

Evaluating the Financial Health of Indian Cities: A Diagnostic Report

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Abstract

The financial health of an urban local body (ULB) is indicated by a set of closely interrelated factors and not merely income-expenditure balance. In fact surplus revenue is often required by statute and may not be a sound indicator of the financial health of a ULB. These questions are of fundamental importance under the recently launched Jawaharlal Nehru Urban Renewal Mission (JNNURM). Based on a sample of 17 out of 63 cities under JNNURM, this paper addresses the following question: Why do some municipalities have better financial performance relative to others and what explains the differential financial performance of municipalities? The paper investigates this question in relation to (i) the impact of fiscal domain on their performance, (ii) the effect of state transfers on the financial performance of municipalities; and (iii) the effect of functional role of municipalities on their performance. The paper is organized accordingly with a final section on the summing up of the analysis added.

Keywords: Municipal Finance, Urban Local Body (ULB), Seventy-Fourth Constitutional Amendment (74th CAA), and Urban Renewal

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The Constitution of India specifies the taxes to be divided between the central and state governments but it does not specify the revenue base for urban local bodies (ULBs). Further the 74th CAA is not specific about the types of taxes ULBs should have but on the other hand the powers for determining the revenue base of ULBs rests with the state governments. The resource base of ULBs typically consists of their own resources (tax and non-tax revenues), shared revenues, state grants, and loans from state governments and market borrowings. Urban areas are known to contribute more than sixty percent of national income. Yet in terms of resources, ULBs raise only 0.63 percent of national income (GDP) from its own resources for the year 2001-02 (NIPFP 2004). It is clear that the resources of ULBs do not derive their basis from the buoyant urban economy.

Table 1: Revenue Significance of the Center, States and Urban Local Bodies

	Own revenues in rupees crores and their percentage share			
	1991-92	1997-98	2000-01	2001-02
Central government	83320.0 (61.3)	189688.0 (63.8)	250022.0 (61.9)	238671.0 (57.5)
State governments	48660.0 (35.8)	99306.6 (33.4)	141786.8 (35.1)	163986.0 (39.5)
ULBs	3900.0 (2.9)	8434.9 (2.8)	12018.4 (3.0)	12748.1 (3.0)
Total	135880.0 (100.0)	297429.6 (100.0)	403827.2 (100.0)	415405.1 (100.0)

Source: NIPFP 1995 and NIPFP 2004.

In 2001-02, the aggregate own revenue of ULBs was Rs.12748 crores compared to the aggregate own revenue of ULBs of Rs.3900 crores in 1991-92. Annual exponential growth rate of ULBs comes to 11.8 percent during 1991-92 to 2001-02 compared to annual exponential growth rate of 12.2 and 10.5 percent for states and center respectively. These revenues formed 3 percent at ULBs level whereas the share of the central government and state governments being 57.5 percent and 39.5 percent respectively. Surprisingly, the percent share contributed by the ULBs over the period of last ten years has not improved as it has marginally grown from 2.9 percent in 1991-92 to 3 percent in 2001-02. "The revenue base of municipalities in Indian states has shown little signs of any change, notwithstanding the 74th CAA, 1992; indeed, octroi – a major revenue for municipalities – has been abolished without substituted by any other local source". NIPFP 2004.

Data for the present paper has been drawn from the City Development Plans (CDPs) which are prepared under Jawaharlal Nehru National Urban Renewal Mission (JNNURM). Seventeen cities of in terms of their financial performances (municipal finance) constitute the sample for the paper. Time period for the present analysis is of three years i.e. 2001/02, 2002/03 and 2003/04. The municipal income and expenditure details have been extracted on the heads such as total income and total expenditure, revenue income and revenue expenditure, capital income and capital expenditure, own resources with tax and non-tax receipts, state transfers with assigned revenues and grant-in-aid, expenditure on establishment and salaries and expenditure on operation and maintenance works. Apart

from these financial statistics tax and non-tax domains together with functional domains have also been taken into consideration. Population for the years 1991 and 2001 residing in municipal limits have been used to estimate population for 2002, 2003 and 2004 on the basis of the annual exponential growth between 1991 and 2001. Based on these population estimates, per capita municipal finance statistics have been generated.

This paper addresses the following question: why do some municipalities have better financial performance relative to others and what explains the differential financial performance of municipalities? The paper investigates this question in relation to-

- i. the impact of fiscal domain on their performance,
- ii. the effect of state transfers on the financial performance of municipalities; and
- iii. the effect of functional role of municipalities on their performance

The paper is organized accordingly with a final section on the summing up of the analysis added.

By looking at the municipal corporations' population size and their population growth during the last decade, it can be clearly seen that the large municipal corporations having population more than three million have shown comparatively much slower annual average growth rate than that of the category of population ranging between 1-3 million and of the category with population less than one million. The municipal corporations, which have shown relatively higher growth rates, are Vishakapatnam, Madurai, Rajkot, Surat, Jaipur, Pune and Raipur. The main reasons for their higher growth rates are due to adding up of periphery areas in municipal limits.

Table 2: Population 1991, 2001, Exponential Growth Rate and Estimated Population

Municipal Corporation	Population	Population	Growth rate (%)	Estimated population	Estimated population	Estimated population
	1991	2001		2002	2003	2004
Hyderabad	30.5	36.3	1.74	36.94	37.59	38.25
Vishakapatnam*	7.44	9.6	8.25*	10.43	11.32	12.3
Vijayawada	7.02	8.45	1.85	8.61	8.77	8.93
Guwahati	5.84	8.1	3.27	8.37	8.65	8.94
Raipur	4.61	6.7	3.74	6.96	7.22	7.5
Ahmedabad	28.77	35.2	2.02	35.92	36.65	37.4
Surat	14.99	24.33	4.84	25.54	26.8	28.13
Vadodra	10.31	13.06	2.36	13.37	13.69	14.02
Rajkot	5.59	10.02	5.84	10.62	11.26	11.94
Mysore	6.53	7.86	1.85	8.01	8.16	8.31
Indore	11.04	15.43	3.35	15.96	16.5	17.06
Pune	16.91	25.38	4.06	26.43	27.53	28.67
Nagpur	16.22	20.5	2.34	20.99	21.48	21.99
Jaipur	15.2	23.2	4.23	24.2	25.25	26.34
Coimbatore	8.06	9.31	1.44	9.45	9.58	9.72
Madurai*	9.41	9.29	5.87*	9.85	10.45	11.08
Chandigarh	6.42	9.01	3.39	9.32	9.64	9.97

Note: Growth rates of Vishakapatnam and Madurai Municipal Corporation are based on population estimates provided in their respective CDPs.

Fiscal powers:

Municipal corporations by virtue of their status derive their fiscal powers from state legislature. Generally, municipal corporations are assigned those revenue powers (tax and non-tax) that are leviable on bases, which are “immobile”, and those whose burden cannot be exported outside the municipal jurisdiction. State Municipal Acts generally divides the revenue powers of municipalities in two broad categories i.e. compulsory taxes and discretionary taxes (see Table 4). Large variations are observed in assignment of the revenue powers across various states and across various municipal bodies – be it the tax authority, tax base, tax rate setting and revisions, local tax autonomy etc. Level and depth of levying these revenue powers also varies across various states and across various municipal bodies e.g. octroi levying municipal corporations’ entire focus on octroi collections rather than implementation of property tax etc.

Table 3: Tax Domain of Municipal Corporations

Tax domain	Municipal corporations
Octroi and composite property tax	Surat, Pune, Ahmedabad, Vadodra, Nagpur, Rajkot
Composite property tax (Octroi abolished)	Vishakapatnam, Coimbatore, Vijayawada, Madurai
General property tax and water tax (Octroi abolished)	Indore, Raipur, Mysore
General property tax only	Jaipur, Guwahati, Hyderabad*, Chandigarh (commercial property tax only)

Note: * In case of Hyderabad, HWSSB (Hyderabad Water Supply and Sewerage Board) levies and collects water related taxes and user charges etc.

On the basis of the fiscal powers the sample cities can be divided in four broad categories. First category of the cities is where the octroi is still being levied together with composite property tax. Composite property tax generally includes water, drainage, sanitation, lighting tax etc. in addition to general property tax. The second category of cities is where the octroi is abolished but composite property tax is being levied. The third category is where general property tax together with water tax is being levied and the fourth category is where only general property tax is being levied either on all properties or on commercial properties only.

Table 4: Revenue Powers of Municipal Corporations Across Sample States

State	Tax		Fee
	Compulsory	Discretionary	
Andhra Pradesh	Property: (lighting*, water*, scavenging*, drainage*, general purposes*), advertisement, vehicles, duty on transfer of immovable property, animals		Mutation fee, registration fee, market fee, trade license fee, compounding fee, slaughter house fee, license fee
Assam		Property: (water*, lighting*, drainage*), markets, toll on bridges, transfer of property	License on carts, carriages, animals, dogs and cattles, boats, betterment, fire brigade, public health
Gujarat	Property, vehicles, boats, animals, octroi	Toll, dogs	Registration fee, development, license fee, swimming bath fee, slaughter house fee, building construction fee, shop registration fee, water or connection fee, cattle pound fee
Karnataka	Land and buildings, advertisement, toll on vehicles, additional stamp duty, water tax		License fee (building, trade, hotel), building betterment fee, birth and death registration fee, food and adulteration fee, slaughter house fee, compounding fee
Madhya Pradesh	Property, water, light, sanitary cess, fire	Latrine, conservancy, drainage, profession, vehicles, animals, toll on vehicles and animals, betterment, pilgrim, persons occupying houses, buildings, land according to circumstances and property, toll on new bridges, entertainment, advertisement, terminal	License fee, market fee animal registration fee hotel/restaurant license fee, composting fee, tehbazari fee, building application fee, compounding fee
Maharashtra	Consolidated property tax (property tax, water and water benefit tax, sewerage and sewerage benefit tax), octroi, dogs, theater, vehicles and animals, education cess	Street tax	License fee, slaughter house fee, building permission fee, water connection fee, warrant fee, PFA license fee, cattle pounds fee, swimming pool fee, birth & death registration fee, development fee
Punjab (Chandigarh)	Lands and buildings, vehicles, animals, advertisement, development	Profession, trade and callings	License fee, slaughter house fee, composition fee, tehbazari fee, fire service fee, connection fee, copying fee, building application
Rajasthan	Property, professions and vocations	Vehicles and other conveyance, dogs, animals, toll on vehicles, boats, scavenging, latrine, sanitary, lighting, water, trade and calling, artisans	Advertisement fee, permission fee, license fee, registration fee, cattle pound fee, bus stand fee, copying fee
Tamil Nadu		Property, profession, lighting, drainage, vehicles, duty on transfer of immovable property, carriage and animals, care, advertisement, timber, servants (hill stations)	License fee (building, hotel, restaurant, dangerous & offensive trade), market fee, slaughter house fee, cart stand fee, encroachment fee

Source: State Municipal Acts.

Note: 1. Vehicles imply non-motorized vehicles, unless otherwise specified.

2. Rajasthan: Tax on trade and calling is different from tax on profession and compulsory tax.

* Included under a consolidated property tax.

vocation, which is a

Revenue structure

Revenue receipts of municipal corporations can be divided in two broad categories i.e. receipts from own resources (tax receipts and non-tax receipts) and receipts from state transfers. The tax receipts of municipal corporations accrue from taxes on properties (general or composite), octroi, advertisement tax, professional tax, taxes on vehicles and animals and theatre tax etc. The non-tax receipts include user charges on services, rental income from municipal properties, fees and fines, developmental charges etc. Transfers from state government generally include shared taxes, general and specific purpose grants and grants recommended by State Finance Commissions.

Table 5: Own Revenue Receipts and State Transfers as Percent of Revenue Receipts

Municipal Corporation	Own revenue receipts as % of revenue receipts			State transfers as % of revenue receipts		
	2001/02	2002/03	2003/04	2001/02	2002/03	2003/04
Hyderabad	67.57	59.68	67.50	32.43	40.32	32.50
Vishakapatnam	78.96	62.67	70.23	21.04	37.33	29.77
Vijayawada	53.92	62.13	61.70	46.08	37.87	38.30
Guwahati	78.97	70.70	63.09	21.03	29.30	36.91
Raipur	38.49	41.01	40.47	61.51	58.99	59.53
Ahmedabad	84.10	85.51	88.08	15.90	14.49	11.92
Surat	93.55	67.77	91.48	6.45	32.23	8.52
Vadodra	86.02	85.44	88.65	13.98	14.56	11.35
Rajkot	94.80	90.07	92.71	5.20	9.93	7.29
Mysore	53.53	54.48	53.55	46.47	45.52	46.45
Indore	44.36	40.34	52.19	55.64	59.66	47.81
Pune	93.11	94.23	93.56	6.89	5.77	6.44
Nagpur	89.44	91.61	91.64	10.56	8.39	8.36
Jaipur	31.07	31.45	20.29	68.93	68.55	79.71
Coimbatore	67.37	53.89	64.92	32.63	46.11	35.08
Madurai	71.72	53.35	57.99	28.28	46.65	42.01
Chandigarh	42.25	41.79	41.93	57.75	58.21	58.07

At macro level the table shows a large variation in the performance of municipal corporations based on the criterion of own revenues. Further there are variations among municipal corporations even within the same state. The cities can be divided in three categories i.e. high, medium and low capacity to generate own revenues respectively. The first category where the ratio of own revenue receipts as percent of revenue receipts had ranged from 88 percent to 93.6 percent for the year 2003-04, these cities have a buoyant source of octroi income, these are the cities of Gujarat –Rajkot, Surat and Ahmedabad and the cities of Maharashtra –Pune and Nagpur. The second category contains cities where the octroi is abolished but other reforms are in process such as property tax reforms etc. In this category the cities are from developing states such as Tamilnadu (Coimbatore and Madurai), Andhra Pradesh (Vishakapatnam, Hyderabad and Vijayawada) and Karnataka (Mysore). Third category contains those cities where the capacity to generate own revenues is low and dependency on state transfers is high, these are Jaipur, Raipur, Chandigarh and Indore.

Own revenue receipts

In per capita terms, the cities with octroi have high own resources and ranges from Rs.883 to Rs.2015 for the year 2003/04; these cities are Surat, Pune, Ahmedabad, Vadodra, Nagpur and Rajkot with per capita amounts of Rs.2015, Rs.1989, Rs.1627, Rs.1431 and Rs.1127 respectively. Non-octroi cities from developing states ranges from Rs.721 to Rs.771 for the year 2003/04, these are Vishakapatnam, Coimbatore, Vijayawada and Hyderabad whereas the cities of under developed states have very low per capita own resources ranging from Rs.86 to Rs.523 only and moreover these cities have negative growth rates of collections which is worrisome feature for the respective municipal administration.

Table 6: Own Revenue Capacity of Municipal Corporations

Own revenue capacity	Municipal corporations
High	Surat, Pune, Ahmedabad, Vadodra, Nagpur, Rajkot
Medium	Vishakapatnam, Coimbatore, Vijayawada, Hyderabad
Low	Chandigarh, Indore, Mysore, Madurai, Raipur, Guwahati, Jaipur

The cities with exceptionally low own resources and negative growth are Jaipur, Guwahati, Raipur and their per capita amounts stand for Rs.87, Rs.175 and Rs.216 with negative growth rates of 20.3, 20.3 and 0.8 percent respectively. The cities of this category that have performed better are Chandigarh and Indore with per capita amounts of Rs.523 and Rs.476 with a growth rate of 16.6 and 15.7 percent respectively. The other cities of this category that have slightly higher per capita own resources but have registered a negative growth during 2001-02 to 2003-04 period are Madurai, Mysore with per capita amounts of Rs.417, Rs.450 and negative growth of 0.06 percent and 6.8 percent respectively.

Table 7: Per Capita Own Revenue Receipts

Municipal Corporation	Own revenue receipts			Annual average growth rate (%)
	2001/02	2002/03	2003/04	
Hyderabad	527.27	542.51	720.96	17.89
Vishakapatnam	895.32	752.01	771.45	-6.71
Vijayawada	350.83	570.18	722.46	44.62
Guwahati	301.40	309.84	175.31	-20.31
Raipur	228.69	272.02	215.91	-0.84
Ahmedabad	1315.48	1436.49	1626.74	11.22
Surat	1521.89	1726.28	2015.36	15.09
Vadodra	1303.03	1376.58	1431.49	4.82
Rajkot	829.79	984.95	882.88	4.17
Mysore	518.00	476.38	450.05	-6.78
Indore	355.77	401.27	475.90	15.69
Pune	1767.42	2070.10	1989.51	6.62
Nagpur	889.51	1120.00	1127.46	13.29
Jaipur	147.80	150.21	86.90	-20.26
Coimbatore	581.67	595.24	734.02	12.82
Madurai	417.70	429.57	416.83	-0.06
Chandigarh	392.58	393.84	523.37	16.60

Tax and non-tax receipts

Own revenue receipts can be divided mainly two categories i.e. tax and non-tax receipts. The larger ratio of tax receipts to revenue receipts shows the larger tax domain of a municipal corporation, which is obvious by looking at the structure of tax, and non-tax receipts of these municipal corporations. The cities with octroi and composite property tax have high percentage of tax receipts compared to non-octroi levying cities with composite or general property tax etc.

Table 8: Tax and Non-Tax Receipts as Percent of Own Revenue Receipts

Municipal Corporation	Tax as a % of own revenue receipts			Non-tax as a % of own revenue receipts		
	2001/02	2002/03	2003/04	2001/02	2002/03	2003/04
Hyderabad	66.83	69.60	56.48	33.17	30.40	43.52
Vishakapatnam	28.27	29.19	30.79	71.73	70.81	69.21
Vijayawada	64.24	60.94	49.55	35.76	39.06	50.45
Guwahati	na	na	na	na	na	na
Raipur	64.39	61.22	66.29	35.61	38.78	33.71
Ahmedabad	90.73	91.66	88.40	9.27	8.34	11.60
Surat	89.27	89.24	89.91	10.73	10.76	10.09
Vadodra	89.20	92.91	93.26	10.80	7.09	6.74
Rajkot	89.55	88.22	89.11	10.45	11.78	10.89
Mysore	20.77	20.93	31.98	79.23	79.07	68.02
Indore	77.77	78.07	69.49	22.23	21.93	30.51
Pune	76.70	71.89	76.58	23.30	28.11	23.42
Nagpur	74.81	73.31	72.76	25.19	26.69	27.24
Jaipur	41.86	38.08	30.06	58.14	61.92	69.94
Coimbatore	60.24	62.65	59.97	39.76	37.35	40.03
Madurai	58.22	64.17	52.78	41.78	35.83	47.22
Chandigarh	0.00	0.00	0.00	100.00	100.00	100.00

More than seventy five percent of own revenue receipts are generated through tax receipts in case of octroi and composite property tax levying cities e.g. Vadodra, Surat, Rajkot, Ahmedabad, Pune and Nagpur whereas for other cities it ranges from fifty to seventy five percent with exceptions of Vishakapatnam, Mysore and Jaipur.

The non-tax receipts include user charges on services, rental income from municipal properties, fees and fines, developmental charges etc. Large variations are observed on capitalization of non-tax receipts also. Vishakapatnam generated Rs.534 from this source whereas Jaipur generated merely Rs.61 for the year 2003-04. The cities of Andhra Pradesh, UT-Chandigarh, cities of Maharashtra, Karnataka and Tamilnadu has higher realization of per capita receipts from non-tax category compared to the cities of Gujarat such as Rajkot, Vadodra, Ahmedabad and Surat. Raipur and Jaipur are the only cities that have realized one of the lowest per capita realizations from both tax and non-tax receipts and registered a negative growth for the past three years time period. The negative growth rate for tax or non-tax receipts in case of Vishakapatnam and Madurai can be justified because of exceptional high growth rate of adding up periphery population with low tax paying capacity.

Table 9: Per Capita Tax and Non-Tax Receipts

Municipal Corporation	Tax receipts			Annual average growth rate(%)	Non-tax receipts			Annual average growth rate (%)
	2001/02	2002/03	2003/04		2001 /02	2002/03	2003/04	
Hyderabad	352.38	377.61	407.23	7.50	174.89	164.90	313.73	42.27
Vishakapatnam	253.13	219.49	237.49	-2.54	642.18	532.52	533.96	-8.40
Vijayawada	225.37	347.47	357.99	28.60	125.46	222.71	364.48	70.58
Guwahati	na	na	na	na	na	na	na	na
Raipur	147.25	166.52	143.13	-0.48	81.44	105.50	72.79	-0.73
Ahmedabad	1193.49	1316.64	1437.97	9.77	121.99	119.85	188.78	27.88
Surat	1358.64	1540.57	1812.09	15.51	163.25	185.71	203.28	11.61
Vadodra	1162.28	1278.91	1335.01	7.21	140.75	97.67	96.48	-15.91
Rajkot	743.04	868.92	786.78	3.74	86.75	116.03	96.10	8.29
Mysore	107.59	99.68	143.91	18.51	410.41	376.70	306.14	-13.47
Indore	276.70	313.28	330.72	9.39	79.07	87.99	145.18	38.14
Pune	1355.53	1488.24	1523.65	6.09	411.89	581.86	465.85	10.66
Nagpur	665.45	821.12	820.39	11.65	224.06	298.89	307.07	18.07
Jaipur	61.87	57.21	26.13	-30.94	85.93	93.01	60.77	-13.21
Coimbatore	350.40	372.89	440.20	12.23	231.27	222.35	293.82	14.14
Madurai	243.17	275.66	219.98	-3.42	174.53	153.91	196.85	8.04
Chandigarh	0.00	0.00	0.00	0.00	392.58	393.84	523.37	16.60

Octroi levying cities have been realizing forty five percent to sixty one percent of own revenue receipts from octroi alone. In per capita terms the receipts from this tax alone hovers around Rs.1000 for the year 2003-04. Another major tax source of tax receipts is property tax, which should have been, contributed a reasonable amount in per capita terms but on the contrary the maximum per capita realization through property tax is Rs.414 only for Coimbatore followed by Vadodra, Ahmedabad, Vijayawada, Pune and Hyderabad with Rs.354, Rs.350, Rs.339, Rs.313 and Rs.308 respectively. Jaipur and Raipur collect the lowest per capita receipts from property tax and amounts stand for Rs.26 and Rs.87 only. The medium range receipts are for Surat, Indore, Madurai, Vishakapatnam and Mysore with Rs.267, Rs.244, Rs.207, Rs.162 and Rs.144 respectively. It is clear from these performances that the cities have not yet explored the most important source of tax receipts.

In theory, property tax should be a buoyant source of own revenue as the value of properties rise over time. Most of the municipal corporations levy property taxes on ratable values of the property and the ratable value is defined as the rentals which property would fetch if it were to be rented out which further is calculated not through market indicators but through administrative procedures. Improper administration, poor collections and legal bottlenecks have made property tax inelastic in most of the municipal corporations. Efforts to increase tax rates, tax base even shifting to unit area based method of assessment have given a marginal effect on the overall structure of own resources.

Table 10: Per Capita Receipts From Octroi and Property Tax

Municipal Corporation	Octroi			Annual average growth rate (%)	Property tax			Annual average growth rate (%)
	2001/02	2002/03	2003/04		2001 /02	2002/03	2003/04	
Hyderabad	*	*	*	*	268.57	359.74	308.26	9.82
Vishakapatnam	*	*	*	*	188.02	157.92	162.00	-6.71
Vijayawada	*	*	*	*	217.47	336.66	339.36	27.80
Guwahati	*	*	*	*	na	na	na	na
Raipur	*	*	*	*	56.16	69.25	87.32	24.70
Ahmedabad	854.99	985.85	1072.15	12.03	334.80	325.34	350.00	2.38
Surat	920.04	1063.35	1071.09	8.15	243.06	271.04	267.26	5.06
Vadodra	785.20	876.40	980.74	11.76	377.08	402.51	354.27	-2.62
Rajkot	509.57	531.74	na	na	214.61	330.30	na	na
Mysore	*	*	*	*	107.65	99.67	143.91	18.48
Indore	*	*	*	*	201.59	231.02	244.02	10.11
Pune	828.36	896.21	925.32	5.72	340.61	359.10	312.72	-3.74
Nagpur	na	na	na	na	na	na	na	na
Jaipur	*	*	*	*	61.87	57.21	26.13	-30.94
Coimbatore	*	*	*	*	333.28	349.54	414.32	11.71
Madurai	*	*	*	*	224.06	247.85	207.50	-2.83
Chandigarh	*	*	*	*	0.00	0.00	0.00	0.00

Note: * denotes not applicable because octroi is no more being levied among these cities.

State Transfers

Municipal corporations receive grants mostly from the state government even the union and external grant assistance that are extended in small doses are channeled via state administration. Transfers from state government include shared taxes, general and specific purpose grants. There are a few state level taxes, which are shared with municipal corporations such as entertainment tax, motor vehicle tax, stamp duty etc. Transfers have several roles, foremost of them being to bridge the gap, since it would be unusual for the revenue raising capacity of municipalities to be perfectly matched with their expenditure needs. General purpose grants are of ad hoc nature are generally given in lieu of octroi abolition, DA grant for maintenance of salary level of municipal staff at par with state government employees whereas the specific purpose grants are for assigned functions like health, primary education and for some other functions etc. However, there is an observed drastic change in structure of state transfers among many states in the methods of state transfers after the implementation of state finance commission recommendations of the respective states. As a proportion of municipal governments revenues, transfers are high or low, depending on their revenue-raising powers and the expenditure needs. Abolition of octroi plays a phenomenal difference to the role of transfers in the finances of municipalities. An important feature of transfers to municipalities is its discretionary nature. Unlike the Constitutional provisions that lay down the revenue-sharing arrangement between the central and state governments, there exist no statutory provisions in the state municipal laws which define the conditions under which transfers should take place from the state governments to municipalities.

“As a preface, it may be pointed out that the finance commission of states (SFCs) have approached their Constitutional mandate in the specific context and conditions of the states, without any commonly-accepted or nation-wide guidelines or norms either for expenditures

or revenues. Further, finance commission of states (SFCs) have formulated the fiscal packages without access to a clear directive on the functional jurisdiction of municipalities, particularly with reference to the functions enumerated in Schedule 12 of the Constitution. Absence of clarity in respect of the functional domain of municipalities constitutes a serious gap in the functioning of the SFCs, and speaks simultaneously of the tardiness on the part of the states in implementing the Constitution (seventy-fourth) Amendment Act, 1992. Clarity in respect of the functional jurisdiction of municipalities is an essential, first step in deciding upon the principles for tax assignment, revenue-sharing, and grants-in-aid. Only after their functions are known could any decision be taken with regard to how these could be financed. In fact, the structure of financing mechanism - the mix of taxes, user charges, and transfers that is appropriate in a given context depends on the functions assigned to municipal governments.” (Raja J. Chelliah and Om Prakash Mathur, 1996; Implications for the Constitution (seventy-fourth) Amendment, 1992).

From the above-mentioned discussion it is quite evident that the system of state transfers is a complex phenomenon and having the limited information on state transfers from city development plans makes it difficult to understand the whole process of state transfers to municipal corporations. Nevertheless a few important observations are made in this regard. First of all the state transfers are found to be on revenue account and for some municipal corporations it is also found to be on capital account. The municipal corporations which receive state grants on capital account are the cities of Andhra Pradesh such as Hyderabad, Vishakapatnam and Vijayawada, cities of Gujarat such as Ahmedabad, Surat, Rajkot and Vadodra, cities of Tamilnadu such as Madurai and Coimbatore and other two municipal corporations are Raipur and Chandigarh probably because of a weak resource base. Three broad categories emerge out based on the ratio of state transfers (revenue and capital) as percent of total receipts; these are of low dependency, medium dependency and high dependency.

Table 12: State Transfers (Revenue + Capital) as percent of Total Receipts

Level of state dependency	Municipal Corporations
High dependency (>40%)	Jaipur, Raipur, Chandigarh, Mysore, Indore
Medium dependency (20-40%)	Vijayawada, Guwahati
Low dependency (<20%)	Pune, Nagpur, Surat, Hyderabad, Rajkot, Vadodra, Coimbatore, Ahmedabad, Vishakapatnam, Madurai

Octroi levying cities have an obvious reason for lower ratio, which are Pune, Nagpur, Rajkot, Vadodra and Ahmedabad. In addition to it, the cities from developing states have also shown a lower dependency on state transfers such as Hyderabad, Vishakapatnam, Coimbatore and Madurai. On the other hand, the cities of low-income states have shown a high dependency on state transfers probably because of abolition of octroi, these are Jaipur, Raipur, Indore and Mysore and Chandigarh. Vijayawada and Guwahati falls in medium dependency category.

Further, it has been noted that the municipal corporations from developing states have registered a declining trend on state dependency or remained stagnant over the past three years period e.g. Madurai has shown a decline from 39.4% to 22.5%, Coimbatore has declined from 18.5% to 14.5%, Vijayawada has declined from 48.4% to 38.4% and Hyderabad has declined from 16.9% to 6.8%. Pune and Nagpur have also shown a marginal declining trend. In addition to it, Indore has shown a declining trend from 55.6% to 40.7% probably because of recent property tax reforms initiatives and high collections from non-tax receipts.

Table 12: State transfers as percent of total receipts

Municipal Corporation	State transfers as % of revenue receipts			State transfers (revenue+ capital) as % of total receipts		
	2001/02	2002/03	2003/04	2001/02	2002/03	2003/04
Hyderabad	32.43	40.32	32.50	16.86	25.21	6.83
Vishakapatnam	21.04	37.33	29.77	10.87	14.72	18.91
Vijayawada	46.08	37.87	38.30	48.41	38.48	38.42
Guwahati	21.03	29.30	36.91	21.03	29.30	36.91
Raipur	61.51	58.99	59.53	71.64	85.14	71.63
Ahmedabad	15.90	14.49	11.92	16.25	19.32	16.47
Surat	6.45	32.23	8.52	5.40	7.00	6.59
Vadodra	13.98	14.56	11.35	12.94	15.55	13.29
Rajkot	5.20	9.93	7.29	7.69	12.50	10.65
Mysore	46.47	45.52	46.45	46.47	45.52	46.45
Indore	55.64	59.66	47.81	55.64	58.04	40.72
Pune	6.89	5.77	6.44	6.88	5.75	6.43
Nagpur	10.56	8.39	8.36	na	na	na
Jaipur	68.93	68.55	79.71	57.13	61.52	72.73
Coimbatore	32.63	46.11	35.08	18.54	23.61	14.55
Madurai	28.28	46.65	42.01	39.40	25.04	22.52
Chandigarh	57.75	58.21	58.07	56.91	60.70	55.89

Whereas the cities of low-income states have shown an increasing trend on state dependency. These are Jaipur, Guwahati that have shown an increased ratio from 57% to 73% and 21% to 36% respectively. Raipur remained stagnant at the ratio of 71%. In addition to it Vishakapatnam has also shown a rising trend i.e. from 10.9% to 18.9%, mainly because of high rise in capital grants.

Functional Responsibilities of Municipal Corporations

Municipal expenditure can mainly be divided in two broad categories i.e. revenue expenditure and capital expenditure. It is assumed that the higher revenue expenditure indicates higher services levels. It is also observed that as the size of municipal corporations increases their functional domain and degree of autonomy also increases. The Constitution (seventy-fourth) Amendment Act, 1992 has laid down in the 12th Schedule of the Constitution a list of eighteen functions that it considers appropriate to be performed by the municipal governments. Although the exact *defacto* situation of transferring and implementation of these eighteen functions is not clear from the city development plans, we try to look at the expenditure levels (together with the functional domain) of municipal corporations in terms of size and trends, and also in terms of composition in an attempt to distinguish between expenditure on establishment, wages and salaries (non-discretionary) from expenditure on the operation and maintenance of services (discretionary).

Table 13: Functional domain of Municipal Corporations

Functional domain	Municipal Corporations
Large functional domain	Surat, Ahmedabad, Rajkot, Vadodra, Pune, Nagpur, Vijayawada, Vishakapatnam, Madurai, Coimbatore, Mysore
Low functional domain	Raipur, Indore, Hyderabad, Jaipur, Guwahati, Chandigarh

Two broad categories of municipal corporations are quite evident based on the functional domain of municipal corporations. Larger municipal corporations from developing states have larger functional domain also, such as, Surat, Ahmedabad, Rajkot, Vadodra, Pune, Nagpur, Vijayawada, Vishakapatnam, Madurai, Coimbatore and Mysore. Whereas comparatively smaller municipal corporations have smaller functional domain, such as, Raipur, Indore, Jaipur, Guwahati and Chandigarh especially because of exclusion of water and drainage functions which is either being performed by some state-level parastatal agency or being performed by state government department.

Municipal Expenditure

Large portion of expenditure has been incurred on revenue account ranging from 50% to 96%. Capital account expenditure is of the nature of developmental works and the cities from developing states have incurred a reasonable ratio of total expenditure on this account.

Table 14: Percentage Composition of Municipal Expenditure

Municipal Corporation	Revenue expenditure as a % of total expenditure			Capital expenditure as a % of total expenditure		
	2001/02	2002/03	2003/04	2001/02	2002/03	2003/04
Hyderabad	53.51	53.90	62.57	46.49	46.10	37.43
Vishakapatnam	70.92	87.08	49.13	29.08	12.92	50.87
Vijayawada	85.10	70.88	57.89	14.90	29.12	42.11
Guwahati	100.00	100.00	100.00	0.00	0.00	0.00
Raipur	77.56	81.80	51.61	22.44	18.20	48.39
Ahmedabad	76.70	80.87	69.80	23.30	19.13	30.20
Surat	69.48	66.73	67.20	30.52	33.27	32.80
Vadodra	96.37	100.00	89.29	3.63	0.00	10.71
Rajkot	66.75	79.29	79.52	33.25	20.71	20.48
Mysore	96.52	95.34	95.95	3.48	4.66	4.05
Indore	85.74	82.42	67.83	14.26	17.58	32.17
Pune	63.12	63.44	61.27	36.88	36.56	38.73
Nagpur	na	na	na	na	na	na
Jaipur	73.75	76.05	74.98	26.25	23.95	25.02
Coimbatore	70.54	75.66	72.39	29.46	24.34	27.61
Madurai	85.14	78.94	68.72	14.86	21.06	31.28
Chandigarh	83.09	82.30	71.54	16.91	17.70	28.46

Further the revenue account expenditure can mainly be divided on three heads i.e. establishment and salaries head, operation and maintenance works and debt servicing. Establishment head of the revenue expenditure is of non-discretionary nature whereas operation and maintenance works are of discretionary nature and debt servicing are the interest payments on the loans taken by the municipal corporation in the past years. High ratio for operation and maintenance works is a strong indicator of good financial health. Cities with high ratio for establishment head and lower ratio for operation and maintenance head do not represent a healthy financial status of any municipal corporation. Jaipur, Raipur, Guwahati has registered a high proportion of revenue expenditure on establishment head i.e. 73%, 70% and 63% respectively; compared to operation and maintenance head. Whereas Indore, the cities of Andhra Pradesh and the cities of Gujarat have shown a lower ratio of establishment and salaries head.

Interestingly some cities have paid more on debt servicing account compared to operation and maintenance account such as Coimbatore and Madurai, 38.5% and 23.9% of revenue expenditure goes on debt servicing account compared to 22.6% and 16.9% of operation and maintenance head. The other cities that have incurred a substantial part of their revenue expenditure on debt servicing are Ahmedabad, Vadodra and Surat registered with 14%, 14.4% and 12.5% respectively probably because of repayments against issued municipal bonds in the recent past and because of high outstanding loans.

Table 15: Percentage Composition of Revenue Expenditure

Municipal Corporation	Establishment expenditure as a % of revenue expenditure			O&M expenditure as a % of revenue expenditure			Debt servicing as a % of revenue expenditure		
	2001/02	2002/03	2003/04	2001/02	2002/03	2003/04	2001/02	2002/03	2003/04
Hyderabad	46.04	44.00	44.63	53.96	51.30	51.49	0.00	4.70	3.87
Vishakapatnam	34.82	35.50	37.12	58.73	63.69	62.13	6.44	0.80	0.75
Vijayawada	75.44	68.50	56.35	17.86	24.02	31.38	0.60	0.58	0.37
Guwahati	73.56	65.52	63.03	14.58	20.70	21.93	0.00	0.00	0.00
Raipur	37.55	53.15	70.05	42.29	42.63	28.58	20.16	4.22	1.37
Ahmedabad	43.68	43.49	45.57	42.94	40.88	40.26	13.38	15.63	14.17
Surat	40.96	47.35	47.36	35.81	37.95	40.15	23.23	14.70	12.48
Vadodra	45.18	46.10	46.20	22.39	22.67	24.19	16.93	15.47	14.42
Rajkot	49.14	47.34	44.10	36.09	39.49	43.55	3.14	2.80	2.26
Mysore	54.27	50.88	47.79	45.73	49.12	52.21	0.00	0.00	0.00
Indore	37.94	36.31	36.96	62.06	63.69	63.04	2.27	3.29	5.67
Pune	39.43	46.88	49.00	55.08	48.26	46.15	1.87	1.37	1.21
Nagpur	53.63	55.30	58.48	36.19	33.11	31.56	2.97	5.41	5.33
Jaipur	72.78	71.79	72.87	22.29	24.56	23.74	4.93	3.65	3.40
Coimbatore	67.42	52.14	37.90	18.66	25.40	22.62	10.51	21.07	38.54
Madurai	58.27	81.23	59.23	8.62	16.02	16.86	33.11	2.75	23.91
Chandigarh	53.29	51.73	50.55	44.73	46.05	46.29	0.00	0.00	0.00

Interestingly while looking at the total per capita expenditure patterns, it has been observed that although the lower functional domain has an impact on lower expenditure levels but lower fiscal powers do not necessarily influence on level of expenditure as the gaps are being met from state transfers both at revenue and capital accounts.

Table 17: Municipal Corporations with their Level of Expenditure

Municipal expenditure	Municipal Corporations
High expenditure	Pune, Ahmedabad, Surat, Chandigarh, Vadodra, Vijayawada, Vishakapatnam, Coimbatore, Indore
Medium expenditure	Madurai, Raipur, Hyderabad, Rajkot, Mysore
Low expenditure	Jaipur, Guwahati

Larger municipal corporations together with larger functional domain and not necessarily with larger fiscal powers (tax and non-tax domain) have registered outstandingly high per capita expenditure on both revenue and capital account. Per capita total expenditure are exceptionally high for Pune, Ahmedabad, Surat, Chandigarh and Vadodra that have incurred Rs.2413, Rs.2155, Rs.1872 and Rs.1761 and Rs.1746 respectively. Municipal corporations of Vijayawada, Vishakapatnam, Coimbatore and Indore have also incurred high expenditure ranging from Rs.1456 to Rs.1265. Whereas the medium category of municipal corporations'

per capita total expenditure ranges from Rs.848 to Rs.1004. Smaller functional domain has lead to lower per capita expenditures in case of Jaipur and Guwahati, Rs.476 and Rs.379 respectively.

Table 17: Per Capita Revenue, Capital and Total Expenditure, 2003-04

Municipal Corporation	Revenue expenditure	Annual average growth rate (%)	Capital expenditure	Annual average growth rate (%)	Total expenditure	Annual average growth rate (%)
Hyderabad	617.42	5.27	369.30	-9.79	986.72	-1.68
Vishakapatnam	669.65	-9.14	693.41	233.15	1363.06	17.47
Vijayawada	842.91	21.37	613.18	146.42	1456.09	47.30
Guwahati	378.75	6.26	0.00	#DIV/0!	378.75	6.26
Raipur	516.65	-12.48	484.43	79.74	1001.07	3.77
Ahmedabad	1504.57	-1.66	650.85	26.34	2155.42	3.22
Surat	1257.72	-5.64	613.83	-0.79	1871.55	-4.19
Vadodra	1558.73	0.83	186.95	#DIV/0!	1745.68	5.02
Rajkot	716.21	6.61	184.49	-19.55	900.70	-2.00
Mysore	813.91	-7.21	34.34	2.45	848.25	-6.95
Indore	857.99	3.44	406.95	77.17	1264.94	15.87
Pune	1478.20	8.40	934.53	12.50	2412.73	9.90
Nagpur	911.06	4.56	0.00	#DIV/0!	0.00	#DIV/0!
Jaipur	357.04	-1.16	119.12	-4.23	476.16	-2.03
Coimbatore	967.10	20.12	368.90	16.60	1335.99	18.53
Madurai	690.05	-6.52	314.09	53.13	1004.14	4.87
Chandigarh	1259.53	3.50	501.10	52.03	1760.62	12.06

Need for proper budgeting and accounting procedures

In the past couple of years lot of emphasis is being given in favour of accrual accounting for infrastructure assets but it may not be the case. An appropriate and adequate accounting for municipalities involves a far more complex set of interrelationships, to be reported to a more diverse set of users with a great variety of interests and needs, than exists in business accounting and reporting (Mautz 1981). Financial statements based on accrual accounting are still limited to data that are both historical and financial. Such data is often not responsive to the decision makers who also need forward-looking and non-financial information. Experience indicates that the financial data must be supplemented by non-monetary quantitative and qualitative information to aid decision-usefulness of the urban managers. Such information sheds additional light on what is necessary to maintain or upgrade system functionality, identifies the potential risk of systems failure, and states the assumptions upon which these assessments are based. Some researchers have an opinion that the cash flow based methods may still be right if supplemented with adequate physical and analytical information.

Since no demand is raised and accounted for by the Accounting Department of municipalities, statements on tax demand and user charges demand etc., collection and balance are not prepared. Coordination seldom exists between the Revenue and Accounting Departments in reporting the demand and collection information in the municipal budgets.

In most municipal bodies, there does not exist a proper financial reporting system even Municipal Acts do not have any compulsion on municipalities to publish and to disseminate financial results for internal users and for public at large. Municipal Acts or Account Codes do not have disclosure norms. Also municipal administration over the years have not felt any need for an efficient financial reporting system in its internal decision making process, has not made much efforts to design a financial reporting system for itself and for external users.

The existing budgeting system of municipalities has many drawbacks, which makes it impossible for judging the financial health of municipalities. First of all there are no uniform classifications of receipts and expenditure in municipal budgets and confusions exist to classify receipts and expenditure under revenue and capital account. Preparing budget estimates on the basis of incremental approach based on past year data is a routine exercise, which often fails to give a realistic budget estimates. Budget documents do not contain physical or performance targets to be achieved through budget allocation therefore there no achievements can be claimed by way of these budgetary expenditure. Exercises with respect to cost incurred on individual services are nearly impossible tasks at municipal level because of reporting and accounting drawbacks of municipal budgets.

Credit rating mechanisms

The Securities and Exchange Board of India (SEBI) regulation needs the agencies to get their debt instruments rated prior to approaching the capital markets for funds. Credit rating is mandatory for debt instruments (if public issue) with a maturity exceeding eighteen months. Three major credit rating agencies are Crisil, ICRA, and CARE. They have partnerships with international credit majors: Crisil with Standard & Poor's, ICRA with Moody's and CARE with Fitch Ratings, together accounting for the entire domestic bond issuance. These agencies rate bonds and debentures, fixed deposits, and short-term instruments.

Agencies use structured obligations, which are rated by rating agencies using the following criteria (a) functional and managerial capability including legal and administrative framework, (b) existing financial position, (c) economic base of the service area and (d) aspects relating to the project under consideration.

Credit rating reveals important information for both the investor as well as for the issuer. Two most important outcomes of these rating are the determination of the default risk association with the bond issuance and it brings into more financial disclosure and accountability. Criteria used by these agencies for issuance of municipal bonds are evolving and credit rating is not just a regulatory issue but also more as a measure of market discipline. The state government guarantees increase a local body's dependence on safety nets and should not be treated as a substitute for important disclosure through credit ratings.

“Given the overwhelming control of the state governments over the local bodies, it is not easy for any rating agency to assess their individual functioning or managerial capabilities in any meaningful manner. Furthermore, the financial position of a local body in no way reflects its strength or managerial efficiency”. (Kundu 2000, MOST, Discussion Paper number 48, Urban Development, Infrastructure Financing and Emerging System of Governance in India: A perspective)

Table 18: Rating Indicators for State and Municipal Governments

State Government ratings	Municipal Government ratings
<p>Economic structure</p> <ul style="list-style-type: none"> ◦ Net state domestic product (NSDP) ◦ Per capita NSDP and growth rate ◦ Demographic profile ◦ Per capita availability of power, roads, railways, etc. ◦ Per capita availability of education and health facilities ◦ Industry growth rate ◦ Per capita sanctions and disbursements by financial institutions ◦ Mineral reserves 	<p>Economic base of the service area</p> <ul style="list-style-type: none"> ◦ Population and its growth rate ◦ Sanctions and disbursements made by financial institutions ◦ Non domestic power consumption ◦ Industrial water connections in the service area ◦ Sales tax collections ◦ Stamp duty collections on property transfers ◦ Per capita income ◦ Number of vehicles registered with the regional transport office ◦ Demand for telephone connections with Department of Telecommunication ◦ Growth in bank deposits raised by major public sector banks
<p>State Government finances</p> <ul style="list-style-type: none"> ◦ Revenue receipts and expenditure ◦ State's own revenues/Total revenues ◦ Grants from Center/Revenues ◦ Fiscal deficit and its composition ◦ Gross fiscal deficit/NSDP ◦ Debt/NSDP ◦ Capital expenditure/Fiscal deficit ◦ Revenue receipts/Interest 	<p>Current financial position</p> <ul style="list-style-type: none"> ◦ Tax receipts/Total revenues ◦ Non-tax receipts/Total revenues ◦ Grants from state government/Total revenues ◦ Revenue deficit ◦ Overall deficit ◦ Collection efficiency of property tax ◦ Collection efficiency of water tariff ◦ Debt service coverage ratio
<p>Economic management</p> <ul style="list-style-type: none"> ◦ State government guarantees ◦ Utilization of ways-and –means advances and overdraft facility ◦ Performance of state –level public sector undertakings ◦ Plan performance 	<p>Operations of the municipal body</p> <ul style="list-style-type: none"> ◦ Expenditure on core services/Total expenditure ◦ Expenditure on wages and salaries/Total expenditure ◦ Water supplied per capita ◦ Per capita expenditure on primary education ◦ Per capita expenditure on health services
<p>Source: Credit Rating Information Services of India Limited</p>	

Credit ratings of ULB's based on its financial health together with administration and legal set up, functional domain, tax domain especially the state control on various administrative matters is not an easy task and it requires in depth analysis of these factors. The functional domain of the local governments has been specified in Article 243W (XII Schedule) of the Constitution of India and the state governments have adopted the conformity legislation accordingly. However not much has been done to devolve these functions together with finances and functionaries to municipalities. Moreover, the state control related to financial matters such as the implementation of SFC's recommendations and timely release of grants, decision on continuing with octroi or abolishing it etc. further complicates the matter. The most important thing is the lack of transparency of the credit rating model used by these agencies. It is well understood that no single model can be applicable to all municipalities but still a basic economic/financial model could have been shared by these agencies with clearly mentioning the quantitative and qualitative indicators with specific weights assigned

to these indicators. The main benefit of this transparency would be that the bond issuer agency would be more aware that the obtained credit rating is highly conditional which is based on the basic model and a slight change in the performance of these indicators may bring down the credit rating of the municipality.

Reliability of financial data and information related to coverage, quality and level of service at municipal level is also questionable and it needs lots of further filtrations because in raw form it may not be in usable form. For example laying out the water pipes in entire area of the city does not necessarily prove one hundred percentage of coverage of households with drinking water. Another indicators of availability of water liters per capita a day could also be misleading because the data generally provided by the municipalities not at the receiving end but at the production level and the data related to leakages and thefts etc. is also not reliable because no specific measurement procedures are taken in this direction. Issues related to budgeting and accounting procedures such as methodology of preparing budget estimates and arriving at demand and collection ratios for various tax and non-tax indicators, estimating exact dependency on state grants by excluding or including octroi compensation, adjusting the limitations arising out of single entry based accounting system; need to be dealt very carefully. Further the linkage of tax department with accounts department is often missing at municipal level, which deteriorates the quality of data because the budget estimates are prepared generally on incremental basis not on the actual bills issues versus the collections by means of arrears and current demands. Providing data on cost recovery for various services is also found to be misleading, as the municipalities are not clear to give an exact classifications of accounts between revenue and capital expenditures. The nature of the accounts is very volatile and I can be manipulated to receive positive rating etc. Bangalore Municipal Corporation followed an age-old budgeting pattern and had not delineated clearly between revenue and capital account (Kundu, Bagchi and Kundu 1999).

Under JNURM, there is a provision of getting credit ratings for all sixty-three cities selected under this mission. MoUD must focus on the transparency in the procedures adopted by the credit rating agencies.

Bond Issue

Traditionally the capital structure of ULB comprised of grants & loans from center & state governments, loans from financial institutions .In context of budget constraints & rising investment needs, it will be imperative for ULB to devise alternate mechanism for financing. After the 74th Constitutional amendment One of the notable endeavor pertaining to resource mobilization and financial strengthening has been seeking recourse to capital markets. The lack of a well-developed capital market in India has posed serious problems for tapping capital market funds for municipal infrastructure. The required investment needs for municipal infrastructure are huge and these generally are for a longer time period. Investments in municipal infrastructure are quite different from investments in Industry sector mainly because the investment in municipal infrastructure have long gestation periods i.e. the returns from these investments in initial years are zero or negligible.

A precondition to Bond financing is bringing a complete overhaul in set practices, accounting reforms, strengthening the fundamentals of Urban Local Bodies. Enumerated below are lists of municipalities that have endeavored to float bonds with reasonable success.

A common feature of Bond financing is that all the bond issue has an escrowed mechanism, which ties revenue streams of ULB for repayment. Except for Ahmedabad where 25 percent bond issue was open to public, all other ULB have opted for private placements, where institutional lenders have parked their funds in bond issue. In contrast to US where municipal bond constitute a sizeable chunk of debt market. The municipal bonds, as a percentage of debt market in India is very small (around Rs.600crores)

Table 19: Key Features of Tax-Free Municipal Bonds

Key Features	
Eligible Issuers	↓ Local self governments, other local authorities or public sector companies* duly constituted under an Act of Parliament or state legislature; other local authorities constituted under relevant state government statutes like water supply and sewerage board; and groups of local authorities through a financial intermediary.
Use of Funds	↓ Capital investments in urban infrastructure namely, potable water supply; sewerage or sanitation; drainage; solid waste management; roads, bridges and flyovers; and urban transport if it is a statutory municipal function.
Requirements	
(a) Project Development	↓ Project development consisting of an approved investment plan including phasing and a financing plan; benchmarks for commencement and completion including the milestone dates for the proposed components of the project; completion of the process of pre-qualification of bidders; initiation of the process of land acquisition and other statutory clearances.
(b) Financial Viability	↓ Financially viable i.e., generation of a stream of revenues sufficient to finance the project; creation of an ESCROW account for debt servicing; appointment of an independent trustee for monitoring the Escrow account.
(c) Other Conditions	↓ Conformity with laws governing borrowing; maintenance of a Debt Service Coverage Ratio (DSCR)** of 1.25 through the tenure of the tax-free municipal bond.
(d) Project Account and Monitoring	↓ Maintenance of a separate account as also establishment of a separate Project Implementation Cell.
Investment, Maturity and Buy-Back	↓ Minimum maturity of five years, with the option for buy-back arrangements of the face value of the bonds.
Ceiling on Amount	↓ Maximum amount of tax-free bonds as a % of total project cost will be 33.3% or Rs.50 crore whichever is lower; debt-equity ratio not to exceed 3:1; contribution of 20% of project cost from internal resources or grants.
Credit Rating	↓ Mandatory to obtain an investment grade rating.
Legal and Administrative Requirement	↓ Adherence to guidelines issued by the Securities and Exchange Board of India (SEBI).

Note:

* Public Sector Company means any corporation established by or under any Central, State or Provincial Act or a Government company as defined in Section 617 of the Companies Act, 1956.

** Debt Service Coverage Ratio (DSCR) is defined as the ratio of net income after meeting all obligations and liabilities of the issuer (except the long-term debt obligations) to long-term debt servicing obligations.

Table 20: Municipal Bonds

City	Amount (in Rs. million)	Placement	Guarantee	Interest	Escrow	Purpose	Rating
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Ahmedabad	1000	Public & Private	No	14%	Octroi from 10 octroi collection points	Water supply and sanitation project	AA-(SO)
Bangalore	1250	Private	State government	13%	State government Grants and property tax	City roads, street drains	A-(SO)
Ludhiana	100	Private	No	13.5% to 14%	Water & sewerage taxes and charges	Water supply and sanitation project	LAA-(SO)
Nagpur	500	Private	No	13%	Property tax and water charges	Water supply project	LAA-(SO)
Nashik	1000	Private	No	14.75%	Octroi from four octroi collection points	A (SO)	AA-(SO)
Indore	100	Private	Yes	NA	Improvement of city roads	City road project	
Madurai	300	Private	No	12.25%	Toll tax collection	Water supply and sanitation project	LA+(SO)
Ahmedabad (tax free)	1000	Private	No	9%	Property taxes of two zones	Road construction and widening	AA (SO)
Hyderabad (tax free)	825	Private	No	8.5%	Non-residential property taxes, advertisement tax, profession tax, etc.	Water supply and sanitation projects in 14 ULBs	LAA+(SO) AA+(SO)
Tamil Nadu (pooled financing)	110	Private	*	9.20%	Monthly payments equal to one-ninth of their annual payments.		

Source: Compiled from Bond Issuance Brochures.

* The USAID provided a backup guarantee of 50 per cent of the bond's principal through its Development Credit Authority.

Summing up: Financial Health of Municipal Corporations

At macro level the table shows a large variation in the performance of municipal corporations based on the criterion of own revenues. Further there are variations among municipal corporations even within the same state. The cities can be divided in three categories i.e. high, medium and low capacity to generate own revenues respectively. Interestingly while looking at the per capita expenditure patterns, it has been observed that although the lower functional domain has an impact on lower expenditure levels but lower fiscal powers do not necessarily influence on lower level of expenditure both at revenue and capital account as the gaps are being met from state transfers at revenue and capital accounts.

Larger municipal corporations together with larger functional domain and not necessarily with larger fiscal powers (tax and non-tax domain) have incurred outstandingly high per capita expenditures on revenue as well as capital account. On the other hand the medium and smaller functional domain of municipal corporations has lead to lower per capita expenditures. Further linking the fiscal powers (tax and non-tax domain) with functional domain, the municipal corporations can be divided in four categories. The municipal corporations with large functional domain and having large tax domain falls in first category, category two have those municipal corporations which have large functional domain but relatively smaller tax domain, the municipal corporations of category three and four have relatively much smaller functional and fiscal domain. The major difference between the municipal corporations of first category and the municipal corporations of other categories is due to octroi on fiscal domain side and on functional domain side its due to the performing of the function of water supply and sewerage.

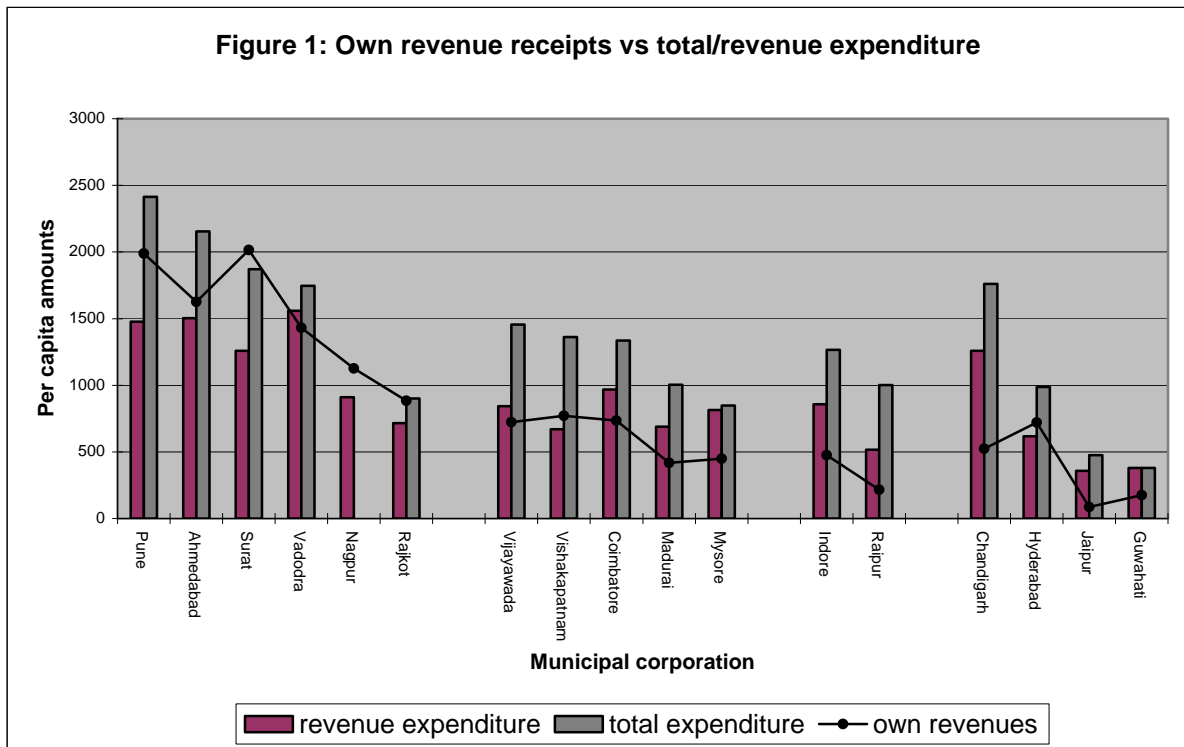
Table 22: Tax and Functional Domain of Municipal Corporations

Fiscal and functional domain	Municipal Corporations
Large functional domain and Large tax domain (octroi, composite property tax)	Surat, Ahmedabad, Rajkot, Vadodra, Pune, Nagpur
Large functional domain and Medium tax domain (composite property tax but no octroi)	Vijayawada, Vishakapatnam, Madurai, Coimbatore, Mysore
Low functional domain (excludes water/drainage) and Medium tax domain (includes water/drainage tax/charges)	Raipur, Indore,
Low functional domain (excludes water/drainage) and Low tax domain (excludes water/drainage tax/charges)	Hyderabad, Jaipur, Guwahati, Chandigarh

The complexities related to functional domain are not simple as the level of performance of functions is much more important than merely a simple comparison of number of functions being performed by municipal corporations, for example two municipal corporations may have the same number of functions but there could have major differences due to taking up of recurring part of a particular function only versus taking up of both the recurring as well as the capital expenditure of a particular function. There are several ratios and indicators, which can describe the financial health of our sampled municipal corporations.

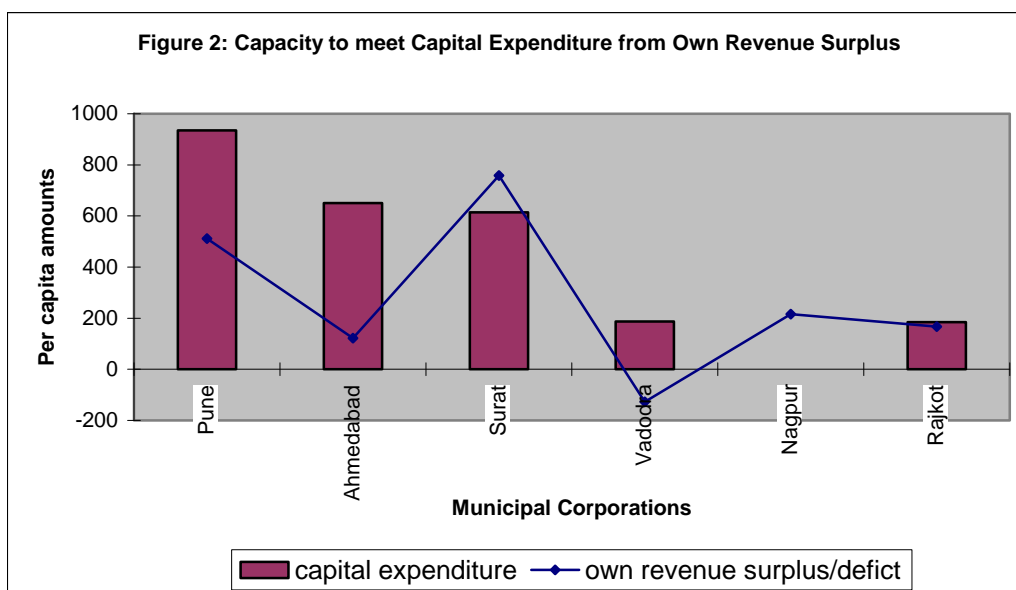
First of all, the ratio of own resources as percent of total expenditure and own resources as percent of revenue expenditure can explain the self reliance of the municipal corporations. Receipts under tax and non-tax heads mainly constitutes the own revenue receipts of a municipal corporation. Let us have a look for these two ratios for our four categories of municipal corporations. The municipal corporations of first category outstandingly performed

better than the corporations of other three categories. Per capita total expenditure and per capita revenue expenditure are much higher than the expenditures of other municipal corporations. All the municipal corporations of this category have shown a surplus on own revenue account after meeting out its revenue expenditure except Vadodra.



For the year 2003-04, Surat stands first with 60 percent surplus followed by Pune with 35 percent and then followed by Nagpur and Rajkot with 23 percent and Ahmedabad with 8 percent. Vadodra is the only municipal corporation in this category which has not been able to meet one hundred percent of its revenue expenditure from its own resources for the year 2003-04.

Second positive feature of any municipal corporation is its ability to spend on developmental works or in other words its capacity to meet out its needs under the head of capital expenditure. The municipal corporations of the first category has high proportion of capital expenditure and has shown high per capita capital expenditure for the past three years period. (See Figure 2)



Capital expenditure is undertaken mainly from capital account grants, capital loans and own revenue surpluses. Interestingly most of the municipal corporations of first category has undertaken a large portion of their capital expenditure from its own revenue surpluses, for example own revenue surplus as percentage of capital expenditure comes to 54 percent for Pune, more than hundred percent for Surat because it has not been able to utilize all its finances, 90 percent for Rajkot and 19 percent for Ahmedabad. These municipal corporations have also been able to arrange finances from market in terms of loans and by issuing municipal bonds because of its high credit ratings, which are based on high own incomes and high repaying capacities.

Another positive feature of the municipal corporations of first category is its higher growth rates of tax and non-tax sources against its lower growth rates of state transfers at revenue account. Pune has shown an annual growth of 6.6 percent against 2.4 percent, Ahmedabad has shown 11.2 percent against (-) 6 percent, Vadodra has shown 4.82 percent against (-) 5.6 percent and Surat has shown 15 percent against 8 percent for the past three years time period.

After presenting a sunny picture for these municipal corporations of first category i.e. the category of large tax domain with large functional domain, let us have a look on some of the important characteristics, which could seriously disturb the financial health of these municipal corporations especially in coming years.

Table 23: Own Revenue as a Percent of Revenue Receipts

Municipal Corporation	Own revenue receipts as % of total revenue receipts			Own revenue (w/o octroi) as % of total revenue receipts		
	2001/02	2002/03	2003/04	2001/02	2002/03	2003/04
Pune	93.11	94.23	93.56	49.47	53.44	50.05
Ahmedabad	84.10	85.51	88.08	29.44	26.83	30.03
Surat	93.55	93.66	91.48	37.00	35.97	42.86
Vadodra	86.02	85.44	88.65	34.18	31.05	27.91
Nagpur	89.44	91.61	91.64	na	na	na
Rajkot	94.80	90.07	92.71	36.58	41.45	40.04

Most of the municipal corporations of first category are largely dependent on octroi, which could be abolished in coming years like other states where it has already been abolished and dependency on octroi compensation has become the most important source of income of those municipal corporations. Even within developed states like Maharashtra and Gujarat, octroi has been already abolished for municipal councils.

In case of abolition of octroi, own revenue receipts as percentage of total revenue receipts comes down to merely 28 percent from 89 percent for Vadodra. In case of Ahmedabad, Rajkot and Surat the ratio comes down to 30 percent from 88 percent, to 40 percent from 93 percent and to 43 percent from 91 percent respectively whereas the ratio comes down to 50 percent from 94 percent in case of Pune. It seems that the municipal corporations of Gujarat are more dependent on this single source than that of municipal corporations of Maharashtra.

Table 24: Property Tax and Non-Tax Receipts as a percent of Own Revenue Receipts

	Property tax as a % of own revenue receipts			Non-tax as a % of own revenue receipts		
	2001/02	2002/03	2003/04	2001/02	2002/03	2003/04
Pune	17.94	16.35	14.71	23.30	28.11	23.42
Ahmedabad	21.40	19.37	18.95	9.27	8.34	11.60
Surat	14.94	14.71	12.13	10.73	10.76	10.09
Vadodra	24.89	24.98	21.94	10.80	7.09	6.74
Nagpur	na	na	na	25.19	26.69	27.24
Rajkot	24.52	30.21	0.00	10.45	11.78	10.89

Property tax which should be the major contributor to own resources and non-tax which mainly consists of user charges, fees and fines; both these heads have either declining proportions as percent of own revenue income during the past three years period or remained stagnant. Growth rates of property tax compared to the growth rates of octroi is also not impressive; in fact it has declined for atleast two municipal corporations i.e. Pune and Vadodra. Most of the municipal corporations of first category has incurred more than 40 percent of their revenue expenditure on operation and maintenance works however some municipal corporations has to cut down its expenditure under this head to meet out its loan repayments which is a worrisome feature of these municipal corporations e.g. Ahmedabad, Surat and Vadodra. Lower growth rates of this operation and maintenance account is also not encouraging infact its negative for some of these municipal corporations such as Ahmedabad, Surat, Nagpur and Pune. Removal of single tax i.e. octroi can seriously disturb the financial health of these municipal corporations, hence municipal authorities should focus on the implementation of property tax reforms and should also focus on high cost recoveries related to the provision of municipal services to keep the pace of self reliance.

In case of second category, which contains the municipal corporations with large functional domain and relatively smaller tax domain compared to the first category. Smaller tax domain of these municipal corporations is mainly because of abolition of octroi. None of the municipal corporations of second category have shown a surplus on own revenue account after meeting out its revenue expenditure except Vishakapatnam. The municipal corporations are largely dependent on state transfers, as they have not able to meet their recurring as well as capital expenditure needs from their own revenue receipts. In case of Mysore, own revenues fell short of 45 percent to meet its revenue expenditure for the year

2003-04. Own revenue fell short by 40 percent, 24 percent and 14 percent in case of Madurai, Coimbatore and Vijayawada respectively. Vishakapatnam is the only municipal corporation in this category, which has shown surplus on own revenue account due to decline in revenue expenditure for the past three years period and not because of high collections under its tax and non-tax heads. Further the decline becomes alarming when we see the growth rate of per capita revenue expenditure, which is around (-) 9 percent. This decline on revenue expenditure account is not understood from the limited available data.

Unlike the higher growth rates of per capita tax and non-tax receipts of the municipal corporations of first category, the municipal corporations of second category has shown disappointing growth rates except of Vijayawada and Coimbatore, all other three municipal corporations of this category have registered a negative growth (combined) on tax and non-tax sources.

State transfers on revenue account have played a crucial role in the revenue income of these municipal corporations. First the proportions of state transfers is much higher in case municipal corporations of second category compared to first and secondly these proportions have either increased over the past three years period or remained stagnant except of Vijayawada where it has declined and thirdly the growth rate of per capita transfers on revenue account is much higher than the own revenues and further these growth rates are much higher than the growth rates of state transfers of municipal corporations of first category.

Table 25: State Transfers as a % of Total Revenue Receipts

Municipal Corporation	State transfers as a % of total revenue receipts		
	2001/02	2002/03	2003/04
Vijayawada	46.08	37.87	38.30
Vishakapatnam	21.04	37.33	29.77
Coimbatore	32.63	46.11	35.08
Madurai	28.28	46.65	42.01
Mysore	46.47	45.52	46.45

The Annual average growth rate of state transfers is 34 percent against the annual growth of 13 percent of own revenue of Coimbatore. Madurai has shown an annual growth of 29 percent against (-) 0.06 percent, Vishakapatnam has shown a growth of 26 percent against (-) 6.7 percent and Mysore is the only municipal corporation, which has registered a negative growth on both of these heads.

Property tax and non-tax, which mainly consists of user charges, fees and fines, should be the major contributors to own resources especially in absence of octroi. Both these heads have either declining proportions as percent of own revenue receipts during the past three years period or remained stagnant except of Mysore in case of property tax and except of Vijayawada and Madurai in case of non-tax. Per capita property tax and non-tax are not very impressive of the municipal corporations of this category except of Coimbatore and Vijayawada. Coimbatore has shown a highest per capita property tax of Rs.414.32 for 2003-04 among all the seventeen cities with 12 percent of annual growth in the past three years time period followed by Vijayawada with Rs.339.36 with an annual growth of 27.8 percent. Mysore also has shown a positive growth but in per capita terms it remained far behind than Vijayawada and Coimbatore whereas other two cities Vishakapatnam and Madurai have registered a negative growth under these heads. Per capita non-tax for Vishakapatnam stood highest among all the seventeen cities at Rs.534 for the year 2003-04 however it has

shown a negative growth rate also, followed by Vijayawada with Rs.364 with whopping annual growth of 71 percent. The performance of other municipal corporations of this category is not very impressive.

Table 26: Property tax and Non-Tax Receipts as a percent of Own Revenue Receipts

Municipal Corporation	Property tax as a % of own revenue receipts			Non-tax as a % of own revenue receipts		
	2001/02	2002/03	2003/04	2001/02	2002/03	2003/04
Vijayawada	33.42	36.68	28.98	35.76	39.06	50.45
Vishakapatnam	16.58	13.16	14.75	71.73	70.81	69.21
Coimbatore	38.60	31.64	36.65	39.76	37.35	40.03
Madurai	38.47	30.78	28.87	41.78	35.83	47.22
Mysore	11.12	11.40	17.12	79.23	79.07	68.02

The municipal corporations of second category have incurred 17 to 62 percent of their revenue expenditure on operation and maintenance works thus showing a mixed behavior. In per capita terms the expenditure under operation and maintenance account remained much less than the expenditure on establishment and salaries account, which is a worrisome feature except for Vishakapatnam and Mysore. However these municipal corporations have done well on cutting down the establishment salaries expenditure in the past three years period. Low ratio of operation and maintenance head is mainly due to interest payments atleast for two municipal corporations i.e. Madurai and Coimbatore. In case of Coimbatore and Madurai, 39 and 24 percent of revenue expenditure respectively has been incurred under debt repayments for the year 2003-04, which is once again a worrisome feature of these municipal corporations.

The municipal corporations of third and fourth categories are the worst performers in generating their own resources to meet out their expenditure needs. The municipal corporations of both of these categories have low functional domain and medium to low fiscal domain. For category three, low functional domain is mainly because of absence of function of water supply and sewerage. State governments have played an important role in taking up of these functions mainly the capital expenditure part. In case of municipal corporations of fourth category, the function of water supply and sewerage has been undertaken by either the public health and engineering department (PHED) of state governments or by a separate parastatal agency. Low tax domain is because of absence of octroi and absence of composite property tax, which means only general property tax is the only major tax source for these municipal corporations.

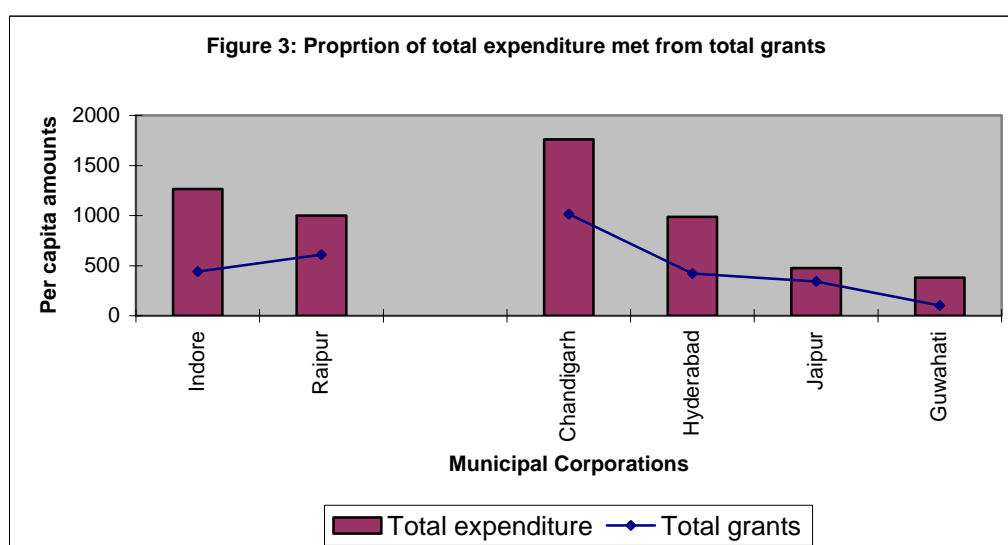
None of the municipal corporations of these two categories have shown a surplus on own revenue account after meeting out its revenue expenditure except Hyderabad. Infact the distance is increasing as we go down the order of high to low per capita expenditures. The municipal corporations are largely dependent on state transfers, as they have not able to meet their recurring as well as capital expenditure needs from their own revenue receipts. In case of Jaipur, own revenues fell short of 76 percent to meet its revenue expenditure for the year 2003-04. Own revenue fell short by 58 percent for two municipal corporations namely Chandigarh and Raipur. Further it fell short by 53 percent and 44 percent in case of Guwahati and Indore respectively. Hyderabad is the only municipal corporation in this category, which has shown surplus on own revenue account. This is mainly because of lower growth of revenue expenditure against the higher growths of tax and non-tax incomes of the municipal corporation and further the state grants are marginal on revenue account and it has shown a declining trend in case of capital grants.

Unlike the higher growth rates of per capita tax and non-tax receipts of the municipal corporations of first category, the municipal corporations of fourth category has shown disappointing growth rates except of Hyderabad and Chandigarh where they have registered the growth rates of 17 and 18 percent respectively. Indore has also shown a positive growth of 16 percent but other three municipal corporations have registered a negative growth (combined) on tax and non-tax sources such as Jaipur and Guwahati both registered a negative growth of 20 percent and Raipur has shown a negative growth of one percent.

State transfers on revenue account have played a crucial role in the revenue income of these municipal corporations. First the proportion of total transfers is much higher compared to the municipal corporations of the first category and secondly, in per capita terms, these are much higher than rest of the municipal corporations of first and second categories. Substantial amount of grants are released on capital account also especially in case of Raipur and Chandigarh; Hyderabad has also received grants on capital account also but it has shown a declining trend. Most of the municipal corporations of these two categories have shown a very high growth rates under the head of state transfers for the past three years time period.

Table 28: Per capita revenue and capital grants

Municipal Corporation	Revenue grants			Annual Average Growth Rate (%)	Capital grants			Annual Average Growth Rate (%)
	2001/02	2002/03	2003/04		2001 /02	2002/03	2003/04	
Indore	446.24	593.55	435.91	3.23	(-)	(-)	4.86	(-)
Raipur	365.51	391.33	317.63	-5.88	274.48	373.42	291.38	7.04
Chandigarh	536.55	548.65	724.76	17.18	264.36	315.71	289.64	5.58
Hyderabad	253.10	341.83	347.07	18.29	195.53	264.03	74.60	-18.36
Jaipur	327.96	327.36	341.46	2.06	(-)	(-)	(-)	(-)
Guwahati	80.26	128.43	102.55	19.94	(-)	(-)	(-)	(-)



Property tax, which should be the major contributor to own resources, and non-tax, which mainly consists of user charges, fees and fines. Property tax has shown a declining proportions as percent of own revenue income during the past three years period for Jaipur and Hyderabad. Chandigarh is not levying property tax at present and for others it remained stagnant or has shown a marginal increase. Per capita property tax and per capita non-tax are also not very impressive of the municipal corporations of these categories however Hyderabad and Indore have done well on property tax account and Chandigarh and Hyderabad have done much better on non-tax account as their collections and growth rates are high. Higher collections of per capita non-tax for Chandigarh against that of Hyderabad is justified because of levying of water supply and sewerage related charges and taxes. In case of Hyderabad the responsibility of water supply and sewerage lies with Hyderabad Water Supply and Sewerage Board (HWSSB) thus income and expenditures cannot be shown on municipal corporation account.

Jaipur and Raipur has incurred more than 70 percent of their revenue expenditure on establishment and salaries account followed by Guwahati, which incurred 63 percent. Other municipal corporations have reasonably done well on operation and maintenance account. In per capita terms the expenditure under operation and maintenance remained much less than the expenditure on establishment and salaries account, which is a worrisome feature especially for Jaipur, Guwahati and Raipur.

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