A STUDY OF URBAN LOCAL BODIES

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A Study of Urban Local bodies:

Analysis of CARE rated municipal corporations and municipalities

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Executive summary

A study of the financial performance of 15 municipal corporations and municipalities (Urban local bodies: ULBs) for the period 2004-09 shows that:

a. Revenue growth has been buoyant over the years. However, the pace of increase in expenditure too has risen commensurately on account of the increased quantum of activity undertaken by these ULBs. There has been a shift to greater dependence on non-tax revenue and grants, which is a concern as these flows are not endogenous to the system being affected by external factors. Revenue expenditure has been mainly on both operations and maintenance as well as establishment expenditure.

b. The ULBs have been successful in maintaining a revenue surplus with 13 of them having a surplus in FY09. Given the deteriorating state of the economy in general, this is commendable.

c. Capital expenditure of ULBs has increased especially after FY08 leading also to pressure on the capital deficit. Relative to revenue deficit, a larger number of ULBs had capital deficits, reflecting hence the prospective need to raise more funds to finance.

d. The debt position of ULBs is fairly stable and with the DSCR ratio being comfortable for a sub-sample of ULBs, there is scope for raising funds in the market.

e. It would be desirable for ULBs to get into the process of monitoring their own performance in terms of net surpluses or deficits on a regular basis to prepare for raising funds in the market. Such a regular appraisal would be necessary in order to ensure that there is financial discipline that is retained as they carry on with their regular business. Obtaining credit rating would be a step in this direction as it would help provide such guidance that will in turn also provide comfort to the market which would evaluate them when funds have to be raised.

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Importance in providing infrastructure

Financing 'Urban Infrastructure'

Due to increasing emphasis on decentralization and the growing level of urbanization, the importance of municipalities in financing large scale infrastructure is growing. 'Urban infrastructure' includes services like water systems, solid waste management, sewerage systems, power generation plants, roads, mass transportation, electricity generation and telecommunication.

Evidence indicates that countries most successful in sustaining high growth backed their cities with investments directed to improve urban infrastructure.

Decentralization for personalization

The decentralization principle states that the government services should be provided by the lowest level of government for better efficiency. When tastes, incomes and needs differ across regions, local governments will be in the best position to determine the expenditure priorities of its citizens. Delegating responsibilities to the lowest level of government allows government services to be adapted more closely to specific demands of local citizens.

Expenditure responsibilities to be borne by the Local bodies

Having assigned expenditure responsibilities local bodies should bear the cost of financing these expenditures. In other words, if local governments are to be given more independence in their expenditure decision, and then such independence should be extended to their responsibilities for execution of planning, financing, constructing, operating and maintaining of all capital projects relevant to the areas assigned to them. If local governments do not have responsibility for these facilities, then they may find it advantageous to stretch on maintenance expenditure, believing that the State government will replace the existing facility. If the municipal governments do not feel 'ownership' of their capital facilities, then there is a problem of 'moral hazard' because it is unlikely that they will choose to invest resources in maintaining them.

Size of the Municipal sector in India

Thirteenth finance commission

According to the Thirteenth Finance Commission (TFC), there are 3,723 ULBs in India, of which 109 are Municipal Corporations, 1,432 are Municipalities and 2,182 are Nagar Panchayats, for a population of 1.15 billion, which is growing at a rate of 1.47% as on 2009.

A world comparison: Total revenue & expenditure as a % of GDP

Total revenue of municipal sector accounts for about 0.75% of GDP of the country. While the same stands at 4.5% for Poland, 5% for Brazil and 6% for South Africa. In terms of total expenditure, the municipal sector accounts for about 0.79% of the GDP of the country. Further the municipal revenue and expenditure accounts for a little over 2% of the combined state and central governments. This is in contrast to the situation obtained in advanced countries, where local bodies account for 20-35% of the total government expenditure.

Purpose of the Study

Roadmap for Future endeavors

The main purpose of the foregoing study is to analyze trend seeing the finances of various MCs and draw inferences which can be used to chart a roadmap for the future in terms of raising resources. Investment requirements will vary depending on the area's service levels and cost of operation. The scale and size of investment requirements cannot be met from government budgetary resources and hence multiple sources of funding are needed. A major chunk of resources would have to come from financial markets.

Limited comprehensive and consistent data

One of the difficulties encountered while studying the municipal finances related to the limited availability of comprehensive and consistent data. Also there is an issue with uniformity in classification and reporting of financial data, which does not allow precise comparison on various parameters.

List of 15 municipal corporations considered in the study

This study analyses the finances of 15 MCs for the period FY04-FY09. Since the detailed finances of all municipals are not available for FY10 we have considered the information only upto FY09.

Agra MC
Allahabad MC
Kanpur MC
Lucknow MC
Mathura MC
Meerut MC
Varanasi MC

Ahmedabad MC

Bhubaneshwar MC
Puri MC
Raipur MC

GVMC
BBMP
Hyderabad MC
Vijayawada MC

Structure of Municipal Revenue

The ***revenue*** base of Municipal Corporations can be broadly classified into:

a) Tax revenue
b) Nontax revenue
c) Assigned (Shared) revenue
d) Grants-in-aid

The constitution of India does not lay down the revenue base for municipalities. The power to determine their revenue base rests with the state government. The state government has specified the taxes that the municipalities can levy and collect.

Apart from the tax and nontax revenue source MCs depend upon grants from the State Governments. These grants are primarily intended to compensate for the mismatch of functions and finance. Most of the MCs receive financial support in the form of revenue grants from State governments to meet current expenses. Similarly, capital grants are provided to meet project related expenditure.

In addition, loans also constitute an important source of municipal revenue in case of some ULBs.

Expenditure of the municipal corporations can be broadly classified into:

a) Establishment expenditure
b) Administrative expenditure
c) Operations and Maintenance expenditure
d) Interest payments on Loans

Amongst all the components of municipal expenditure, the expenditures incurred on capital works, established and administrative expenditure & operations and maintenance assume importance.

REVENUE ACCOUNT SUMMARY (15 MCs)

Table1. shows that the aggregate revenue receipt has been increasing continuously at a compound annual growth rate of 23%. The revenue receipts grew by a mere 8% in FY05 from Rs. 2,233 crore in

Figure 1: Revenue of ULBs

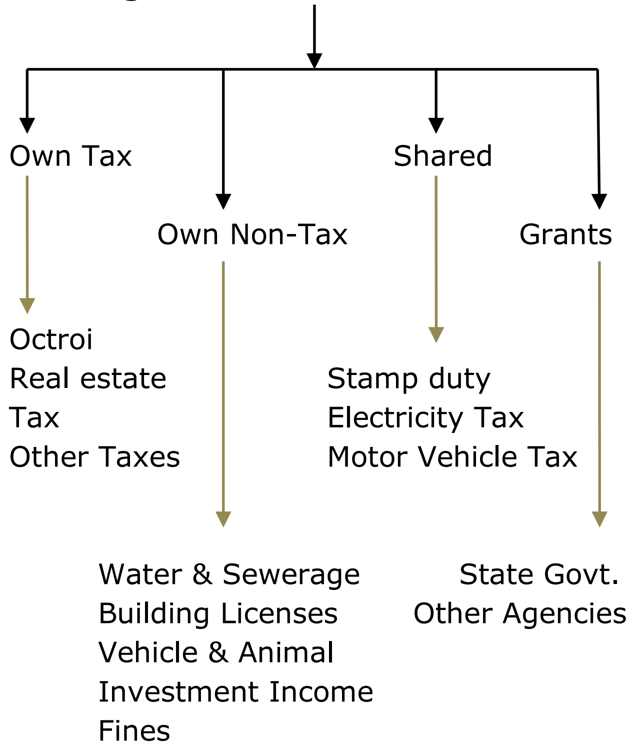
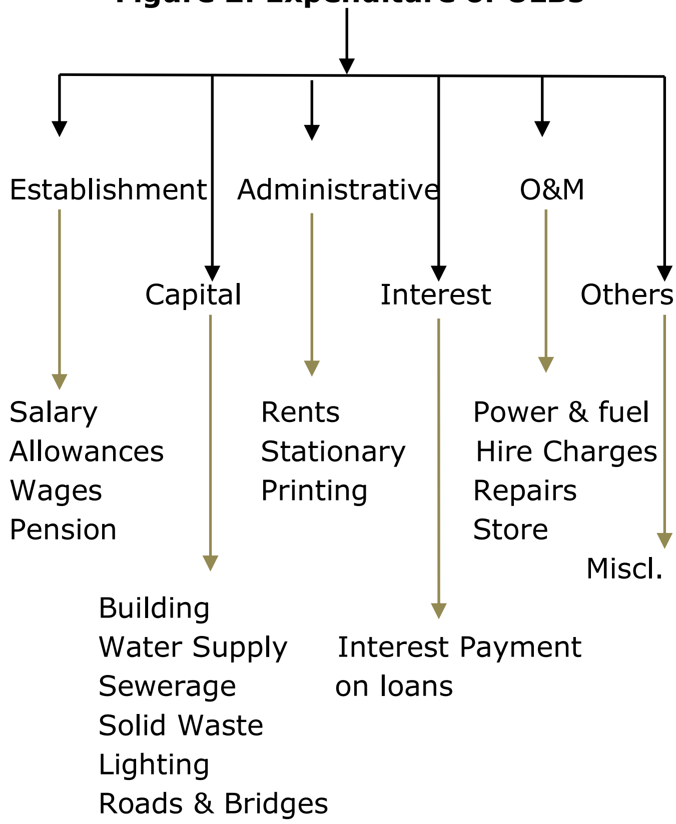


Figure 2: Expenditure of ULBs



FY04 to Rs. 2,414 crore in FY05 followed by a 17% growth in

FY06. It is observed that in FY08 and FY09 (RE) it has increased by 31% and 39% respectively.

Table1. Aggregate Revenue Receipts Profile (in Rs. Crore)

MC	FY04	FY05	FY06	FY07	FY08	FY09
			ACTUALS			RE
Aggregate	2233	2414	2819	3385	4449	6166
% change		8	17	20	31	39

The increase in FY08 and FY09 (RE) has been mainly due to high growth rate registered by some municipals like BBMP, Hyderabad, and Greater Vishakhapatnam Municipal Corporations. Together they comprised 43% of the total share in the total revenue receipts in FY08, which increased to 65% in FY09.

- BBMP contributed 20.8% to the total revenue receipts in FY08 and is estimated to remain stable at 20.5% in FY09.
- Hyderabad comprised 17.4% of the total revenue receipts the same increased to 26% in FY09.
- GVMC formed 5% of the total revenue receipts and this share increased to 8% in FY09.
- Ahmedabad, on the other hand, contributed over 30% to the total revenue receipts registered a 17.7% increase in FY08, which declined to 10.9% in FY09.

Table 2: Aggregate Revenue Expenditure Profile (in Rs. Crore)

MC	FY04	FY05	FY06	FY07	FY08	FY09
			ACTUALS			RE
Aggregate	1161	1259	2050	2313	3167	4496
% change		8	63	13	37	42

The revenue expenditure table (Table2.) shows that the revenue expenditure has been increasing steadily at the compounded annual growth rate of 31%. However, the growth rate rose needlelike by 37% in FY08 and continued on the same track with 42% growth rate in FY09 (RE). FY06 registered an increase from Rs. 1,259 crore to Rs. 2,050 crore primarily on account of the increase in Operation & maintenance expenses.

Summary of Revenue account

The aggregate revenue finances of 15 municipal corporations indicate that there has been a revenue surplus position all throughout. It increased from Rs. 1,072 crore in FY04 to Rs. 1,282 crore in FY08 and is estimated to rise further to Rs. 1,670 crore in FY09.

Table 3: Number of Municipal Corporations with Revenue Surplus and Revenue Deficit

Numbers	FY05	FY06	FY07	FY08	FY09
Surplus	10	14	12	14	13
Deficit	5	1	3	1	2

Table 3 shows that the number of municipal corporations registering a revenue deficit position has been falling, with FY06 and FY08 being remarkable with 14 municipals accounting a revenue surplus position. This implies improvement in the revenue finances of the municipals.

CAPITAL ACCOUNT SUMMARY (15 MC)

The aggregate capital income of the 15 municipal corporations considered is increasing at a high rate of 85% and 118% in FY08 and FY09 (RE). This is primarily on account of Raipur, Allahabad, Greater Vishakhapatnam, Bhubaneshwar, Kanpur and Hyderabad municipal corporations, attributing around 75% to the total capital receipts. It may be noted that capital expenditure has increased specifically after FY08.

Capital Expenditure profile (Table 5) indicates that the growth in the aggregate capital spending has increased by 41% and 132% in FY08 and FY09 (RE). The increase has been attributed primarily by the municipal corporations of Allahabad, Kanpur and Greater Vishakhapatnam.

Overall Capital account shows a deficit of Rs. 248 crore in FY05 which gradually came down to Rs. 195 crore in FY08 but is estimated to increase further to Rs. 916 crore in FY09

Table 6 shows that as compared to the revenue profile the capital profile is more inclined towards deficits. However, a tendency to improve can be observed. In FY08 the number of municipals with a deficit fell to 3 from robust 6 in the previous three years.

Table 4: Aggregate Capital Receipts Profile
(in Rs. Crore)

MC	FY04	FY05	FY06	FY07	FY08	FY09
			ACTUALS			RE
Aggregate	1239	1431	1461	1759	3262	7099
% change		15	2	20	85	118

Table 5: Aggregate Capital Expenditure Profile
(in Rs. Crore)

MC	FY04	FY05	FY06	FY07	FY08	FY09
			ACTUALS			RE
Aggregate	762	1679	1795	2456	3457	8015
% change		120	7	37	41	132

DETAILED REVENUE ACCOUNT

Table 7 gives the detailed breakup of the sources of revenue receipts of the 15 municipal corporations.

Grants and Own Tax revenue have been the primary contributors to the total revenue receipts.

- Own tax revenue has contributed over 45% from FY04 to FY07. However, from FY08 the share has been falling, it fell to 38% in FY08 and the revised estimates of FY09 indicate a 28% share.

Table 6: Number of Municipal Corporations with Capital Surplus and Revenue Deficit

Numbers	FY05	FY06	FY07	FY08	FY09
Surplus	9	9	9	12	10
Deficit	6	6	6	3	5

Table 7: Aggregate Detailed Revenue Receipts Profile
(in Rs. Crore)

MC	FY04	FY05	FY06	FY07	FY08	FY09
			ACTUALS			RE
Own Tax Revenue	1080	1216	1414	1756	1696	1699
% change		13	16	24	-3	0
Own Non Tax Revenue	331	357	378	417	633	1613
% change		8	6	10	52	155
Assigned Revenue	260	253	274	262	393	416
% change		-2	8	-4	50	6
Grants	484	516	671	799	1483	2191
% change		7	30	19	86	48
Others	78	72	82	151	244	248
% change		-8	15	84	61	2

Table 8: Aggregate Detailed Revenue Expenditure Profile
(in Rs. Crore)

	FY04	FY05	FY06	FY07	FY08	FY09
			ACTUALS			RE
Establishment Exp	640	633	962	1022	1273	1460
% change		-1	52	6	25	15
O&M	376	447	886	1016	1591	2437
% change		19	98	15	57	53
General Admin Exp	55	67	92	118	125	240
% change		21	38	28	6	93
Others	90	112	110	157	179	358
% change		25	-2	43	14	100

- The share of Own non-tax revenue, which was 15% in FY04 and FY05, fell to 14% in FY08 but is estimated to increase to 26% in FY09. While this is a good sign, the sustenance of non-tax revenue is a pertinent issue for them.
- Contribution of Grants peaked in FY08 to 33% and the revised estimates for FY09 indicate further rise to 36%. This is significant as it indicates that if such a trend continues there will be pressure on MCs to look progressively at grants which in turn will depend on the states' wherewithal to support such expenditure.

Primary source of Tax revenue for Municipal corporations is Property tax. It is important to understand that the responsibility of designing the property tax system in India lies with the state governments. The state governments in turn lay down the responsibility of tax bases, for property tax procedures for valuation, exemption and rebate policies, rate structures, and measures for dealing with delays, tax evasion, with the municipal corporations. However, the autonomy of municipal governments in formulating property tax policy or designing the system is severely restricted and allowed at best in fixing the tax rates within certain ranges and often in designing collection strategies.

This study observes that the property tax rate revisions and tax collection efficiency of the municipal corporations has been satisfactory. 10 out of the 15 municipal corporations analyzed have a property tax collection efficiency of over 65%. On the other hand, 5 municipal corporations have collection efficiency below 55%.

Table8. gives the detailed breakup of the sources of revenue expenditure of the 15 municipal corporations.

- The two major components of municipal revenue expenditure are establishment and Operations and maintenance (O & M). The former consists of salaries, pensions, travel, etc and the latter includes expenditure on street lighting, building repairs, machinery maintenance etc. The two comprise more than 80% of total expenditure. In FY08 the share of Establishment expenditure was 40% which declined to 32% in FY09. On the other hand, O&M operations comprised 50% of the total revenue expenditure. This is estimated to increase to 54% in FY09.

Both these activities, prima facie, would be increasing over time and cannot be expected to decline though the pace of change could slow down or increase depending on circumstances. In fact, as cities expand, the O & M expense would tend to rise sharply necessitating expansion in such services. Typically higher O & M expense is indicative of development activity while higher share of establishment expenses would pressurize the MC going ahead, as they are usually irreversible and would continue to put pressure on the finances.

Increase in Established expenditure as well as O&M

DETAILED CAPITAL ACCOUNT

- The profile on capital receipts (Table 9) reveals that there are basically two phases in the considered life cycle of the MCs. In the first phase the 'others' category, comprising primarily loan, was the major source of long term funds. However, since FY07 grants have become important and have come through both the state government and JNNURM. Grants come in various forms form central and state governments, international agencies, works-specific etc. By FY09, the two sources are estimated to be more or less evenly matched.
- Devolution of resources from centre to state and from state to the local bodies is an important feature of the federal finance system. The Central Finance Commission is responsible for assessing and advising the respective levels of government on the financial needs of local governments. The Central Finance Commission also reviews the financial position of local bodies and recommends devolution of taxes, user charges, shared revenues and other intergovernmental transfers.

Table 9: Aggregate Detailed Capital Receipts Profile (in Rs. Crore)

MC	FY04	FY05	FY06	FY07	FY08	FY09
			ACTUALS			RE
Grants	235	150	207	624	1494	3370
Others	1004	1281	1254	1135	1769	3728

Table 10: Aggregate Detailed Capital Expenditure Profile
(in Rs. Crore)

MC	FY04	FY05	FY06	FY07	FY08	FY09
			ACTUALS			RE
Services	536	590	860	1135	1881	4023
Grant works	20	112	154	269	498	2003
Others	207	977	781	1052	1078	1986

- In Table 10, 'services' refer to expenditure outlays on Roads & Bridges, Water supply, Sewerage & Drainage and Street lighting etc while Grant works are those projects undertaken which are associated with the specific grants given to the MC.
- The share of services in capital expenditure is higher than the other two categories. The share of services has been increasing over the years from 35% in FY05 to 54% in FY08. This has declined to 50% in FY09. While the grant works are to increase from 7% in FY05 to 14% in FY08 and the revised estimates show a 25% for FY09.

DEBT SERVICING PROFILE

Information on debt profile was available for 9 MCs. Of these 3 did not have any debt and hence the sample size for analysis reduced to 6.

Table 11: Aggregate Detailed Debt Profile
(in Rs. Crore)

MC	FY06	FY07	FY08	FY09	FY10
		ACTUALS		RE	BE
Aggregate Debt	1078.8	1152.6	1358.9	1517.1	6509.5
% change		6.8	17.9	11.6	

- Table 11 shows that the aggregate amount of outstanding debt has risen from Rs. 1079 crore in FY06 to Rs. 1359 crore in FY08, and further by 11.6% to Rs. 1517 crore in FY09 and further to Rs. 6509 crore in FY10. (The increase in the total amount of debt in FY10 has been mainly on account of one MC taking a long term loan of Rs. 6300 crore.)
- The low level of debts of the MCs is indicative of two things. First, they have generally been meeting their requirements from the available funds and not resorting to major works which require borrowed funds. The second is that it shows the potential that exists for further borrowing to meet the growing requirements of urbanization which will entail substantial deployment of funds over the next 5-10 years.

DSCR Ratio

Table 12: DSCR Profile
(in Rs. Crore)

	Number of Municipal Corporations				
	FY05	FY06	FY07	FY08	FY09
		ACTUALS			RE
Less than 1	2	1	1	1	1
1-2	1	3	3	3	3
More than 3	3	2	2	2	2

Debt service coverage ratio (DSCR) measures the availability of cash for debt servicing to interest and principal. It is a benchmark used in the measurement of a corporations' ability to produce enough cash to cover its debt payments. The higher this ratio is, the easier it is to obtain a loan.

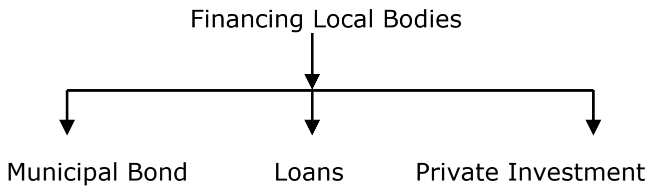
Stable DSCR position

Table 12 classifies the DSCR into three categories namely: below the desired level moderate and high. The data on 9 municipal corporations, of which 3 have zero debt, states the classification of various corporations in the three categories. In FY05, 3 corporations showed a DSCR of greater than 3%,while 2 are below the minimal 1% required, implying that the corporations are not in a position to service their debt. This ratio has improved with two corporations moving in the comfortable DSCR band of 1-2%. Therefore, we can interpret this statistic as a positive sign, implying that the corporations are improving their financial positions and are more capable of servicing their debt.

OBSERVATION

The patterns of urban public finance in India are based on the model of Anglo-Saxon countries like United Kingdom and Australia, which have an elaborate system of inter-governmental transfers. In addition to 'own' and 'shared' revenues, grants-in-aid received from the concerned State Governments constitute a major resource of ULBs. However, the fiscal position of the states themselves has been weak with high levels of deficits and outstanding liabilities.

Figure 3: Financing Urban Infrastructure



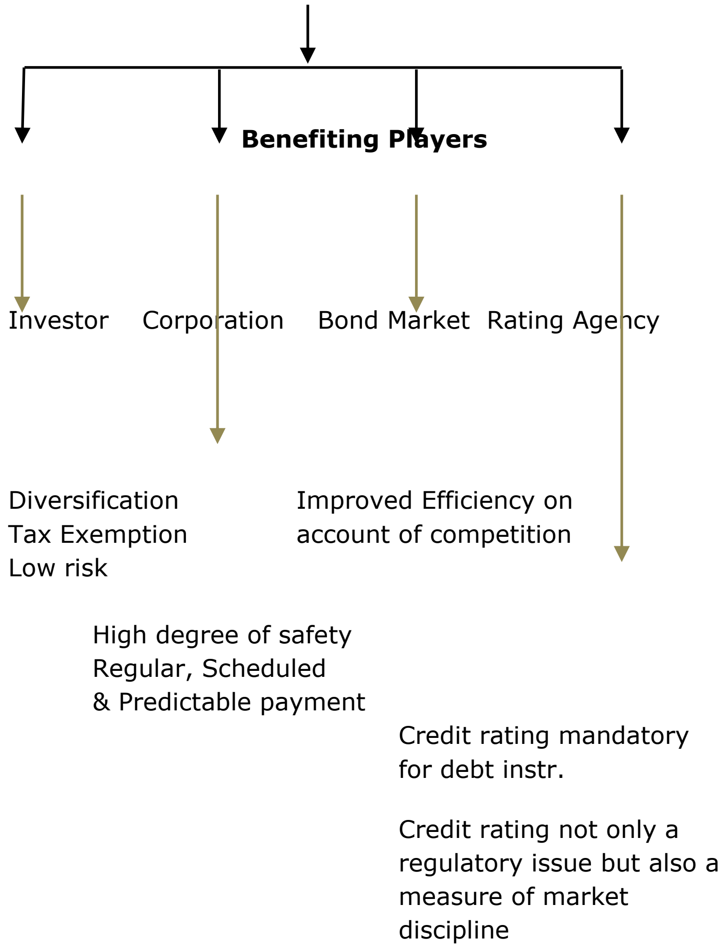
The study notes that local bodies in India, urban and rural are yet to be put prominently on the public finance map of the country, which is needed to facilitate inclusive economic growth and equitable development.

Low Debt levels

The local bodies have low outstanding debt and debt sustainability parameters such as debt coverage ratios that these bodies have considerable scope for debt financing of their expenditure.

Growth in the Bond market

The bond market has witnessed significant growth and sophistication in recent years in terms of issuers and investors, instruments, trading volumes and market awareness. Financial institutions have progressively used bond markets to raise resources for lending various 'infrastructure' projects.



In the view of the above, the approach to urban development and management should be the prime focus of the municipal corporations. Urban India will be the focus of future economic growth with more cities coming up as economic activity expands and migration takes place. The demand for urban services would increase manifold for which MCs will have to prepare themselves. While they would necessarily gain in terms of revenue buoyancy on account of a growing base of taxable income and services, urban infrastructure would be a challenge. Water supply, street lighting, garbage disposal, sewerage treatment, social services etc. would have to keep pace with urbanization. For this MCs would be looking for funds.

In other words, MCs will have an important role to play in future with the proliferation of urbanization. With increasing pressure on fiscal restraint on central and state governments there will be a tendency for flow of funds in the form of grants to slow down to the MCs. In this environment, there would be need for MCs to source the market for funds for bringing about the development activity.