Financing Urban Services: User Charges and Local Taxation

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Urbanisation and development are inseparably linked in part because cities are the leading edge of economic dynamism in every country. The concentration of enterprises and people from various walks of life in cities facilitates productive interaction and the exchange of ideas and creates a climate for creative activity and enterprise development that leads to innovation and productivity. Cities generate externalities that facilitate transactions, production, and distribution activities and serve as centres of entrepot trade. Large cities in particular may achieve the critical mass required to attain high degrees of specialization in labour, knowledge and businesses, services, infrastructure, institutions and media, all of which increase economic dynamism (Rao and Bird, 2010, Bird and Slack, 2007).

However, the extent to which cities succeed in realizing their potential to galvanize innovation and accelerate growth depends to a considerable extent on whether they succeed in providing not only adequate urban public services but also good policies, high-quality institutions, and the tolerant and open social environment needed to facilitate creative social and economic interaction. Achieving agglomeration economies in cities requires the sustained provision of a wide range of urban public services that underpin both private sector activities and the well-being of the urban population such as water, sewers, garbage collection and disposal, drainage systems, police and fire protection, and transportation.

In India, over 330 million people live in urban areas distributed over 5,165 cities. Urban population has grown at an annual rate of 2.7 per cent and, even though overall population growth is expected to decelerate, the urban population is likely to continue to grow at about 2.5 per cent until 2031 (Ramanathan and Dasgupta, 2009). In 2005, there were 96 municipal corporations, 1494 municipalities and 2092 Nagar Panchayats in 2005 (India, 2004). Over a million people lived in each of 35 cities, and of the 10 largest metropolises in the world, three (Mumbai, Delhi and Kolkata) are in India. The urban sector presently contributes about two-thirds of GDP and this share is likely to increase to 75 percent by 2021 (India, 2008). India's cities are thus already large, economically important, and growing.

Demands for better infrastructure and better public services in India's urbanized areas are large and growing. In contrast, the resources now available to urban local governments are clearly inadequate, falling short even of the norms (adjusted for inflation) set long ago by the Zakaria Committee (India, 1963). Mohanty et al. (2007), for example, found that on average for the period 1999-2000 to 2003-04 actual spending in 30 large municipal corporations in India was only about 24 per cent of the requirements established by the Zakaria Committee almost half a century earlier. While there was considerable variability in the sample, the extent of 'under spending' on urban services was over 75 per cent in 17 municipal corporations, and indeed over 50 per cent in all of them except for three -- Pune (31.6 per cent), Nagpur (30.8 per cent), and Nasik (35.5 per cent). At the other extreme, spending in the Patna Municipal Corporation was estimated to be only 5.6 per cent of the normative requirement, and the shortfall was over 90 per cent in almost all municipal corporations in the poorest States of Uttar Pradesh and Bihar.

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Financing urban infrastructure and services adequately is thus a formidable challenge. Exponentially growing urban public service requirements cannot be financed from local tax bases that are inflexible and have low buoyancy. This note explores the various revenue options for the municipal governments in India to finance their growing demand for public services and capital resources to build essential urban infrastructure. The note analyses the various options for generating resources based on the principles of local finance and best practices.

II. Sources of Urban Finance:

An important implementable rule of fiscal decentralization is the need to ensure a strong linkage between revenue raising and expenditure decisions (Bahlo, 2002). Such a "Wicksellian Link" is important for reasons of efficiency and accountability. The literature on Market Promoting Federalism, in particular, makes this a precondition for an efficient federation. Thus, even as sub-national governments do not have a comparative advantage in raising revenues and even if the assignment of revenues can lead to some inefficiency in terms of tax harmonization, it is necessary to assign taxes to ensure linking of revenue-expenditure decisions at the margin.

Potential mobility of tax bases prevents the assignment of broad based mobile bases to local governments. Thus in terms of the theory, the local governments should be assigned tax bases that are not mobile and if indeed some mobile bases have to be taxed, it should on the basis of the benefits received by them. Furthermore, since the local governments provide many public services that are rival and "excludable", it is possible to levy user charges on them. Given that at local levels, it is possible to identify the benefits of various services such as water, sewers, garbage collection and disposal and drainage systems, it is possible to levy user charges on them.

Unfortunately, the only important tax handle urban local governments have is the property tax. At one time, some states allowed urban local bodies to levy a tax on the entry of goods into a local area for consumption, use or sale (octroi). This tax was distortionary and inefficient, but it also provided a buoyant source of local revenues. Now, however, all States except Maharashtra have abolished this tax, and even in the latter the tax is levied only by municipal corporations and not by smaller municipalities. Some States, like Punjab, Haryana and Rajasthan, have done even more to ensure that urban local revenues are inadequate by abolishing the residential property tax. Everywhere urban local bodies have proved unable (or unwilling) to effect periodic revision of property values, thus rendering the tax non-buoyant in raising revenues. As for other revenue sources, intergovernmental transfers from the States to local governments are not only inadequate, they are also generally ad hoc and poorly designed and targeted. Finally, the absence of a debt market for local government bonds makes financing infrastructure even more difficult.

(i) User Charges:

To a considerable extent, local governments provide services which are in the nature of 'private goods' (like water) to its customers -- local residents. Financing such services through user fees or charges not only provides resources for efficiently supplying such services but also provides invaluable information on which services should be provided, in what quantity and quality, and to whom. Often, however, it appears to be politically impossible to levy user charges when the quality of the services delivered is poor. The result is that a vicious circle is set up, with low quality public services leading to an inability to collect user charges leading to further deterioration in the service levels. This circle needs to be broken. User charges are especially important as providing signals to consumers of the scarcity value of the services and to providers about the demands that need to be met through service provision. They are particularly relevant for services such as water, sewers, electricity, garbage disposal, public transit and recreation and are hence generally most important in large metropolitan areas which provide more of such services.

At present, user charges are negligible in India, with the proceeds from non-tax revenues from all urban local bodies amounting to a mere 0.13 per cent of GDP. Mohanty et al (2007) show that in 10 large municipal corporations less than 10 per cent of the cost of providing services was recovered through fees; in another six, cost recovery was between 10 to 20 per cent. Only in two of the 25 municipal corporations examined was cost recovery greater than 75 per cent. Interestingly, on the whole cost recovery was relatively greater in those cities in which the estimated normative under-spending was lower. Thus, it may be possible to collect more user charges, especially if the quality of the services provided can be improved – for example, with the aid of a well-directed transfer system.

Other important sources of non-tax revenues are licence fees for shops and establishments and parking fees. Both the present system of issuing licences and the common flouting of regulations by shops and establishments provide enormous and highly undesirable rent-seeking opportunities for local officials. Further, parking fees in major metropolitan cities might be able to generate substantial revenues (Barter 2010). The main rationales for levying parking fees are to reduce congestion of vehicles on the roads and to generate resources to construct parking spaces. With sharp increases in household incomes and the emergence of a large middle class, the number of vehicles is going to increase sharply in the coming years. Introducing as part of a more rational road and urban policy a more comprehensive policy of charging parking fees in accordance with the scarcity value of open spaces in cities should both reduce traffic and at the same time generate revenues to construct multi-storeyed parking places – although neither objective may be achieved without much more rigorous enforcement of street parking regulations.

An important pre-requisite for levying appropriate user charges is the availability of proper information on the volume of services consumed, the long run marginal cost of delivering the service, the social benefit component in the service requiring subsidization.

(ii) Local Taxation

Indian municipal bodies can levy and collect only those taxes that are in the State List in the Constitution and are authorised by the States. Unsurprisingly, the taxing powers assigned are non-uniform across states. However, the most important local taxes are: (i) taxes on lands and buildings, (ii) a tax on the entry of goods into a local area for consumption, use or sale which is known as octroi, (iii) taxes on luxuries including those on entertainment, amusement, betting and gambling, (iv) taxes on advertisements other than advertisements published in newspapers, or broadcast in radio or television, (v) taxes on non-motorised vehicles, (vi) taxes on animals and boats, (vii) tolls, and (viii) taxes on professions, trades, callings and employment.

In reality, however, most of these taxes are simply not levied in most urban areas. Octroi was an important source of municipal revenue in some States until recently. However, the tax was considered obnoxious, distorting, iniquitous, and a major source of corruption and it is not surprising that all states except Maharashtra have now abolished the tax and even in Maharashtra, the tax is levied only in municipal corporations. In a few states, municipal governments do have some limited access to consumption taxes. In Kerala, for instance, the power to levy entertainment tax is given to the urban local governments. In Andhra Pradesh, local governments receive a fixed share of the revenue from entertainment tax. In some states, urban local bodies also collect some revenue from advertisement tax.

The property tax is, by far, the most important source of own revenues of municipal bodies although, the collections are generally poor and the revenue buoyancy of the tax is low. Recently, however, initiatives in some municipal corporations have shown that revenues from this tax can be substantially increased with proper reform. Bruhat Bangalore Mahanagara Palike (BBMP), for example, reformed its property tax by revising the area-based values, introducing a self-assessment system and e-filing and payment of the tax with the result that revenue increased from Rs. 385.3 crore in 2008-09 to Rs. 795 crore in 2009-10 and is estimated at Rs. 1500 crore in 2010-11.

The starting point for property tax reform in India was the introduction of area-based assessment by the Patna Municipal Corporation in 1992-93. Previously, the tax was collected on the basis of the annual rental value, defined as gross annual value rent at which the property may be 'reasonably' be expected to be rented. This system gave enormous discretion to tax collectors and yielded little in tax revenue. The prescription of unit values (per square foot) based on the area of location and type of construction of the property instead of the annual rental value removed most discretion from the tax collectors and resulted in increased the value of the base resulting in the reduction of the tax rate from 44 per cent to 9 per cent.[1] Subsequently, municipal corporations in a number of States adopted the Patna model. In Bangalore, for example, properties were classified into different zones based on the guidance values set by the Department of Stamps and Registration.

[1] In view of the very considerable degree of under-spending in Patna – the worse of the 30 cities examined by Mohanty et al. (2007) -- its pioneering role in property tax reform has apparently not been carried through over time in a way that sustains municipal revenues.

For each zone, rental value per square foot was determined on the basis of type and quality of construction and age of the buildings. A handbook was brought out detailing these values so that each individual property owner can now compute his tax liability simply by plugging in the location, type of construction and area of his property, and then pay the tax online.

A major weakness of this system is the need to revise the unit values periodically in keeping with changes in prices. In the absence of periodic revision revenues will not respond to changes in the values of properties, and the buoyancy of the tax will depend only upon the addition of new properties. As a rule, it is politically difficult to change values periodically. One way to overcome this problem and keep tax revenues expanding with needs might be to link the guided values automatically to the index of property values in various cities determined by the National Housing Bank. This system could be expanded if states could initiate the estimation of price changes on real property in every urban local body based on the methodology adopted by the National Housing Bank and then link the guided values automatically to the price index to estimate the tax liability.

Several important lessons from the Bangalore experiment in the reform of property tax are worth noting. First, the system should be simple and transparent enough to be easily understood by the general public. Second, there should be clarity in the reform process and thorough public discussion and debate when the reform is adopted. It is important for the tax department to provide prompt and clear answers to queries by the general public in newspapers, video and audio channels. It is also important to facilitate online payment of the tax so that the taxpayer does not have to be in contact with the tax collector. Computation of the property tax liability based on the guided values and online payment of the tax obviates the need for taxpayers to go to the tax department and face harassment simply in order to pay the tax. None of this is rocket science; but it is exactly this kind of direct, simple action to simplify and improve local fiscal procedures which is needed to enable Indian cities to cope more adequately with their changing reality.

Another major reform needed in the property tax system is the expansion of the tax base. The Administrative Reforms Commission (India 2007) noted that only about 60-70 per cent of the properties in urban areas are actually assessed. A large number of property owners simply do not pay the tax. The Commission recommended the matching of the properties paying the tax with those in the Geographical Information System (GIS) to identify those that are not paying the tax. BBMP has undertaken this exercise for all properties within its 800 sq. kilometre area. By matching the actual properties paying the tax, excluding government buildings and slums, it is possible to identify the properties evading the tax.

One reason for widespread evasion is because much new construction and additions to existing buildings have been done without getting proper approval. Some have expressed the fear that allowing such properties to pay the tax could mean giving them legal recognition. It is important to keep these two issues separate. It is also important to examine the nature of violations. In general, if violations are not major property owners should be allowed to pay the penalty and regularise them.[2] On the other hand, in cases where the violations are major, the structures should be demolished.

The basic reform of the property tax system requires a good data base. Unfortunately in most municipal bodies, there is no proper record of ownership of dwellings, leave alone the area of the plots, covered area and the floor space. Nor do they collect information on the alterations made by the owners. In the absence of a good information system on various properties and their improvement, it becomes difficult to enforce the tax even though many of the reformed systems have a self-assessment principle. In fact, in many cities, the number of properties subject to property tax was found to be much lower than the properties identified in the GIS system. Considering the fact that municipal governments are closer to the people it should be easy to build an information system on properties to prevent free-riding in public services. In fact, many of the properties in urban areas do not have clear titles. Lack of organised market for land and housing is a major reason for underreporting the value of transactions and invariably guided vales of land and buildings used for determining the property tax are significantly underestimated. While it is necessary to remove the causal factors preventing development of

[2]Recently the government of Karnataka state attempted to pass an ordinance regularising 700,000 illegal constructions within the Bangalore Municipal Corporation area on the eve of an election to the municipal body. The scheme (called the “Akrama-Sakrama” scheme) was approved by the state cabinet but in the end did not receive the approval of the Governor on the grounds that the government should pass the legislation and not simply pass an ordinance.

organised markets for real properties, it is also necessary for the municipal governments to have a good information system on the values of different types of properties transacted.

Another potential source of revenue to municipal governments is the surcharge on the consumption taxes levied by higher levels of government. Gujarat recently decided to impose an additional one percentage point levy on the VAT, earmarking the levy as compensation to the municipal corporations for the loss of revenue from abolishing octroi. As the present consumption tax system is replaced by the GST regime, the possibility of providing additional revenue to local governments more generally by (as in Japan, for example) levying an additional percentage point for this purpose at either the central level or perhaps as each state decides and then distributing the revenues to localities by formula might perhaps be considered.[3] Firm estimates of GST base are not available but a conservative estimate made at NIPFP for 2007-08 put the GST base at Rs. 16,000 billion after adjusting for the prevailing exemptions. A one per cent levy on this base would yield Rs. 160 billion for municipal governments which is about 0.34 per cent of GDP. Since even the most optimistic estimate of revenue from property tax is just about 0.2 per cent of GDP a one per cent levy on the GST could yield virtually double the amount collected from property tax.

As a final note on local taxes, it is particularly important that states cease the pernicious practice of abolishing local taxes without providing adequate substitute sources of revenue to municipalities. For example, the Gujarat government abolished octroi to fulfil its election promise without any mechanism to compensate the municipal corporations, although later they decided to levy a one percentage point additional rate on the sales tax. Rajasthan and Haryana simply abolished the property tax without even consulting the urban local governments. Punjab put the threshold for the property tax so high that almost two-thirds of the properties are exempted. Since the property tax is the only important tax for municipal

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[3] Conceivably, some states may perhaps even want to consider allowing at least the large metropolitan areas to 'piggyback' an additional rate of their own on the state tax base but this is unlikely to be a good idea given the complexities involved in making such a system work. Even Canada, which makes considerable use of such provincial 'piggyback' rates on its central GST (as described in detail in Bird and Gendron (2010)), has not considered, and is unlikely to consider, extending this facility below the level of the province.

governments, when a State government abolishes or severely restricts this tax it is deliberately disempowering its municipalities.

III. Financing Urban Services: Intergovernmental Transfers

In most countries, municipalities are seldom able to generate the required revenues from their own source. Transfers from higher levels of government either by way of tax devolution or grants are therefore found in every country, as are specific purpose transfers intended to ensure minimum standards of services for those with significant benefit spillovers.

(i) General Grants:

In India, state governments are constitutionally required to appoint a State Finance Commission (SFC) every five years to determine the measures needed to improve the financial position of the municipalities including the distribution between the state government and the municipalities of state revenues and the allocation of such proceeds between municipalities at all levels, the revenues that may be assigned to or utilized by municipalities, and the grants-in-aid to municipalities from state funds. Since the 1991 constitutional amendment, the Central Finance Commission (CFC), which reports every 5 years, has also been obligated to make recommendations on measures needed to augment the consolidated funds of the states to supplement municipal resources as recommended by the respective SFC. Unfortunately SFC reports are not available nor are they reliable to CFCs and therefore, most state transfers to municipalities are ad hoc; they are inadequate, opaque and often discretionary.

(ii) Specific Purpose Grants:

The major specific purpose central transfer for urban local bodies is the Jawaharlal Nehru Urban Renewal Mission (JNNURM) under which grants are given to upgrade the urban infrastructure on the condition that the States and the municipalities will undertake reforms. This ambitious programme, intended to augment urban infrastructure and services, is linked to a reform agenda that includes doing away with urban land ceiling act and rent control act as well as reforms in property tax. Rs. 500 billion is to be allocated from central funds during

2006-12, with matching contributions from city and state governments. Under Track I of JNNURM, assistance is to flow to 63 identified cities to enable planned development, ensure integrated development of urban infrastructure and ensure provision of urban services to the poor. Under Track II, assistance will be extended to other cities under two programs -- Urban Infrastructure Development Schemes for Small and Medium Towns (UIDSSMT) and Integrated Housing and Slum Development Programmes (IHSDP).

Admissible components for assistance under JNNURM include urban renewal, sewerage and water supply, solid waste management, storm water drainage, urban transport, parking spaces on PPP basis, development of heritage areas, prevention and rehabilitation of soil erosion, and preservation of water bodies. Among the municipal level reforms associated with JNNURM financing are introduction of an accrual based accounting system, reform of the property tax by using GIS information, levying user charges to recover 100 per cent of operation and maintenance charges, provision of basic services to urban poor, and internal earmarking of budgets for this purpose. State level reforms under JNNURM include enactment of public disclosure law, full implementation of the provisions of 74th Constitutional amendment including the setting up of District Planning Committees and Metropolitan Planning Committees, enactment of community participation laws, associating elected representatives with the function of city planning, repeal of urban land ceiling act and reform of rent control act, and rationalisation of stamp duty to bring it down to no more than 5 per cent within the next five years. In addition, optional reforms relate to revision of bye-laws, simplification of legal and procedural frameworks for conversion of agricultural land for non-agricultural purposes, earmarking 20-25% of developed land for economically weaker sections of the population, introduction of computerised process of registration of real properties, making water harvesting mandatory in all buildings and bye-laws to introduce re-cycling of water, encouraging public-private partnerships, and sundry structural and administrative reforms. The grant and loan portions and the matching ratios for the centre, state and local bodies (including parastatals and financial institutions) are shown in the following table.

Financing Pattern for JNURM (Per Cent of Total Project Cost)			
Urban Infrastructure and Governance Funding Pattern	Grant		ULB/Parastatals Loan from Financial Institutions
	Centre	State	
Cities with more than 4 million population	35	15	50
Cities with more than one million but less than 4 million population	50	20	30
Cities in North Eastern States and Jammu and Kashmir	90	10	-
Other Cities	80	10	10
Setting up desalination plants	80	10	10

JNNURM is clearly a comprehensive specific purpose scheme for urban renewal and infrastructure support intended to foster many of the reforms in urban governance and finance discussed earlier. Indeed, it is in all likelihood too comprehensive and might perhaps have been more effectively focused on a shorter and more easily attainable list of objectives. In reality, however, little has so far happened since states have proved reluctant to undertake the reforms required to access the assistance. In the first year (2005-06) of operation, only 15.6 per cent of the grants estimated in the budget were allocated. In the second year, although the estimated outlay increased to 78 per cent of budget, the total amount disbursed was still less than Rs. 36 billion. However, with the onset of the financial crisis in 2008-09, disbursements increased sharply. Unfortunately, this increase was achieved in part by diluting the reform content of the package – for example, by using the funds to purchases buses as part of the fiscal stimulus to the commercial vehicles sector.

IV. Financing Urban Infrastructure:

For India's cities to play the role they should in the country's future development, considerable investment will be needed in urban infrastructure. Four ways to finance major capital expenditures are discussed briefly here: local borrowing; levying developmental charges in the residents; selling land and other assets; and public-private partnerships.

(i) Borrowing:

When the benefits from infrastructure projects are enjoyed over a period of time, it may be both fair and efficient to finance such projects in part or whole by borrowing. Moreover, borrowing may be the only practical way to finance large capital projects without large and undesirable fluctuations in local tax rates from year to year. However, municipalities in India can contract loans only if they are permitted to do so by the state governments.[4] In most cases, state governments have to guarantee local borrowings, in which case the loan becomes the liability of the state and is included in the overall ceiling under the respective fiscal responsibility legislations. States are reluctant to guarantee municipal bonds because their fiscal responsibility legislation requires them to limit their committed liabilities to half a percent of Gross State Domestic Product (GSDP) and their fiscal deficit at 3 per cent of GSDP.[5] Municipal corporations must thus issue bonds on the strength of their own credit rating rather than based on state government guarantees.

State governments permit urban local governments to borrow under their respective municipal laws, which lay down the framework for borrowing: the projects for which the borrowing is allowed, the volume of borrowing and the security to be pledged, the procedure for applying to the state for the permission to borrow, and the manner in which accounts must be kept. If local bodies borrow without state government guarantees, generally they must place some revenue stream in escrow in order to guarantee the service of the debt. In most cases, state governments only allow municipal corporations to borrow from the market based on the value of their real property tax base. Most states have issued guidelines for local borrowing such as that borrowing should be for less than 30 years, that the interest

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[4] Under Article 293 of the Constitution, even state governments have to seek the permission of the central government to borrow if they are indebted to the latter. The pattern of plan financing until 2004-05, when much plan assistance was given to the states in the form of central loans, ensured that states were indeed usually so indebted. Consequently, when states borrow from the market in effect the Union Finance Ministry, Planning Commission and the Reserve Bank of India really determine the allocation of market borrowing to each state.

[5] The 3 per cent GSDP target recommended by the Twelfth Finance Commission was supposed to be reached by 2009-10. However, the Government of India raised the fiscal deficit limit to 3.5 per cent and later to 4 per cent of GSDP in 2008-09 as a part of its fiscal stimulus package, and many states revised their targets accordingly. The Twelfth Finance Commission also recommended that states should enact fiscal responsibility legislation; 28 states (with the most important exception being West Bengal) have done so.

rate should not exceed interest rate on government securities and that there should be sufficient provisioning for debt servicing.

The poor development of municipal bond markets is a major shortcoming in the financing of urban infrastructure in the country. Only recently have municipal corporations have started borrowing funds. By and large, most such borrowing has been from public institutions such as Housing and Urban Development Corporation (HUDCO) or Life Insurance Corporation (LIC) for housing and water supply schemes. After Credit Rating Information Services Ltd (CRISIL) began rating municipal corporations in 1996, however, the groundwork necessary for the municipal bond market was established. Ahmedabad Municipal Corporation was the first municipal entity to issue Rs. 1 billion bond with the credit rating of "A+". Subsequently, other credit rating agencies began to rate municipal corporations and a number of municipal corporations have issued bonds, particularly after the Ministry of Urban Development issued guidelines for tax-free municipal bonds. The critical requirement for issuance of such bonds is that the municipal corporation issuing the bonds is required to maintain a debt-service coverage ratio of at least 1.25 throughout the period.[6]

Despite these developments, the volume of bonds issued has been small and trading very thin. So far, only nine municipal corporations have so far issued bonds amounting to Rs. 6.2 billion, in part because few can fulfil the collaterization condition mentioned above. Although so far the amount of resources raised from the bond market by the municipal corporations is small, so long as there is no state bailout, as time goes on the demonstration effect may lead to still more municipal recourse to borrowing for capital finance. Another impetus for widening and deepening the bond market is that under the JNNURM program the centre and states together are to provide 50 per cent of the resources required for investment in urban infrastructure as grants provided that the other 50 per cent has to be generated or borrowed by the municipal corporation.

(ii) Development Charges:

A development charge is a one-time levy imposed on property developers (including Development Authorities) to finance growth-related capital costs for the area where the development takes place. Generally, developers recover the

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[6] Debt-service coverage ratio is defined as the ratio of net income (after meeting all obligations) to long term debt service obligations.

amount by charging the property owners based on the land area owned by them in the new development project. Who ultimately bears the cost of course depends on the demand and supply conditions for land and housing in the area. On the whole, however, in view of the relative scarcity of land and the strong demand for land and houses in urban areas in India, most development charges are probably borne by the buyers. When properly designed and implemented, development charges amount to a form of marginal cost pricing mechanism for urban infrastructure and may thus encourage more orderly and efficient development of urban agglomerations.

Such charges are feasible in newly developed areas within urban agglomerations. However, in practice in places where parallel Development Authorities exist with the mandate of creating housing infrastructure, the charges are collected by them and not by the municipal bodies. Unfortunately from the perspective of sensible urban finance and planning, these Authorities are directly responsible to the respective state governments and not to the municipal body concerned.[7] Dividing up capital and operational functions and finances in this way evidently makes it more difficult to develop coherent urban policies.

(iii) Proceeds from Sale of Land and Buildings:

In all urban areas, land is scarce. In many urban agglomerations, as just mentioned, Development Authorities have been set up to acquire land and to develop it either for sale or to directly build affordable houses for the poor and middle income groups.[8] They acquire land from the private owners, put the basic infrastructure in place and sell it for housing or commercial building purposes.

There is often considerable land potentially available in urban areas, much of it owned by public sector agencies such as railways and defence as well as by municipal bodies themselves. An essential first step is to make a complete inventory of land available for development and sale in municipal areas. In the case of the defence sector, for example, when cantonments were initially created they were outside cities. However, as cities expanded over the years, they have come within the urban agglomerations. The central government, with co-operation from the

[7] The Delhi Development Authority until recently was not even accountable to the Delhi State administration but was under the Union Home Ministry.

[8] In some instances, however, the Development Authority has ended up acting as a monopoly agency, thus restricting the supply of housing in cities and defeating its original purpose.

state governments, should take action to relocate such establishments, with the state government or the municipal corporation paying for the cost of land acquisition and redevelopment. The proceeds from the sale of these properties can be used for redevelopment of defence establishments outside the city, and any surplus revenue earmarked for augmenting urban infrastructure and services. Much the same could be done with vacant land belonging to other agencies which could also, after proper development, be disposed of and the proceeds shared between the municipal body and other owners. Of course, all these issues are contentious, and consensus on them will not be easy to achieve. Nonetheless, if centre and state governments can cooperate in doing so, it should certainly be possible to work out an acceptable formula for sharing the proceeds from the sale of land that would provide some needed infrastructure finance to growing cities.

One of the major problems with the municipal governments is the lack of information system on common properties. Although 13th Finance Commission has recommended land owned by various government departments much be identified and a proper information system should be created, there has been no initiative. At the municipal level, it is necessary to get a clear idea of the land owned by the various governmental departments. Even to effect the sale of land or to construct buildings and sell them, it is necessary to have a clear idea.

(iv) Public–Private Partnerships:

Often, however, in India's complex public sector it may be so difficult to get different components of the public sector to cooperate that public-private partnerships (PPPs) may have significant potential for financing and delivery of urban services. Indeed, PPPs have a number of potential advantages in delivering urban public services. First, the urban local government does not have to spend the money up front. Second, contracting out services may result in greater efficiency as better service delivery. Empirical studies show that contracting out generally results in lowering of unit costs of services (Kitchen, 2002).

In India, Chennai was the first city to contract out municipal solid waste management services to a foreign private agency- -ONYX, a Singapore based company. The scope of privatization includes activities such as sweeping, collection, storing, transporting of municipal solid waste and creating public awareness in three municipal zones. ONYX collects about 1100 Metric tons of waste from three zones per day and transports it to open dumps. A number of other municipalities have contracted out waste disposal and solid waste management to the private sector including NGOs.

Another example of successful PPP is in the provision of water supply in Hubli-Dharwar, Belgaum and Gulbarga cities of Karnataka State. Residents of these cities used to get water supply for only one or two hours a day. However, the PPP arrangement, undertaken on a pilot basis to cover about 2 lakh residents in the three cities, enabled them to enjoy the benefits of 24X7 water supply with a state of the art water distribution system and at little additional cost. The private partner in this case is a French water company 'Veolia Water' which was entrusted with the task of providing 100 per cent metered customer connections. The responsibility for providing adequate supply of bulk water was entrusted to the Karnataka Urban Water Supply and Drainage Board (KUWSDB). Considering the enormous success of this pilot, Karnataka government has approved upscaling of the project to the entire population in the three cities (Ahluwalia and Nair, 2010).

Mixed public-private financing of urban infrastructure definitely deserves to be further explored in the Indian context. At the same time, care must be taken to ensure that certain conditions are satisfied if this approach is to produce beneficial results (Engel et al 2010). This approach is most likely to prove successful when projects are carefully designed and implemented, and when the responsible public agencies are technically and financially able to hold up their end of the deal. Weak governments cannot rely on private agents to overcome their weaknesses and expect to make the best possible bargains for the public they represent. Governments must also be careful that they do not end up assuming the 'downside' risk of projects, while allowing their private partners to reap any 'upside' gains. Similarly, care must be exerted to ensure that what occurs is not simply the replacement of public sector borrowing by (often more expensive) private sector borrowing. Privatizing the design, construction, and operation of urban infrastructure may have many merits if done properly, but it is neither a panacea nor free.

Need for a strong information system

A major shortcoming which has inhabited both efficient public service delivery and ensuring adequate raising of resources in the lack of a good information system at the municipal level. The information system should comprise of

(i) data on land, buildings, ecology and geography and these will have to be obtained from the geographical information system (GIS); (ii) information on the demographic profile of the population including the sex ratio, age groups, human development indicators of the population (literacy rate, enrolment ratios, child mortality, maternal mortality, life expectancy etc.,); (iii) social and economic information including various activities and employment and incomes, values of various types of properties; number and types of shops and establishments, number of hospital beds, doctors, nurses, number of schools and teachers at various levels and (iv) fiscal information relating to different types of revenues and expenditures of the states and per unit of cost of providing various public services, and gap between the normative standards of public services to be provided and the actual public services provided.

V. Conclusion

Financing urban infrastructure and services adequately is a formidable challenge. The infrastructure deficit in urban areas is not only large but growing. In contrast, the resources available to urban local governments are scant. The result is the poor state of urban infrastructure and significant under-provision of municipal services. Even in terms of the norms fixed as long ago as 1963 by the Zakaria Committee, the actual spending in 30 large municipal corporations in India was less than a quarter of their requirements. Financing urban public services, therefore, is a key to imparting dynamism to the cities which is a necessary pre-requisite for taking the economy into a double digit growth trajectory.

The paper discusses a variety of ways of augmenting the resources of the municipal bodies in the country including essential reforms in the property tax system and adequate exploitation of user charges and fees for various services delivered. The paper also suggests that consideration should be given to the possibility of empowering metropolitan governments to piggyback on the GST when it comes into existence: even a 1 per cent surcharge on this base could generate one and a half to twice the amount of revenue that is being collected from the property tax at present. The paper also makes important recommendations for the reform of central and State transfers to urban local governments. A critical element in the reform of urban finances is the need to develop a strong information system comprising of GIS, demographic, social, economic and fiscal variables.

With respect to financing urban infrastructure, development charges should be used more effectively and more should also be done to utilize public lands more effectively. In addition, to a considerable extent capital expenditure requirements will have to be financed through borrowing. Development of the municipal bond market is, therefore, an important area where much remains to be done. Credit rating municipal governments, encouraging them to undertake reforms, and ensuring hard budget constraints are all important for developing a healthy bond market. Another important area is to encourage public private partnerships. The paper points out some successful cases of PPPs which have helped to augment water supply and solid waste management in municipal bodies. It is important to involve the private sector in the provision of urban services to the extent feasible to ensure efficiency and accountability.

Reform of urban governance and finance are critical not only to improving the quality of life of the people living in urban areas but also to ensure that cities, and especially the large metropolitan areas, become the drivers of economic growth in the country. Ensuring adequate availability of finances and improving governance is an imperative, and the rate at which urbanization is taking place makes it urgent than reform initiatives must be undertaken. If India is to expand its national rate of economic growth significantly, concerted action to reform both urban policies and urban initiatives are required soon.

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