development-related tax base – mobilization of revenue increments – servicing of bonds and further borrowing through bonds – more development – more revenues – more borrowings – more development is expected to lift the city up to higher trajectories of development.

Reforms in Levy of Fees/Charges

Betterment Charges

6.15 The Hyderabad Municipal Corporation Act, 1955 originally provided for the levy of betterment charges to meet the costs of internal infrastructure and services in the case of new development projects. The Government of Andhra Pradesh amended the Act to enhance the scope of such levy to include external betterment. Under this concept, the municipal authority is empowered to collect external betterment charges at the time of according approval to layouts or sub-divisions of plot or issue of building permit. These charges are collected for the laying of major infrastructure facilities such as freeways/ring roads/arterial roads, regional parks, flyovers, etc. At present MCH is collecting external betterment charges at a rate of 30 per cent of the regular betterment charges.

Impact Fees

6.16 The Government of Andhra Pradesh permitted the Municipal Corporation of Hyderabad to levy Impact Fees to mitigate the impacts of construction of commercial complexes that lead to increased traffic necessitating decongestion measures. Distinction is made between on-site and off-site (local area) development cost and city-wide impact cost. The Impact Fees are meant to address city-wide problems emanating from high density commercial development. These fees – levied at Rs.25 per square feet – are required to be deposited in a separate account of the Municipal Corporation and utilised for implementation of capital improvement and decongestion plans i.e., for works such as road widening, link roads, slip roads, parallel roads, junction improvements including traffic signals, fly-overs, rail over-bridges, rail under-bridges, etc. Under no circumstances, the amount is to be spent for salaries and maintenance works.

Open Space Contribution

6.17 To augment resources for enhancing lung space in the city, the Municipal Corporation of Hyderabad introduced Open Space Contribution to be collected from persons applying for development permission. This is required only in the case of lands belonging to layouts, which have not provided 40 per cent statutory open space (for roads and parks). The contributions are used to take up avenue/parks/woodlot/green-belt plantations, parks and compensatory greening. It is proposed to rationalize open space charges and contributions for the creation of a Green Hyderabad Fund.

Bulk Garbage Collection Charges

6.18 Traditionally the Municipal Corporation of Hyderabad has been recovering sanitation costs through the levy of conservancy tax as a component of the property tax. However, the recovery has been inadequately low due to the fact that small and large generators of trash were treated alike under the property tax net. Following the ‘polluters pay’ principle and in order to make the public aware of health and hygiene issues, MCH introduced Bulk Garbage Collection Charges from the bulk generators of garbage such as commercial complexes, markets, hotels, function halls and industries. The establishments identified and brought under coverage for payment of bulk garbage collection charges during 1998-2002 include:

Private/Agricultural Committee Markets	17
Commercial complexes	185
Hospitals: Private & Government	325
Diagnostic Centres	48
Clinics	95
Private Hostels	30
Hotels & Restaurants	576
Function Halls	240
Cinema Theatres	56
Cottage industries & Workshops	180
Total	1752

Administrative Charges

6.19 The Municipal Corporation introduced the collection of Administrative Charges from persons committing sanitation offences such as littering, spitting, dumping of debris, etc. Enforcement and Nuisance Detection Squads of the Corporation are required to go for enforcement operations and education campaigns every day. The rates of administrative charges levied are as follows:

	Rupees
Littering	20 – 100
Debris dumping	100 – 400
Garbage throwing	100 – 200
Easing in the public	50 – 100
Defacing of public walls	200
Road side tethering	200 – 400
Road side dung depositing	200

Budgeting & Accounting Reforms

6.20 The Municipal Corporation of Hyderabad has adopted a three-tier approach to city development planning. This involves the framework of a long-term Perspective Plan (20-25 years), a medium-term Development Plan (5 years), and an Annual Action Plan. The most critical elements of the Annual Action Plan include an appropriate capital improvement plan and a capital budget. The Municipal Corporation has resolved to use the ‘budget’ not only as a tool for financial planning and control but also as a significant instrument to steer the development of Hyderabad. The municipal budget is to be used for effective municipal management and promotion of accountability in service delivery and provision of infrastructure on the part of civic functionaries in addition to being a guide for planning revenues and expenditures. The medium-term budgetary goal of the Corporation is to have the following broad allocation of budgetary resources:

Salaries and Employee Benefits	20%
Maintenance Works	30%
Capital Projects	50%

6.21 The budget of the Municipal Corporation of Hyderabad has been restructured to usher in functional budgeting, with each municipal function treated as a cost centre. The goal fixed by the Corporation is that each function or service must pay for itself directly, with appropriate cross-subsidization policies and safeguards for the poor when required. If the same is not possible, benefit taxes or general taxes will be resorted to. If any subsidy is required to be given from out of the Corporation's general funds, the same must be transparent, targeted and fully justified.

6.22 The Municipal Corporation of Hyderabad has undertaken the computerization of all its accounts and has taken steps to completely switch over to Modified Accrual-based Accounting with a view to making the Corporation's accounts transparent and amenable for easy scrutiny in the context of raising loans from the market by floating bonds. The Corporation has taken steps to have an annual credit assessment so as to have a market view of the Corporation's financial performance and to enable MCH to undertake introspection and corrective measures year after year.

Hyderabad City Development Fund

6.23 The Municipal Corporation of Hyderabad resolved to constitute the Hyderabad City Development Fund to earmark resources for undertaking development/capital improvement works of city-wide significance. The Fund would be used to implement plans for the sustained improvement of infrastructure in the city in conformity with the Hyderabad City Development Strategy. The proceeds of the following sources - collected through the Town Planning Department - would flow into the Hyderabad City Development Fund:

(1) Development Charges;
(2) Receipts towards Internal/On-site/Local Amenities including Betterment Charges;
(3) Receipts towards External/Off-site Amenities including External Betterment Charges;
(4) Layout/Sub-division/Building Permit Fees;
(5) Building Regularisation Fees;
(6) Building Use Regularisation Fees;
(7) Impact Fees;
(8) Compounding Fees;
(9) Projection Charges;
(10) Proceeds from Purchasable Development Rights;
(11) Open Space Contribution;
(12) Other Town Planning Fees/Charges.

The objective behind the creation of the City Development Fund is to ensure that planned spatial development is promoted, using town planning permission as resource. It is believed that sizable resources can be generated from those who gain unearned increments from town planning or planned city development on the principle of "beneficiaries pay". The City Development Fund is to be strengthened every year, receiving funds from earmarked revenues and contributing towards the implementation of municipal capital budget on a sustainable basis.

Hyderabad Community Development & Services Fund

6.24 When the erstwhile ODA (UK)-supported Hyderabad Slum Improvement Project (HSIP) came to a close in 1996, the funding for slum upgradation and poverty alleviation programmes fell to abysmally low levels and the tempo of development under HSIP could not be maintained. The Corporation took a bold resolve in 2001 to create the Hyderabad Urban Community Development & Services Fund with the following components:

(1) 20 per cent of Property Tax collected annually;
(2) 30 per cent of annual Per Capita Grants received from the Government;
(3) Funds received from Government of India/State Government under various ongoing urban poverty alleviation programmes such as Swarna Jayanthi Shahri Rozgar Yojana (SJSRY), National Slum Development Programme (NSDP), Balika Samrudhi Yojana (BSY), Chief Minister's Empowerment of Youth (CMEY) Programme, Adarsh Basti Scheme, etc.

The objective of the Fund is to ensure the sustained flow of resources for slum development, redevelopment and poverty alleviation programmes even in the absence of externally-supported or Government of India-funded projects.

Salary Reserve Fund & Pension Fund

6.25 The Municipal Corporation of Hyderabad has made significant efforts in the recent past to remain a financially strong and sound organisation. It was realized, however, that sometimes on account of time-consuming processes such as elections, summary/special revision of electoral rolls, census, natural calamities and other factors, it might not be possible for MCH to continue the tempo of tax collection and development. Accordingly, the Corporation needed to keep adequate reserves towards salaries and pensions so that the serving municipal employees are always assured of their salaries and retired municipal employees receive their pensions in time whatever be the unforeseen contingencies. The creation of Salary Reserve and Pension Funds by MCH in 2001 was made considering that in many parts of the country and in some Municipalities, the staff do not receive pay for months in view of the precarious ways and means position. Another objective behind the Funds is that the amounts kept could be escrowed and used as collateral in the context of borrowing funds from the market either through Municipal Bonds or institutional finance.

As resolved by MCH the Salary Reserve would be Rs.756 million - equal to one year salary of the municipal employees. The Pension Fund would amount to Rs.250 million.

Expenditure Management & Service Delivery

6.26 In addition to augmenting resources, cost reduction and expenditure rationalisation measures were introduced by the Municipal Corporation during 1998-2002. The latter include reforms in tenders and purchases, elimination of works on nomination basis except in cases of emergencies or works of specialised nature, adoption of competitive bidding and unit rate procedures, introduction of privatisation in sanitation, maintenance of parks, etc. It was decided that a Committee of Additional Commissioners rather than any single officer would deal with all tenders and purchases in the Corporation in a transparent way. While for small standard works, which are repetitive in nature, unit rate system of contract is preferred, for large and heterogeneous works, open tendering is adopted. The unit rate system has resulted in cost-effectiveness and elimination of monopoly by a handful of contractors who used to form cartels, prefer low bids, bag contracts, abnormally delay execution of works and drag MCH to litigation.

Unit Rate System for Public Works

6.27 The Municipal Corporation of Hyderabad introduced the Unit Rate Contract System with a view to improving the quality of general public works by private contractors. The

Corporation has about 1500 registered contractors, who are eligible for tendering for municipal works. Earlier certain powerful groups within the contractors used to form cartels, bid low rates for as many works as possible, get works allotted to them based on lowest tender norm, create monopoly, and resort to the mal-practices of delay, pressure-building and litigation. This resulted in poor quality of works and prolonged court cases. To address the problems, the Municipal Corporation of Hyderabad introduced the Unit Rate system. For different types of works, open tenders are called for constituent work components. The rates quoted by contractors for each component are compared and unit rate for the same is arrived at adopting the minimum figure quoted as the unit rate. Thus, if a work has components A, B, C, D, etc., the basis of work allotment under the standard tendering system and unit rate system would be as follows:

Standard Tendering System:	Minimum (A+B+C+D+….) for each work
Unit Rate System:	Min (A) + Min (B) + Min (C) + Min (D) + .. for a standard work - to be applied to all similar works with pre-qualified or empanelled contractors selected on lottery basis or by a Committee

Under the Unit Rate system, contractors are allocated works in turn on lottery basis. Thus, no single contractor is in a position to monopolize as his turn returns only after all the registered contractors in the queue get a chance. Contractors doing bad work are black-listed and are not allowed to participate in the unit rate process.

6.28 The Municipal Corporation of Hyderabad follows the Unit Rate system for the vast number of small homogeneous local works. For the small number of major works, the procedure of National Competitive Bidding is chosen. The Unit Rate system has given a blow to the monopoly and blackmailing practices of anti-social local contractor groups. It has also contributed to improvements in work quality and savings in cost of tender notifications in news papers.

Privatization of Sanitation

6.29 The Municipal Corporation of Hyderabad is the first municipal corporation in the country to adopt a unique system of outsourcing of sanitation called the "Unit System". Under this system, the entire area of Hyderabad is divided into uniform units for sweeping and garbage lifting purposes. Each uniform unit has a sweepable road length of 7-9 kms and garbage generation to a tune of 7-8 metric tonnes. The cost of sweeping the entire area in the unit and lifting the entire garbage are calculated by MCH based on engineering schedule of rates and the unit cost is determined. The units are allotted to different pre-qualified contractors, invited through an open notification, on the same cost on lottery basis. Performance measurement and monitoring systems are followed strictly, imposing heavy penalties for non-performance. As on date, about 60 per cent of garbage sweeping/lifting in the city is privatized. This Unit System is simple and has proved advantageous as compared to the conventional tender system due to the following reasons:

(1) The possibility of some tenderers quoting very low rates, consequently bagging the contract, forming a cartel and later not performing well is eliminated.

(2) A healthy competition is generated amongst different contractors as the units are uniform, contractual amounts are equal and specifications in the unit cost are clear.

(3) The monitoring is scientific, with both quantity and quality indicators adopted for gauging performance. The unit contractors give undertaking to follow the unit specifications and abide by the performance requirements.

(4) Heavy penalties, including termination of contract, are contemplated for non-performance on the basis of objective considerations.

(5) Good and performing contractors who fail to obtain work on contract basis in a unit rate cycle are kept on waiting list so that they can be assigned units in the event of some contracts being terminated or special units being created.

6.30 One garbage processing plant has been commissioned by a private company, namely M/s. SELCO International at the Gandamguda landfill site of the Municipal Corporation to generate fuel pellets. It is designed to process 700 MT of municipal solid waste (MSW) every day and generate 10 MW of electric power. It is one of its kind in the country to utilize garbage for power generation. The company is now producing coal substitutes and using the same to produce electricity.

Voluntary Garbage Disposal Scheme

6.31 The Municipal Corporation of Hyderabad encourages the public to take up door-to-door collection of garbage in their areas through appointment of their own sanitation workers. MCH provides a tricycle, costing Rs.4500, free of cost to a colony/group of 100-150 houses. The latter engage a rag picker for collecting the garbage from their door-steps every day and pays him @ Rs.10 per household per month. By adopting this scheme, the people get a garbage-free locality and poor rag pickers get gainful employment. This scheme is called Voluntary Garbage Disposal (VGD) scheme. The erstwhile garbage bins from VGD colonies are removed and the collected garbage is deposited at one convenient spot by the tricycle rickshaw puller. Prompt and timely lifting of this garbage by MCH vehicles is ensured every day. About 500 Resident Welfare Associations (RWAs) in the city are having this scheme and are operating about 700 tricycles. The Municipal Corporation has introduced special conditions for new provision of tricycles/replacement of old tricycles with new ones freely. These include: (a) more than three years of good record in scheme implementation/cleaning efforts and (b) prompt property tax payment through the Self Assessment Scheme.

Community Contracting: Women Groups

6.32 Community contracting is a novel scheme introduced by the Municipal Corporation of Hyderabad. The Corporation allotted 14 sanitation units to DWCUA (Development of Women and Children in Urban Areas) Self-help Groups of women on the same terms and conditions for sweeping and garbage lifting as applicable to private unit system contractors. The scheme is running successfully. The women groups are direct contractors to the Corporation and they no longer operate through middlemen. They are working with zeal and dedication. As stipulated by the scheme, the women organize into a thrift and credit group, which decides on the monthly amount to be saved per family. Group savings are used to mobilize credits from banks for members to take up income generation activities and to meet family exigencies.

NGOs in Health Care Service Delivery

6.33 Under the World Bank-supported IPP VIII Project, 19 NGOs were inducted into community development activities in Hyderabad in an integral fashion. Unlike many development projects in which NGOs are engaged in isolated tasks, such as managing a health centre or vocational training program, in IPP VIII Hyderabad, NGOs were involved in all community-based activities: health, education, women's empowerment and slum development. A recent study by the World Bank has observed that the experience of IPP VIII Project in

Hyderabad is exceptional because it has succeeded in gaining an unusually high extent of both NGO and Community participation and has shown strong health-related results. In addition to mobilizing the community and motivating volunteers, the contribution of NGOs has been significant in the areas of immunization, ante natal and pre-natal care, family welfare, counseling for adolescent girls regarding vocational training, continuing education, disadvantages of early marriage, family planning, safe motherhood, prevention of atrocities against women, income generation, thrift and credit, etc.

6.34 Under IPP VIII Project, the NGOs established a network of communication through which all messages relating to health, education, sanitation, etc. are passed on to the community without ambiguity. The slum-dwellers were enabled to establish close linkages with the Municipal Corporation of Hyderabad and Government Departments. 7,800 women slum-dwellers were chosen to work as Link Volunteers in 662 slums to assist their community in accessing better health and other services. Each Link Volunteer is kept in charge of 20 households. These volunteers are not paid any remuneration or given any special benefit. The recognition of the community and the Municipal Corporation are the forces driving them apart from the desire to render social service.

6.35 The key responsibilities assumed by NGOs under IPP VIII Project includes the following:

- Oversee maternal and child health and family planning activities in 20 or more slum communities;
- Identify, train and manage Link Volunteers;
- Organize and manage women's health groups – Mahila Arogya Sanghams;
- Maintain a regular dialogue with community members and health staff through monthly meetings at the Urban Health Post for NGOs, health staff, and IPP VIII Women's Development Officers, monthly meetings in the slum for Link Volunteers, NGOs, and women from the community, monthly meetings in the IPP VIII Project Office for NGOs and project officials, quarterly meetings in the IPP VIII Project Office for NGOs and Medical Officers and annual meetings of all the Link Volunteers in the city;
- Raise awareness on health, environment and family planning issues by organizing health camps, competitions for Link Volunteers and adolescent girls in the slums, special programmes such as World Health Day and Pulse Polio Campaigns;
- Register vital events in slums;
- Manage IPP VIII community-based health and development activities such as revolving funds for women's groups, nursery schools, schools for former drop-outs, adolescent girls' workshops, first-time mothers' workshops, pollution prevention campaigns, etc.
- Establish additional community development activities in accordance with community needs, such as legal literacy programmes and income generation schemes.

The NGOs have been instrumental in establishing networks of Link Volunteers in Hyderabad to expand the outreach of the IPP VIII Project.

Service Delivery Coordination

6.36 Metropolitan cities are multi-governmental. Several levels of government, governmental undertaking and institutions operate in the metro cities. The size and complexities of these cities result in several day-to-day problems of co-ordination, especially in the delivery of civic services and infrastructure. To facilitate co-ordination and collaboration on regular basis, the Government of Andhra Pradesh constituted a City Level Co-ordination Committee. The

Commissioner of the Municipal Corporation of Hyderabad acted as the nodal officer/co-ordinator. The other members in the Committee include senior-most city officers from Police Department, State Electricity Board, Urban Development Authority, Revenue Department, Metropolitan Water Supply & Sewerage Board, State Road Transport Corporation, Roads &Buildings Department, Traffic Police, Telecom and other Departments. The Committee undertakes city level inspection once every week along with the media to sort out various co-ordination problems including those in connection with widening of roads, shifting of services, road cutting to lay service lines, restoration of roads cut, undertaking development and maintenance works, etc.

6.37 The City Level Co-ordination Committee in Hyderabad, apart from sorting out day-to-day city problems, took steps for the co-ordinated preparation of development plans covering aspects such as metropolitan transport, parking, heritage conservation, lakes, parks and playgrounds, city forests, road widening, light rail transit, etc.

Transparency: Face to Face with Public

6.38 As part of reforms, all the senior city level officials and non-officials representing the city attended a 'Face to Face with the Public' programme every Wednesday at MCH in a direct television broadcast programme watched by the public. Any citizen watching the show or not can ask any question over the telephone to the officials and non-officials highlighting civic problems such as water supply, road conditions, street lighting, public bus operations, traffic, law and order, land matters, encroachment, unauthorised construction, conduct of public officials, etc. Assurances are to be given by the concerned officials and the action taken is to be informed to the complainants in writing. The programme had the effect of continuous vigilance by the public over the conduct of civic officials and non-officials and increased responsiveness in service delivery.

7. Lessons for Public Policy

7.1 In the light of the discussions in this paper, focusing on known principles and best practices of municipal finance reforms and citing the Hyderabad municipal reforms experience, we suggest the adoption of a three-pronged Urban Agenda for vitalizing our cities and towns, the engines of national economic growth. This agenda for urban sector reforms should deal with critical institutional aspects related to urban sustainability, issues of municipal organisation and local initiatives for improving the functioning of urban local bodies within the existing frameworks. The key institutional issues that need to be addressed include:

- Creating a legal-institutional framework aimed at enabling the municipalities to function as institutions of self-government and implement plans for economic development and social empowerment;

- Keeping the municipal functions clear and simple so as not to demand highly specialised administration and skill and ensuring that those functions which greatly spillover beyond municipal jurisdictions are not assigned to municipalities;

- Distinguishing between 'production' and 'provision' of public services and creating an enabling framework for public-private-people partnerships, privatisation and outsourcing, where beneficial and feasible;

- Following the broad (Bahl-Linn) principles of assignment of revenues (taxes, user charges, fees, shared revenues, grants-in-aid, borrowings, etc.) to balance municipal responsibilities with finances;

- Matching the benefit areas with the financing areas as far as possible and avoiding the assignment of taxes which can be easily exported to non-municipal areas;

- Most municipal functions being essential, adopting tax buoyancy and adequacy as the key criteria for choosing municipal taxes and according fiscal autonomy to the municipalities to the extent possible;

- Allowing the municipalities to fix their own tax rates; lower and upper limits, if any, may be prescribed 'by law';

- Simplifying property tax system adopting self-assessment scheme and providing for maintenance of property tax base adequately through indexing and regular valuation supported by appropriate legal safeguards;

- Fixing user charge for a service to equate the cost of its provision at the margin as far as possible;

- Addressing the objectives of equity and concern for the poor through subsidies targeted at the beneficiaries and not the services;

- Using specific benefit taxes and user charges for the provision of ‘earmarked’ services (water supply, in particular);

- Adopting "users pay", "beneficiaries pay" and "polluters pay" principles; fiscal instruments to address both direct and indirect beneficiaries.

- Making inter-governmental transfers including sharing of state taxes and grants-in-aid formula based, not amenable to negotiation;

- Incorporating measures of optimal exploitation of ‘own’ taxes into the formula for transfer of funds from the central/state governments to the municipalities to incentivise local resource mobilisation;

- Providing a system of addressing the vertical fiscal gap of municipalities by ensuring better matching between revenue sources and expenditure responsibilities and the horizontal fiscal gap, by a suitably designed grants-in-aid system;

- Adopting borrowing and user finance as the primary sources of capital funding in municipalities;

- Establishing state level financial intermediary and endowing it with appropriate capabilities with a view to promoting market access to the municipalities for financing of infrastructure;

- Developing service standards, unit costs and cost centres for planning, programming, budgeting, and performance appraisal;

- Reforming budgeting, accounting and auditing procedures so as to promote accountability on the part of municipal officials and to decentralise budget management to operational levels;

- Enabling preparation of city perspective, development and annual action plans, capital investment plan and capital budget and making a clear distinction between capital and revenue budgets;

- Developing a transparent system of municipal accountability and disclosure to the public and the higher levels of government through laws and regulations;

- Developing laws and guidelines on information gathering, dissemination, budgeting, accounting, financial reporting, contracts, dispute settlement, design of user charges and grants, audit evaluation, etc., to fully inform the public about the consequences of municipal decisions;

- Enabling the public to have free information and full knowledge of the role of the service providers, the cost of the services, the sources of their financing and the distribution of responsibilities, keeping in view the Freedom of Information Act;

- Defining state-municipal administrative and fiscal relationships clearly on the principle of local autonomy without ambiguity and providing for state intervention in municipal affairs only in exceptional cases.

7.2 While institution-building measures as described above are critically important for the medium- and long-term, the Hyderabad Case Study suggests that improving internal capacity of the municipal organization in the short-term can be equally or even more promising. Agenda to build an efficient and effective municipal organisation and service delivery system may include the following:

- Clarity of vision, objectives and commitment to address the overall challenges of urban sector at the highest authority levels;

- Strong business culture to enhance efficiency. A combination of business-oriented culture and strong administrative leadership provides greater focus and clarifies accountability and capacity to take view of urban needs;

- Location of authority - a vital issue. Decision-making powers in the case a municipal organisation is highly fragmented; for improving efficiency of the municipal organisation there is a need for decentralisation of authority and a greater decision-making capability at the grassroots levels.

- Financial management of a large public agency like a municipal organisation deserves integrated direction by managers with a professional training and commitment. Financial viability based on vigorous exploitation of the local revenue base and sound financial management cannot be compromised;

- Improving technical competence in the choice, design and execution of investment in infrastructure, and in its operation and maintenance;

- Improving human resources through training, process consultation, action research methods and role workshops;

- Improving responsiveness to the needs arising from urban growth, with the ability to plan development of the city and its services ahead of, or at least in pace with demand;

- Sensitivity to the needs of the urban poor, and a weighting of public interventions to promote their access to shelter, basic services and employment; and

- Concern for environmental protection, through public service provision and regulation of the private sector.

Leadership and teamwork are critical for any municipal organisation which manages scores of people: councilors, other political leaders, employees, planners, architects, engineers, contractors, businessmen, citizens, NGOs, CBOs, Neighbourhood Committee members etc. There is a need for effective leadership development and change management programmes to be undertaken for the municipal managers regularly.

7.3 The municipal reforms experience of Hyderabad city provides a number of lessons for improving urban management even within the existing frameworks without major institutional changes. These include:

(a) Tax reform strategy depends to a great extent on the pre-conditions; but certain principles such as the close involvement of the taxpayer, tax-service linkage, incentives for filing of tax returns, disincentives for non-filing, tax education, etc. are important in the designing of successful tax reforms;

(b) Arbitrary adoption of slab rates of tax in the name of elimination of discretion in the levy of tax is not desirable. Slab rates are useful in the case of homogeneous properties. But for heterogeneous properties such as commercial and institutional buildings, slab rates tend to be regressive. They over-tax properties with low rentals and under-tax those with high rentals as averages are affected by extreme items. This is against a fundamental principle of tax reforms, i.e. the market orientation of the tax system.

(c) Correction of inequities in the tax system can be an important source of enhanced mobilization of tax revenues in most cities. Keeping tax rates low and emphasizing enforcement and compliance led to significant increases in the property tax collection in Hyderabad.

(d) Tax education and organized publicity campaigns to address the psychology of taxpayers are often more important in realising the potential of property tax than economic factors such as tax rate and tax base; people must perceive the tax system to be fair and appreciate the linkage between tax and service provision.

(e) Direct involvement of taxpayers in the provision of civic services and providing them information regarding the costs and benefits of services ensure better tax compliance on part of taxpayers;

(f) Expenditure rationalization and cost cutting are equally important reform measures as resource mobilization efforts. Service delivery can be improved significantly with methods such as tender and procurement reforms, outsourcing, involvement of citizens in the provision of services, etc.

(g) Tax reforms need to be pursued in an incremental manner. Elaborate and time-consuming designs may lead to the bouncing back of effort to clean a tax system. Many small experiments may be preferable to mega strategies. Furthermore, 'charity begins at home' and 'small is beautiful'.

7.4 The Hyderabad municipal reforms experience 1998-2002 reveals that sound urban management is perhaps the most vital element of municipal reforms in a developing country like India at present. Institutions are important, but managers running the institutions can only make the difference. Thus, the development of a cadre of professional municipal managers is of critical importance. The resource problems faced by many large cities in India and other developing countries can be tackled to a considerable extent by better tax administration and expenditure management by effective municipal managers with the application of key principles of local public finance and tool of effective urban management and e-governance in several spheres. The Hyderabad experience suggests that:

"Vast schemes, grandiose theories can never achieve the same benefits as the accumulation of smaller, consistent, attainable goals. Hyderabad is one example of what the sum looks like when the many smaller parts that actually work are added up".

'Hyderabad, India: the next Silicon Valley?' - National Geographic, November 2002

Appendix 1
Population Growth Rates of Urban Agglomerations & Cities: 1981-1991 & 1991-2001

U .A./City Proper	Urban Agglomeration (Growth Rate)		City Proper (Growth Rate)	
	1981-91	1991-2001	1981-91	1991-2001
1.Greater Mumbai	33.7	29.9	20.4	20.0
2.Kolkata	19.9	19.9	6.6	4.1
3.Delhi	46.9	51.9	43.2	36.2
4.Chennai	26.4	18.5	28.9	9.7
5.Banglore	41.3	37.8	7.4	61.3
6.Hyderabad	66.5	27.4	39.2	12.8
7.Ahmadabad	29.5	36.4	22.9	18.9
8.Pune	44.8	50.6	30.2	38.3
9.Surat	64.4	85.1	62.2	62.3
10.Kanpur	23.8	32.5	25.8	35.0
11.Jaipur	49.6	53.1	49.2	59.4
12.Lucknow	65.7	35.8	70.8	36.3
13.Nagpur	36.4	27.6	33.2	26.2
14.Patna	19.7	55.3	18.1	33.4
15.Indore	33.7	47.8	31.6	46.3
16.Vadodara	44.0	32.4	40.4	26.6
17.Bhopal	58.4	36.9	58.3	34.9
18.Coimbatore	19.6	31.4	15.9	13.1
19.Ludhiana	71.8	33.7	71.7	33.7
20.Kochi	38.3	18.8	13.5	2.4
21.Visakhapatnam	75.1	25.7	33.0	28.9
22.Agra	26.9	39.4	28.5	29.2
23.Varanasi	29.3	17.5	29.6	18.4
24.Madurai	19.7	10.0	14.6	1.9
25.Meerut	56.5	37.4	67.9	42.5
26.Nasik	63.7	58.8	80.6	63.9
27.Jabalpur	17.4	25.7	20.8	22.0
28.Jamsedhpur	21.9	32.9	5.1	23.8
29.Asansol	52.0	42.7	42.9	85.4
30.Dhanbad	18.9	30.5	26.2	31.1
31.Faridabad	86.7	70.8	86.7	70.8
32.Allahabad	29.9	24.3	28.7	24.9
33.Amritsar	19.2	42.6	19.2	27.3
34.Vijayawada	37.8	19.6	32.9	17.6
35.Rajkot	47.1	53.1	25.7	72.8

Source: Census of India 1971, 81, 91 and 2001

Appendix 2
Hyderabad Municipal Corporation: Self Assessment of Property Tax Scheme 1999

1.1 In terms of economic criteria, property taxes are the ideal taxes suitable for assignment to and administration by Municipalities, being taxes on immobile land and buildings. They belong to the class of general benefit taxes and are indirect user charges for municipal services whose benefits are collective and not confined to identifiable individuals. Sometimes, property taxes are decomposed into components such as water tax, drainage tax, conservancy tax, lighting tax, fire tax, street tax, and general tax. For example, the Greater Mumbai Municipal Corporation levies the following types of property taxes: (i) General tax, (ii) Fire tax, (iii) Water tax, (iv) Water benefit tax, (v) Sewerage tax, (vi) Sewerage benefit tax, (vii) Education cess, (viii) Street tax, and (ix) Tree cess.

The Municipal Corporation of Hyderabad collects property tax under the following components: (a) General Tax, (b) Conservancy Tax, (c) Drainage Tax, (d) Lighting Tax and (e) Library Cess. When property taxes collected under various components are linked to or ‘earmarked’ for the services for which they are collected, they serve as indirect market prices of those services.

1.2 In spite of the fact that property taxes are “ideal” local taxes, because of problems in tax administration they are empirically seen to suffer from the lack of adequacy, buoyancy and acceptability. They are also frequently subject to administrative difficulties including court litigations. Heavy reliance on property taxes is seen to lead to heavy dependence on inter-governmental grants. Residential property taxes are politically unpopular owing to their high visibility and not being related to the current incomes of the taxpayers. In fact in many cities in India, property tax-payers are property-rich but cash-poor. As regards non-residential property taxes, there is an economic case to keep rates reasonable as such taxes are 'exported' to the consumers. However, in the current context of most cities in India, including Hyderabad, tax rate is not the central issue. Undoubtedly the yield from the property tax can be considerably improved by administrative reforms and better enforcement. This point is amply proved by the property tax reform experience of the Municipal Corporation of Hyderabad through the Self-Assessment Scheme 1999..

1.3 General revision of property tax as contemplated under the Hyderabad Municipal Corporation Act, 1955 was not done in various Tax Circles of the Municipal Corporation of Hyderabad for the past few decades on account of several reasons:

Circle	Since how many years Tax not Revised
Circle 1	19
Circle 2	19
Circle 3	23
Circle 4	21
Circle 5	21
Circle 6	17
Circle 7	20

Due to non-revision of tax for a long time, the property tax system in Hyderabad became iniquitous, with large vertical and horizontal imbalances. The property owners continued to pay taxes levied decades ago, causing heavy financial loss to the Corporation. The total number of assessments in the Twin Cities was only about 410,000 in 1998-1999 with total current demand of about Rs. 490 million as against an estimated number of taxpayers of about 600,000.

1.4 Attempts to rationalize and improve the property tax made in Hyderabad earlier were caught in legal problems. Slab rates of tax per square foot of plinth area were fixed during 1992-93 for broad types of properties located in different zones and devoted to different uses. But the scheme could not be implemented for 7 years due to ongoing litigation. After the court case was over, it was thought that earlier the litigation was on the slab rates fixed but the possibilities of new litigation on case by case basis could not be ruled out. Fears of prolongued litigation and the locking up of potential taxes left the Corporation with no alternative but to go in for the scheme of Self-assessment of Property Tax by tax-payers in December 1999.

1.5 Amendments to law take time and go into debates and litigations. Keeping this fact in mind, the Self-assessment of Property Tax scheme, introduced by the Hyderabad Municipal Corporation during 1999-2000, took advantage of the existing legal provisions under the Hyderabad Municipal Corporation Act, 1955. Section 213 of the Hyderabad Municipal Corporation Act, 1955 stipulates :

“Commissioner may call for information or returns from owner or occupier or enter and inspect assessable premises:-

(1) To enable the determination of rateable value of any building or land and the person primarily liable for the payment of any property tax leviable in respect thereof the Commissioner may require the owner or occupier of such building or land, or of any portion thereof, to furnish him, within such reasonable period as the Commissioner specifies in his behalf, with information or with a written return signed by such owner or occupier-

(a) as to the name and place of abode of the owner or occupier, or of both the owner and occupier of such building or land; and

(b) as to the dimensions of such building or land, or of portion thereof, and rent, if any, obtained for such building, or land, or any portion thereof.

(2) Every owner or occupier on whom any such requisition is made shall be bound to comply with the same and to give true information or to make a true return to the best of his knowledge or belief.

(3) The Commissioner may also for the purposes aforesaid make an inspection of any such building or land”.

While calling for mandatory information under Section 213, the tax-payers were given the opportunity of calculating their own tax under the Self-Assessment Scheme, keeping in view the relevant legal provisions.

Rationale for Self-Assessment

1.6 The objectives behind the introduction of the Self-Assessment of Property Tax scheme are:

(1) To ensure complete transparency and openness in the levy and collection of property tax and to enable citizens/tax-payers to understand the basis of taxation so as to calculate the tax by themselves;

(2) To build a computerised property tax data base with each property in the Twin Cities of Hyderabad and Secunderabad being assigned a unique Property Tax Identification Number (PTIN) so as to eliminate discretion in the levy and collection of tax, minimise inconvenience to the public, prevent any complaints of harassment and raise resources for city development;

(3) To promote equity in tax payment (similar properties devoted to similar use in same or similar areas with similar rent-earning capacity must pay similar taxes);

(4) To link local services with tax payment so that tax-payers get value for money (quality services) and also feel proud of contributing their mite to the development of their own city and also assisting their fellow citizens, living in slums and poor localities, to gain access to basic minimum services;

(5) To minimise prolongued disputes between tax-payers and MCH running into years and to establish a healthy relationship between MCH and Tax-payers/Resident Welfare Associations.

Filing Requirement

1.7 The Self-Assessment Scheme required the filing of Self-Assessment Return by all property owners/occupiers (owners/tenants/lessees, etc.) in the prescribed form in the following cases:

(1) whose properties were assessed by MCH before 1.4.1991 (Date of 1991 Census);

(2) whose properties were assessed after 1.4.1991 but who feel that they are not paying adequately given the legal provisions;

(3) whose building/property has not been fully assessed (some part of Plinth Area yet to be assessed);

(4) who have completed their buildings in the recent or distant past but who have not informed MCH regarding the same as required under Section 210 of the HMC Act, 1955 and/or who have not applied for assessment;

(5) who have made additions or alterations to their buildings or have reconstructed their buildings fully or partly but have not applied to MCH for assessment/reassessment of added/altered/reconstructed portions;

(6) who have fully or partly converted their buildings from residential into non-residential use (commercial/institutional/industrial, etc.) after last assessment but have not applied for assessment/reassessment of converted portions;

(7) who have been exempted from payment of tax in the past. The filing of return is necessary to enable MCH to renew the exemption granted (to the extent of what is legally permissible).

1.8 The Self-Assessment Scheme prescribed who could file self-assessment of property tax returns as follows:

(1)	In case of Owner-occupied individual building/flat	: By the Owner
(2)	In case of Rented building/flat	: By the Owner and/or Tenant/Occupier
(3)	In case of Company	: By the Secretary
(4)	In the case of Partnership Firm	: By the Managing Partner
(5)	In the case of Public Body (Corporation or Society)	: By the Secretary or Principal Officer
(6)	In any Other Case	: By the Owner and/ or Person who has taken the Premises on Rent.

The above prescriptions take into account Section 204 of the Hyderabad Municipal Corporation Act, 1955 which stipulates:

"Primary responsibility for property taxes on whom to rest:-

(1) Property taxes shall be leviable primarily from the actual occupier of the premises upon which the said taxes are assessed if such occupier holds the said premises immediately from the Government or from the Corporation.

(2) Otherwise the said taxes shall be primarily leviable as follows, namely:-

(a) if the premises are let, from the lessor:

(b) if the premises are sub-let, from the superior lessor: and

(c) if the premises are unlet, from the person in whom the right to let the same vests.

(3) But if any land has been let for any term exceeding one year to a tenant, and such tenant has build upon the land, the property taxes assessed upon the said land and upon the building erected thereon shall be primarily leviable from the said tenant or his legal representative, whether the premises be in the occupation of the said tenant or of his legal representative, or of sub-tenant".

1.9 Self-Assessment Tax Calculation: Guide

Step 1: Measure Plinth Area (PA) of your Property/Building. This determines PA.

Step 2: If Self-occupied, find out prevailing Market Rent per Square Feet per Month for similar Properties in the vicinity. This will give MRV per Sft.

If rented out, state the rent obtained per Sft per Month (based on Rental Agreement). If the rent obtained is low, you may state the prevailing Market Rent for similar properties for the purpose of taxation and make the Occupier pay the property tax. This will give MRV per Sft.

Step 3: Property Tax payable may be calculated as follows:

Residential:

No Tax: If Monthly Rent expected is less than Rs.50.

Tax = Plinth Area (PA) X MRV per Sft X 12 X 0.17 if Monthly Rent expected is between Rs.51 and Rs.100 – 10% Depreciation
Add 8 per cent towards Library Cess

= Plinth Area (PA) X MRV per Sft X 12 X 0.19 if Monthly Rent expected is between Rs.101 and Rs 200 – 10% Depreciation
Add 8 per cent towards Library Cess

= Plinth Area (PA) X MRV per Sft X 12 X 0.22 if Monthly Rent expected is between Rs.201 and Rs 300 – 10% Depreciation
Add 8 per cent towards Library Cess

= Plinth Area (PA) X MRV per Sft X 12 X 0.30 if Monthly Rent expected is more than Rs.300 – 10% Depreciation
Add 8 per cent towards Library Cess

Non-Residential:
Tax = Plinth Area (PA) X MRV per Sft X 12 X 0.30 - 10 % Depreciation
Add 8 per cent towards Library Cess

The above formulae were notified as guidelines only. The enlightened Tax-payers of the Twin Cities were requested though advertisements to calculate their own Self-Assessment Tax taking account the provision of law as appropriate, prevailing rental values, the costs of civic services and the need to contribute to the development of their city.

Benchmarks for Acceptance
1.10 Under the Hyderabad Municipal Corporation Act, the taxpayer is required to pay three and half months rental value as tax. However, in practice, citizens had been paying less than a month's rent in a large number of cases and there had been thousands of court cases when attempts were made to increase tax. Accordingly, under the Self-Assessment Scheme, no stipulation was made by the Corporation as to at what rates tax-payers should file returns. However, meetings with numerous Resident Welfare Associations were facilitated by the Municipal Corporation. These associations were educated regarding the legal provisions and were also informed that ignorance of law is no excuse while ignorance of fact can be ignored. The Corporation facilitated the process of formation of groups of resident welfare associations into federations and a proposal was mooted to form a confederation of resident welfare associations for the city as a whole. One of the resident welfare associations, namely, Resident Welfare Association of Madhuranagar came with suggestions regarding benchmarks for acceptance of tax returns during 1999-2000. The Association resolved that properties could broadly be divided into three categories: (a) high rent areas, (b) middle rent areas and (c) low rent areas. The benchmark Monthly Rental Values for acceptance of tax returns for the above categories were adopted by the Association at Rs.1/-, 0.60 Paise and 0.40 Paise respectively. These rates were accepted by many Resident Welfare Associations.

Instead of the Municipal Corporation of Hyderabad formally declaring tax rates, the facts of resident welfare associations adopting benchmark rates were published in print and electronic media. Once the benchmark monthly rental values were published, other resident welfare associations adopted the rates and filed self-assessment returns.

1.11 The only moot point in the fixation of three slab rates was whether a property owner, which is supposed to adopt a higher slab, escapes with a lower one. However, this was not a matter of great concern as tax-payers had been paying at so low rates and taking recourse to law suits so frequently that MCH wanted to ensure that reforms took place in stages and initial efforts did not bounce back. Successful experiences of tax reforms suggest that major reforms need to be incremental. Accordingly, MCH was content with the position that at least one month's honest rent would accrue as tax and that there is adequate temptation for tax-payers to file returns without taking the risk of being caught and being subjected to regular process of valuation with the risk of paying 3 and ½ months rent as tax and getting harassed.

MCH did not accept the systems of slab rates adopted by Corporations like Patna, Bangalore and Chennai as slab rates are averages and averages are affected by extreme items. Averages are representative only when the data are homogeneous. Thus, in case of residential properties, slab rates could be adopted with precision but for heterogeneous properties such as those belonging to commercial and institutional categories, averages have the tendency of under-taxing the properties at the upper end of the real estate market and over-taxing those at the lower rung. Thus fixing slab rates with a mix of heterogeneous commercial properties turns out to be regressive. Moreover, for most commercial properties rental data are now available. Especially in Hyderabad all rental deeds need to be compulsorily registered for the purpose of payment of stamp duty. Thus, when market information is available, there is no need for approximation by a round-about and regressive method in the name of eliminating discretion on the past of tax assessors.

Verification of Returns

1.12 The Self-Assessment Notification issued by the Corporation informed the citizens that MCH would take up random verification of Self-Assessment Forms as in the case of Income Tax Assessment. However, during 1999-2000, MCH proposed to undertake field verification of about 25% of the Returns filed by Residential Property owners/Occupiers. The property owners were told that those concealing measurements and/or rent and adopting unbelievably low Tax Rate per Square Feet in their Returns would be taken up for detailed field verification and assessment following the legal process. Further those property owners/occupiers who did not file the returns by the date fixed would be dealt with in accordance with the penal provisions of the HMC Act, 1955 and other Acts.

Tax Education Campaign

1.13 Tax education is very important for the success of tax reforms. Accordingly, the Municipal Corporation of Hyderabad resorted to systematic publicity campaigns, covering aspects tax law, tax-service linkage, Corporation's duty and citizens' responsibility.

Achievement of Self-Assessment Scheme

1.14 The Self-Assessment scheme has been very successful. About 130,000 filed self-assessment returns within 4 months of the introduction of the same, resulting in more than 50 per cent increase in the property tax within months. Property tax collection went up from Rs.58 crores in 1998-1999 to Rs.82 crores in 1999-2000 although the effective tax rate went down by almost two-thirds. The sources of the increase have been the correction of long-standing inequities in the property tax system and better record-keeping.

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