

Municipal Finance Series

2

Urban Local Bodies in Financial Stress

Exploration of the definite link between the state of services and its linkage with financial health of the local Municipal Bodies

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Published by:

P R I A

42 Tughlakabad Institutional Area

New Delhi-110 062, India

Ph: Ph: 011-2995 6908, 2995 0931/32/33

Fax: 011-26080183

E-Mail: info@pria.org

Web: www.pria.org

Foreword

Provision and maintenance of municipal services is the key function of all municipal bodies. Most of the basic infrastructural capital projects including water supply, sewerage, solid waste management, housing etc that are developed by a variety of urban institutions such as water supply and sewerage boards, development authorities etc are handed over to the municipalities for operation and maintenance. Thus, the municipalities have the primary task of assuring the performance and effectiveness of these installed systems.

But, how successful are these urban local bodies in accomplishing their primary objective of efficient service delivery? What are the stress areas? and most importantly how does the financial health of these municipalities affect their functioning?

With the aim to seek answers to the above issues a research was commissioned by PRIA in 2003. Mr. Mukesh Mathur prepared the paper with a focus on the intervention municipalities in which the Urban Programmes are being undertaken by PRIA. The study involved a detailed analysis of the aspect of municipal finances in light of the 74th Constitutional Amendment Act in the country. Site investigation visits were also undertaken by the researcher to analyse the situation in the intervention municipalities.

This series on Municipal Finance is a concise documentation of the findings and recommendations of this study. The series include:

I. Challenges of Delivering Select Municipal Services

A documentation of the status of Municipal Services in the country with causative factors of the present condition.

II. Urban Local bodies in Financial Stress

Exploration of the definite link between the state of services and its linkage with financial health of the local Municipal Bodies

III. Strengthening Municipal Finance

Recommendations and suggestions for augmenting the municipal resources and achieving financial stability to ensure better municipal services

Urban Local Bodies in Financial Stress

Municipal governments in India are vested with the statutory responsibility for the provision and maintenance of basic infrastructure and services in cities and towns. Additionally they have been assigned a range of planning functions through the state legislature and other administrative orders. A detailed description of the functions of the urban local bodies and the existing status of these services have been described in details in the earlier pamphlet of the series – *“Challenges of Delivering Select Municipal Services”*.

A study conducted by the National Institute of Public Finance & Policy (2001) reveals that most of the urban Local Bodies are constrained in discharging their obligatory functions due to a limited resource base. The low per capita receipts of municipal governments do not enable them to meet the minimum standards of services. The study also shows that the finances of municipal bodies are in a mess; a majority of them are not able to raise adequate resources from their own sources to meet increasing expenditure on services. On the whole, the status of municipal finance in India suggests that the present revenues are insufficient to meet the growing expenditure needs of urban areas and the local municipal bodies are in a state of constant financial stress.

As indicated in Table A, municipal bodies raised approximately only Rs.3900 crores from their own sources during the year 1991-92, which constitutes a mere 4.7 per cent of revenue raised by the central government and 8 per cent raised by state governments. This amount is estimated to be only 0.6 per cent of the country's GDP (Gross Domestic Products at factor cost). In per capita terms, own sources of municipal bodies work out to be nearly Rs.205 as against Rs.987 for the centre and Rs.574 for the states. Although urban centres contribute nearly 60 per cent of the country's GDP, it is evident that the municipal bodies have not benefited from the economic activities that take place within their own jurisdictions, and thus remain peripheral to the Indian Economy (NIPFP 1995).

Table A : Revenues of the Centre, States and Municipalities, 1991-92

Unit	Revenues (in Rs. crores)	Per capita (in Rs.)
Centre	83,320	987
States	48,660	574
Municipalities	3,900	205

Source: *Finances of State Governments, RBI Bulletin, February 1994, as quoted in NIPFP (1995)*

The local government and finance are constitutionally the domain of the state governments, however, the latter, over the years, became indifferent to the ways and means of empowerment of local self-government. The inter-governmental financial relations are characterized by dualism. Whereas the Centre-State financial relations are not only specified in the Constitution of India it self, it is reviewed and updated every five years by constitution of Central Finance Commission by the President of India, the state-local fiscal relations however, have been neglected over the years and are *ad hoc, unspecified and uncertain*.

Municipal Financial Structure

The municipal financial structure in India primarily consists of tax and non-tax sources of revenue. They also receive funds from the State Government in the form of grants-in-aid as also share in taxes collected by the State Government. The various sources of tax, non-tax and transfer revenue are given below :

Table C : Resource Structure of Municipal Bodies in India

Sources	Major Components
Internal/Own Sources	Property taxes; tax on vehicles, animals, trade and callings and Tax Revenue professions; theater tax/show tax; tax on advertisements, boats, etc.
Non-Tax Revenue	Rents from municipal assets; income from municipal undertakings; user charges; fee and fines; income from municipal investments; etc.
Sources	Major Components
External Sources	General purpose; specific purpose; grants in lieu of taxes
Grants- in-aid	
Shared Taxes	Entertainment tax; motor vehicle tax; land revenue; stamp duties; profession tax; etc.

The study of the taxation powers of the municipalities reveals that there is a little variation among the states in the matter of taxation powers, authorized to the municipalities. However, significant variations exist across states in their application. Taxes on the entry of goods (octroi), which was among the most buoyant and elastic of the local taxes, are currently levied only in few states, namely Gujarat¹, Maharashtra², Manipur and Punjab³. The inclusion or exclusion of this tax, has an overwhelming impact on the revenue base of municipalities. Many municipalities in Rajasthan do not levy property taxes. The Punjab government has recently abolished the levy of property taxes on properties for domestic use. Similarly, there are inter-state differences in respect of taxes on entertainment and tax on professions, trades, callings, and employment. The differences in the tax jurisdiction, the degree of control exercised by the State Government in terms of the fixation of tax base, rates, exemptions etc. has a direct impact on the finances of municipalities (Mathur 2001)

Municipal Expenditure

Municipal expenditure can be categorized into three main components: Wages & Salaries; Operations and Maintenance; and Interest on Payments. Wages and Salaries constitute nearly 60 per cent of the total municipal expenditure, followed by operation and maintenance (20%) and Interest on payments (7.17%). Table D presents the picture.

¹ Levied only in municipal corporations.

² Levied only in municipal corporations.

³ On the basis of latest information available in this regard. Orrisa has abolished octroi recently.

Table D : Composition of Revenue Expenditure, 1997-98

<i>States</i>	<i>% to Total Revenue Expenditure</i>			
	<i>Wages and salaries</i>	<i>Operation and Maintenance</i>	<i>Interest and debt</i>	<i>Others</i>
Andhra Pradesh	49.21	49.60	0.24	0.95
Assam	42.43	54.14	1.90	1.53
Bihar	77.21	21.13	1.03	0.63
Gujarat	53.20	30.02	6.30	10.48
Haryana	48.76	44.49	0.00	6.75
Karnataka	20.93	78.11	0.48	0.48
Kerala	55.04	34.57	5.19	5.20
Madhya Pradesh	51.01	37.67	0.61	10.71
Maharashtra	61.50	13.29	9.89	15.31
Orissa	38.30	21.61	0.00	40.09
Punjab	52.46	28.68	4.27	14.59
Rajasthan	-	-	-	-
Tamil Nadu	49.13	47.49	2.53	0.86
Uttar Pradesh	69.18	29.62	0.00	1.20
West Bengal	71.09	18.52	1.01	9.38
Himachal Pradesh	46.98	52.32	0.00	0.71
Manipur	70.69	8.73	0.00	20.58
Meghalaya	52.28	30.37	0.00	17.35
Tripura	56.64	1.15	2.26	39.95
Total	60.32	20.00	7.17	12.51

Source: NIPFP (2000), Mathur (2001)

The aggregate expenditure on operations and maintenance (O&M) of municipal services accounts for only one fifth of the total expenditure, ranging from a mere 1.15 percent in Tripura state to as high as 78.11 percent in Karnataka. The other two states that have

recorded more than half of the total expenditure on account of O&M of services during 1997-8 were Assam and Himachal Pradesh. In all the other states, O&M expenditure was less than 50 percent of the total spending in the said period. The level of spending on O & M of core services is important for maintaining a minimum standard of services in the urban settlements. Low resource allocation to this sector results in poor quality of urban services.

Recent data on expenditure on core services viz; water supply, sewerage and drainage, conservancy & sanitation, municipal roads, street lighting is presented in the Table E.

**Table E : Per Capita Revenue Expenditure on Core Services,
1997-98 (In Rs.)**

States	Water Supply	Sewerage & Drainage	Conservancy & Sanitation	Municipal Roads	Street Lighting	All Functions
Andhra Pradesh	50.52	55.12	63.37	102.53	13.19	313.38
Assam	2.98	7.46	12.60	24.17	2.49	81.77
Bihar	4.32	40.45	39.85	2.93	1.29	104.29
Gujarat	60.40	44.28	119.37	52.23	29.76	438.21
Haryana	191.84	89.99	108.56	57.77	30.74	598.22
Karnataka	62.56	42.91	74.19	46.46	25.92	321.05
Kerala	2.84	8.98	66.14	46.49	8.37	228.38
Madhya Pradesh	79.44	31.92	37.10	27.19	13.16	322.74
Maharashtra	230.00	155.58	195.87	117.35	43.08	1750.50
Orissa	9.66	42.58	67.91	16.29	13.08	248.29
Punjab	95.38	109.70	118.44	48.67	23.35	542.81
Rajasthan	-	165.07	-	12.28	5.40	497.24
Tamil Nadu	45.92	13.39	111.86	56.13	23.25	331.46
Uttar Pradesh	16.48	5.41	112.10	34.64	9.52	223.23
West Bengal	60.01	41.58	119.48	63.71	13.72	522.83
Himachal Pradesh	89.57	36.67	251.76	304.90	15.62	1112.85
Manipur	0.03	-	27.05	16.38	-	101.42
Meghalaya	46.57	16.66	55.98	47.32	23.03	272.10
Tripura	0.01	-	-	2.13	4.99	255.90
Total	125.77	93.21	123.36	70.19	23.28	747.02

Source: NIPFP (2000).

It is important to note that not all the municipalities provide all the services to their citizens'. The municipalities in Uttar Pradesh, Karnataka, Kerala and Rajasthan, for example, are not responsible for provision of water supply and sewerage in their areas of operation. Thus the figures given against these states on account of these services seem to be mis-reported/ quoted at the data source level, and this analysis could be taken as an illustration to have an idea on the spending pattern of the municipalities on the core urban services.

Declining Municipal Resources

The revenue structure of municipalities presented in following table shows that the relative share of own sources of revenue to transfers has declined. The share of taxable income to total income although declined substantially between 1974-75 and 1979-80 fiscal years, in the following years it went up from 15.39 per cent in 1979-80 to more than 48 per cent in 1997-98. The share of non-tax revenues however, declining over the years as it went down from nearly 22 per cent in 1979-80 to 17 per cent in 1997-98.

Table F : Trends in Revenue Structure of Municipalities in India

Year	Total Receipts (Rs. Crore)	% Distribution		
		Tax	Non-tax	Transfers
1974-75	311.44	63.19	15.27	8.00
1979-80	835.85	15.39	21.52	22.16
1990-91	3930.75	49.21	20.55	30.40
1996-97	10325.25	49.40	16.91	33.69
1997-98	12178.79	48.38	17.47	34.15

Source: NIUA (1997a), CFC (2000). Mathur (2001)

As the traditional known sources of local revenue are becoming increasingly exhaustive and do not seem to be adequate to yield sufficient revenue, the non-tax sources like remunerative and commercial projects are promising areas for revenue generation. Finance Commission, of many states have suggested that municipal authorities should utilize their properties for commercial purpose in a big way. Studies show that cost recovery in many of the basic services like water supply is also extremely low. On an average, local governments recover only 20-30 per cent of the total expenditure that is incurred, on the operation and maintenance of water supply.

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Table G and H provide information on the selected states for which time series data is available on the finances of municipalities. It shows that both revenue income and expenditure of municipalities has risen rapidly over the years.

Table G: Trends in Municipal Finances in Selected States (In Rs.)										
States from Own Source	Per Capita Revenue				Per Capita Total					
	1974-75	1979-80	1992-93	1997-98	Revenue	Expenditure	1974-75	1979-80	1992-93	1997-98
Gujarat	67.70	98.00	486.25	618.66	85.90	119.40	501.56	438.21		
Maharashtra	103.40	149.00	775.80	1829.00	107.20	131.40	877.20	1750.50		
Punjab	41.90	78.00	275.66	444.23	40.50	55.20	298.20	542.81		
Andhra Pradesh	37.30	38.00	89.55	210.03	28.30	53.90	163.26	318.38		
Assam	13.70	11.00	43.75	47.13	18.50	20.00	59.57	81.77		
Kerala	28.30	46.00	146.62	193.70	22.30	37.00	190.95	228.38		
West Bengal	33.40	28.00	44.74	337.23	41.00	54.60	121.88	522.83		

Source: NIUA (1989) and NIPFP (2000), Mathur (2001)

Table H : Trends in Municipal Finances in Selected Cities at Constant Prices (in Rs.)

States	Per Capita Revenue from Own Source				Per Capita Total Revenue Expenditure			
	1974-75	1979-80	1992-93	1997-98	1974-75	1979-80	1992-93	1997-98
Gujarat	402.85	477.12	726.97	618.66	511.15	581.31	749.86	438.21
Maharashtra	615.28	725.42	1159.86	1829.00	637.90	639.73	1311.46	1750.50
Punjab	249.33	379.75	412.13	444.23	241.00	268.75	445.82	542.81
Andhra Pradesh	221.95	185.01	133.88	210.03	168.40	262.42	244.08	318.38
Assam	81.52	53.55	65.41	47.13	110.08	97.37	89.06	81.77
Kerala	168.40	223.96	219.20	193.70	132.70	180.14	285.48	228.38
West Bengal	198.75	136.32	66.89	337.23	243.97	265.83	182.22	522.83

* 1997-98 base year.

Source: NIUA (1989, NIPFP (2000), Mathur (2001).

It is of interest that in 1997-98, municipalities of Gujarat and Maharashtra states have not only met the expenditure from their own sources but are also able to generate some surplus. In the remaining states, a substantial proportion – above 60 per cent of revenue expenditure is being financed by the municipalities, using their own sources of revenue. The picture that has emerged is however, far from the ground level realities of the municipal institutions.

The ULBs, in a majority of cases, have devolved a system for financing their regular activities by diverting employees provident fund/pension fund and also by holding payment of contractors, debt servicing, etc. Further under state municipal acts, municipalities are

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barred from preparing and presenting 'deficit budgets'. For example section 286(3) d of the Karnataka Municipalities Act, 1964, states that the municipal council shall "allow for a balance at the end of the said year, of not less than such sums as may be required to meet the establishment charges for a period of three months (NIUA 1987). Thus the higher revenue incomes of the municipalities than their expenditures in a year appear to be illusory as :

- (i) it is maintained to satisfy the statutory provisions, and
- (ii) by stopping the payments and transfers on account of provident fund, pension fund, debt servicing, etc.

Table I illustrates examples of fiscal liabilities in the selected states.

Table I: Accumulated Financial Liabilities of Municipal Bodies in the Selected States (Including Pending payments and non-remitted amount under Provident Fund, etc.)

State	Nature of liability	Reference period	Amount (lakh Rs.)	Financial Liability as percentage to current revenue (1993-94)		
				Income Own Sources	Total Receipts (including state transfers)	Expenditures
Tamil Nadu	a. Repayment of loans and Ways & Means Advances	As on 31-03-94	34747.00	108.42	71.19	85.36
	b. PF not remitted including Vth pay commission arrears to be credited in PF A/c	“	2493.70	7.78	5.11	6.13
	Total	“	37240.7	116.2	76.3	9 1.49
Kerala	Repayment of loans	As on	1007.00	13.23	10.59	13.97
U.P.	a. Re-payment of loans	As on 31-03-94	12836.55	2.19	1.06	0.97
	b. Dues pending for payment	“	15681.78	2.68	1.29	1.18
	c. PF Gratuity and Pension	“	5620.37	0.96	0.46	0.42
	d. Arrears of Salaries	“	1962.84	0.34	0.16	0.15
Total	“	36101.54	6.17	2.98	2.72	
Rajas- than	PF and pension	As on 31-03-94	2736.44	12.85	11.34	14.91

Source: Mathur (1999b), Mathur (2001).

It is evident that many local bodies use capital nature grants or even loans taken by them for various development works, to finance their regular civic activities. In some cases they also hold the payments of contractors, re-payment of loan installments, electricity charges, etc. beside diverting pension and other statutory funds. Thus most of the municipalities in

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the country have a high income-expenditure differential. The all India average reveals that the municipalities have been able to generate only 5.30% of the total revenue spent in the year 1997-98 (All India Average : Own Receipts – Rs. 8018.95 cr ; Revenue Expenditure – Rs. 151308.42 cr. *Source- CFC 2000*). The municipalities, particularly of small and medium towns do not have sufficient financial resources to manage their functions efficiently. They always run in the deficit budgeting and are heavily dependent on state governments grants to bridge the gap.

In the light of the above, it is necessary that financial analysis of any municipality should consider the issue of fiscal assets and liabilities, and collect the data on it to analyse the actual financial status of the urban local body. It has been observed that most municipalities are not maintaining a assets and liabilities register and other related documents and that makes assessment of the financial liabilities difficult.

The 11th Central Finance Commission has taken cognizance of this situation and recommended a special grant of Rs.200 crores for development of data- base on the finances of the PRIs and ULBs and Rs.98.61 crores for maintenance of accounts (CFC 2000).