Urban Services Planning
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Lecture 05
Municipal Management and Finance: Part II

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Welcome back, in lecture 5, we will cover the second part of municipal management and finance.

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The different concepts that we will cover in this lecture are on municipal finance and service provision, municipal taxes, charges and fees, grant in aid and subsidies, foreign direct investment, loans from financial institutions, municipal bonds and debentures, public private partnership.

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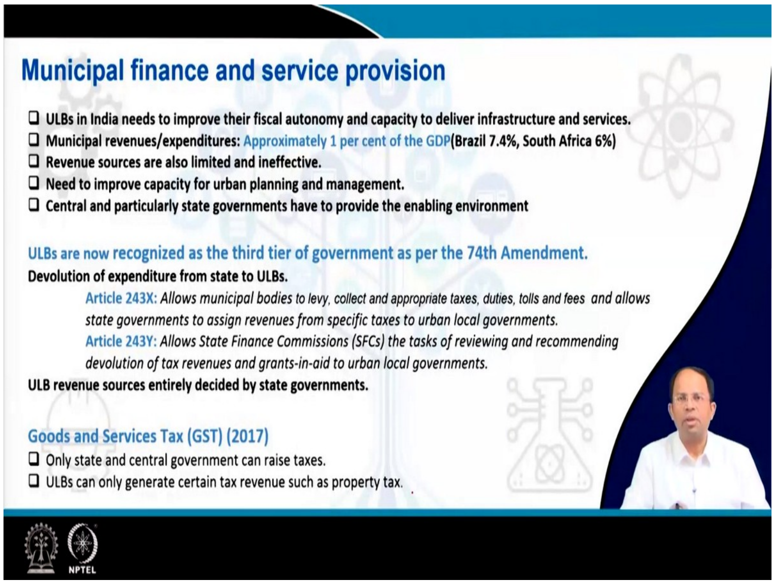

Now, in our last lecture, we have seen that a municipal body has to be organized, it has to have a proper structure to actually provide services to different parts of the urban areas. And this organizational structure is very important in effective provision of services. Similar to that, if along with the organizational structure of the institutional capacity, we require finances or money to actually provide or to provide these kind of services or to create infrastructure for other kinds or future service provision.

So, in most cases, we have seen that ULB's in India, they still lacked the financial autonomy and they need to improve upon that. So, that means that they cannot generate that much amount of income and accordingly, because they cannot generate that much of income or they are tied up because they are not given the power to raise so much amount of revenue. So, in that case, their capacity to deliver infrastructure and services also suffer.

And in India, we have seen that municipal revenues or expenditure you can say is approximately 1 percent of the GDP. Whereas in many countries such as Brazil, it is around 7.4 percent South

Africa 6 percent, what it means is the municipalities does not have the capacity to generate money and because if they do not have the capacity to generate money they also does not have the capacity to spend money, and because they cannot neither generate or spend money, obviously, the overall service quality of the municipalities are very, very poor.

So, revenue sources, because are also limited, because the state government in most cases determined what are the revenues that the ULB will be able to collect. So, that is also limited, because the state does not give that much amount of power, they need to improve. Then the other problem is the capacity for urban planning and management, overall capacity also is also lacking and the central and the state government should provide a sort of environment which facilitates this kind of autonomous decision making or revenue generation and so on, which environment is still lacking, that needs to be worked upon.

So, as per this, the 74th Amendment, ULB's has been considered as the third tire of governance. So, we have the state government, we have the central government and along with that, we have the ULB's, which are which is this third tire of government. So, what it means is, it can take a lot of decisions regarding the well being of the people it administrates, and to do that it requires finance it requires money.

And for that it requests the power to also collect money from for provision of services in that area or to collect money via taxes. So, article 243X allows municipal bodies to levy collect levy collect this taxes and duties tolls and fees and allow state governments to assign revenues from specific taxes to the urban local governments. So, this actually defines that which tax the municipal bodies would be allowed to collect. Similarly, article 243Y, this says that or allow state finance Commission's, State Finance Commission, Central Finance Commission, these are basically bodies, which determine how much money would be allocated for what purpose.

So, this is the job of the Finance Commission. So the task of reviewing and recommending devolution of tax revenues and grant in aid to urban local bodies. So that means the State Finance Commission determines how much amount of grant has to be given for provision of service or for day to day operation of municipal bodies. So that grant in aid or what kind of tax revenues that the state collect how much portion of that that will go to the ULB that is determined via by the State Finance Commission and that power is given via article 243Y.

So, in most cases, we see that ULB revenue sources are entirely decided by the state government. So, state government state says that these are the things that you can collect your taxes or revenues from. Now, after the goods and service tax, which was implemented in 2017, what happened was the GST is only a state and central government, because of GST only state and central government can raise tax. So, that is state level GST and the central level GST.

So, ULB's earlier which was supposed to raise certain kinds of taxes, they have been taken out the power to put those or charge taxes or charged revenue that has been taken away once the GST came in. So, the money that is being generated is now going directly to the state or the center. So, the same services and all for which earlier the ULB used to charge money some of those services are going to the state or the center instead of the ULB.

So, that means, the state and center should transfer that money or there has to be a mechanism to transfer that money back to the ULB. Now, ULB's can generate certain tax still, that means, not everything has been taken away from the ULB, like property tax and certain other taxes that ULB's get still, earn money from those kinds of taxes at the municipal level. So, this taxes this property taxes and all this does not goes to the state or the center. So, this remains with the municipality.

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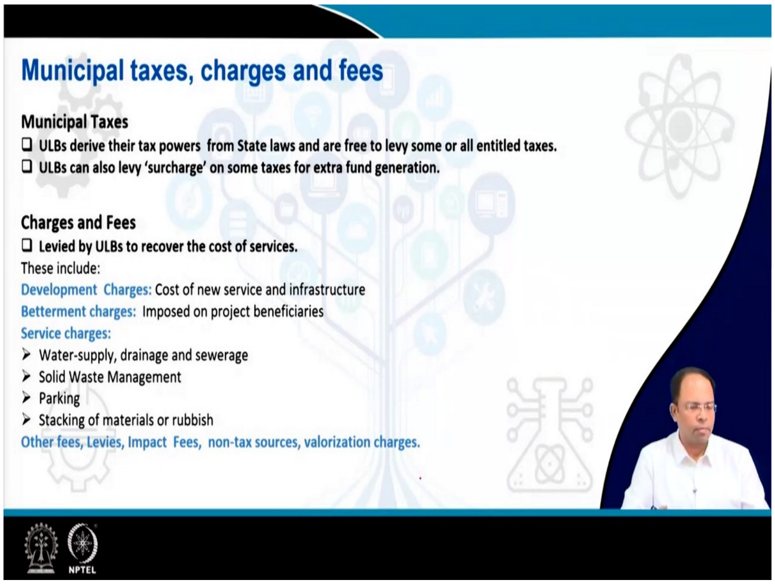

So, talking about municipal taxes, the what kind of taxes the municipality can charge that comes from that, that is determined via the state laws and the municipality based on whatever is allowed by the state laws the municipality can levy some of those charges there they can also decide that some of the charges they may not wish to levy. So, based on their capacity and all the way determine that these are the charges that I will take these are the other charges that I will not charge.

For example, municipality may decide that I will not charge any water for taxes for water supply. So, that depends on the municipality. ULB’s can also levy some surcharges. So, some taxes are generated by the state or we have to pay some taxes to the state. Now, the municipality can put some surcharge on that tax as well, that means some additional component has to be charged over that tax which will come as the revenue for the municipality. So, in addition to taxes, there are also charges and fees which are levied by the municipality or the ULB.

So, what are these? These include development charges, like for example, new infrastructure new service has been provided. So we can charge some extra money because of that. So that is called a development charge, because of that, the overall area improves. Then there are betterment charges, if that exactly people who are benefited of sub projects and all, they can be charged somebody. Then service charges such as for water supply, drainage, sewerage, we can charge some money. For solid waste management, parking, stacking of materials in urban areas, we can also ask for some money to be paid to the municipal body or the urban local body.

So in addition, there are some other fees, some other levies, some impact fees, some non tech sources, some valorization charges, like solid waste management, those kinds of charges, treatment charges, so, all these charges are also divided by the municipality.

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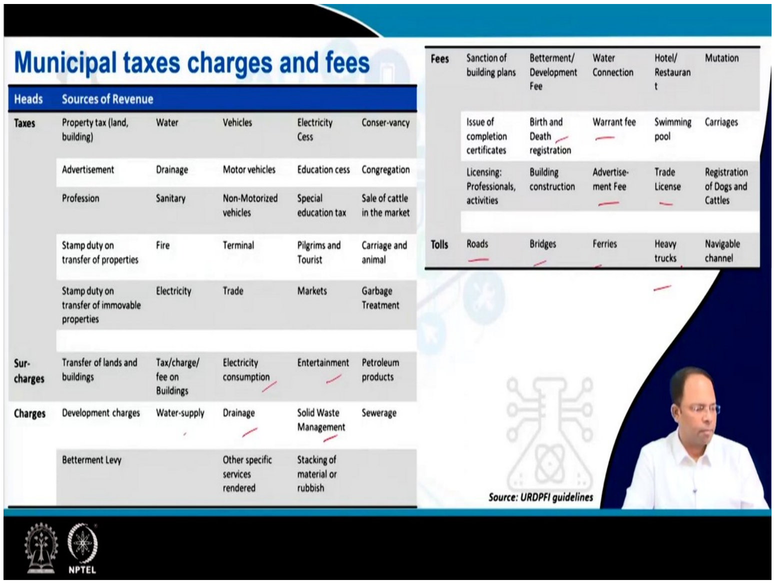

So, this table is provided by URDPFI. So, you can see that some of the taxes of course, you are not given all the taxes and all, so, this is also pre GST, so that means some of these taxes are not able to be like Octroi and all has been abolished. So, we the municipal body cannot charge Octroi and all but certain taxes still remain, like property tax, the municipality can collect tax on land, property, tax on building and also it can collect taxes on empty lands or empty lands which have not been developed and so on.

So taxes could be on vehicles could be on electricity it could be on different kinds of garbage treatment or it could be on some markets and all could be tax. Some trade activities could be taxed, stamp duty on transfer on property stamp duty on transfer of immovable properties, all this thing could be some form of taxes could be charged for that and this tax goes to the municipal body.

Then there are surcharges, like for example, as I told that there are certain taxes but we asked for some extra surcharge on those taxes. These are transfer of land and buildings there could be a surcharge, electricity consumption based on the electricity that you consume there could be a surcharge, tax on that, that could be charged by the municipality for entertainment that could be a surcharge tax that means you buy a ticket for this movie and you have to pay an extra tax which goes into to the ULB.

So, these are the surcharges, they charges, different kinds of charges into development charges, water supply charges, drainage charges, solid waste management charges and so on. Fees, charges and fees are more or less synonymous, but some variations could be there, like advertisement fee, trade license fee, so, these are like you will get a service from the municipality like you will get a trade license for that you have to pay a fee, then warrant fee birth and death registration certificate for that you have to pay a fee. So, these are the different kinds of fees that you have to pay.

And finally, there are tolls, that means like when we travel on a particular road, the municipality can charge some money for the maintenance of that road or if the road is being newly constructed, the municipality also can charge money for using that particular road. So, this is a toll could be charged from roads, some bridges, some ferries, trucks and so on. So, these are the different kinds of municipal taxes, charges and fees that are usually seen in different urban areas.

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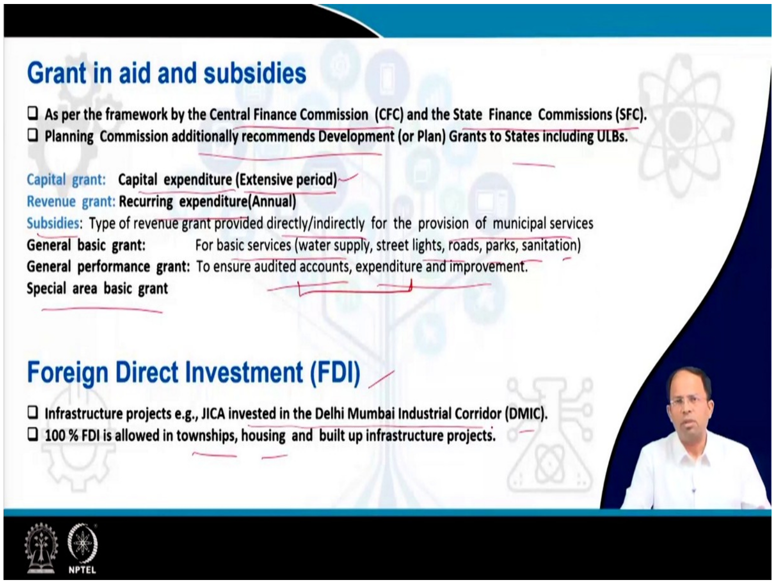

Now, the taxes and fees are as we are discussing are very limited that means it the municipality generates some revenue out of that, but that is very, very limited. And particularly for large scale infrastructure projects we require we required revenue from different sources or we require finance from different sources. So, sometimes, this is provided in terms of grants in aid and subsidies which are provided by the central government or the state government.

So, as per the framework of the central Finance Commission, and the State Finance Commission. So, these are the bodies which does the budgeting and determines how much money goes where so, they can transfer some of the money to the ULB's, they do transfer some of the money to the ULB, so that some capital infrastructure projects or for day to day activities, could we also take it up, because the revenue generated by the municipality is not adequate.

Then planning commission additionally recommends some development grants to states and because this development grant comes to state some part of it has to go to the ULB's as well. So, that means for certain programs, certain kinds of special activities or some kind of special initiatives where the government some extra fund also comes which comes to the state and eventually to the ULB's.

So, this grants could be divided into different parts. One is a capital grant, which is for capital expenditure. And usually using this capital grant we can develop infrastructure or we can buy certain kinds of infrastructure or certain kinds of equipment, which can be paid over for a extensive period that means it could be a multi year grant that means in each year we get certain components of it. So usually it can be for an extensive period.

Then there are revenue grants, that is recurring expenditure, like annual expenditure to meet that revenue grants are provided, which could be every day every year some expenses on salary, some expenses on certain maintenance activities that has to be incurred. So that can be made from the revenue grant. So, in addition to revenue grant, there are some revenue grants are also known as subsidies, which are also your which are primarily for use for provision of municipal services. Like for example, there is a transport service provided by the municipality.

Now the money that is generated by the transport service from selling of tickets and all we maybe only 50 percent of the actual cost of provision of the service. So, the rest is provided as a grant from the central of the state government, which is the subsidy. So, this is called a subsidy in that particular case. So, this is one kind of revenue grant you can say. Then there is another way to categorize this is to say general basic grant, this is this kind of grants are provided for supply of basic services, water supplies, streetlights, roads, parks, sanitation and so on.

And then there are general performance grants, that means if the municipality does a good job of administrating that particular area providing good quality service, definitely we if that could be actually proofed and recorded. And based on the performance of the municipality based on the audited accounts, the municipality is also given some additional grants, which is performance based grants.

So this can help you in further development of infrastructure. And also there is some sort of accountability in the process. That means you are doing some work and because of that, you are doing good work, you are rewarded for that, so, these are performance grants. And then there is special area basic grant, that for some special areas or areas which are underdeveloped or very areas which are sensitive in other ways maybe for defense and other things that maybe some special area grants also that could be given.

So, one of the major ways to get for larger projects and all or for a big chunk of expenses by the municipality supplied by the grant in aid and subsidies. Now, but if I go for a very large infrastructure project, for example, I want to construct but the high speed rail corridor in India, So it is not for an urban area, but for connecting multiple urban areas, but that could be similar projects in urban area in terms of a sewerage network development for an urban area. So for that, we require a huge amount of money.

So for there may be different avenues to get this money. So the grant in aid may not be adequate to, or like the capital grant may not be adequate to meet the expenditure required to meet do those kinds of infrastructure projects. Now, my idea is once I do the infrastructure, I will be able to generate money, and using that I can pay the loan that I have to take to develop that particular infrastructure.

So if I do not take the loan, or if I do not get money to develop that infrastructure, I would not be able to make generate money. But if I do that, then I would be able to generate money and I would be able to pay my loan. So, there are different ways to do that. So, one way is to go for foreign direct investment, investment FDI. So, that means the government of India has now allowed 100 percent FDI in certain kinds of development projects, such as township development, housing development, certain infrastructure projects, which require a huge quantum of money.

So, foreign companies, foreign entities can come and invest and they can invest 100 percent and they have a stake in that particular project and the money that they that will be generated out of that project, that could be used to actually or the profit that will be generated out of that project, that will actually help in meeting the investment goals of that particular entity.

So, that means, like, for example, JICA, this is Japanese International Cooperation Agency for International Development, this they have invested in the Delhi Mumbai industrial corridor, and they this is a full FDI project. So, that is the entire money has come from foreign investors. And this has been put into the project and the benefits eventually that would be generated out of that project that will be able to pay up for this particular investment.

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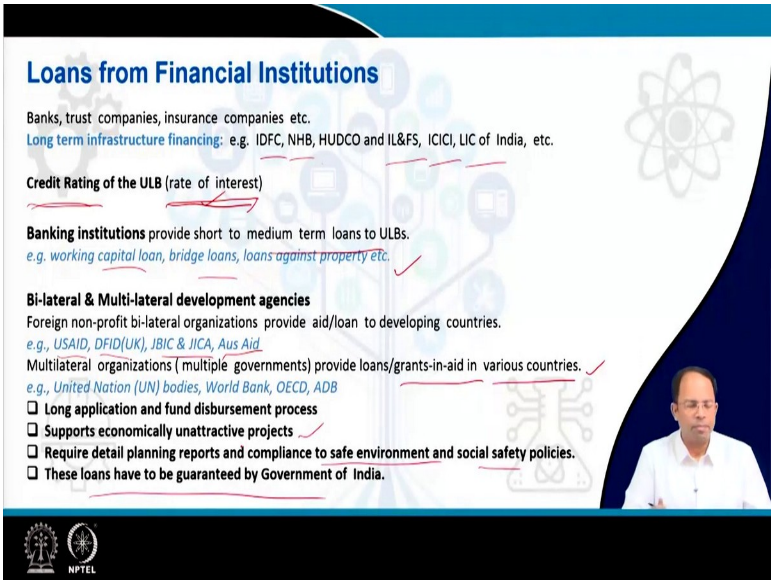

So in additional to FDI, which is the investment path, the other is the loan path, like for example, the fine the ULB can take a loan from a particular agency and they have to pay the loan over a period of time. In case of investment, it is a little different, that means the profit that would be generated to be able to pay back for that particular investment, but it is not a payment of a loan, it is a profit that has been generated out of that investment.

Now, in case of ULB's, the ULB can take long term infrastructure financing like infrastructure, which is developed for a long period like 10 years 15 years some infrastructure developed. So, in that case, there are certain companies like banks, some trust companies, some insurance companies, these are the ones which can provide long term infrastructure financing. So, these are like in case of India, we see IDFC, NAHB, HUTCO, ILFS, ICICI, LIC of India these are the different agencies which actually provide long term infrastructure finance for ULB's.

Now, to get a loan that ULB has to have a credit rating, that means the credit rating determines the capacity of that municipality to pay back that loan, it depends on the kind of assets that municipality own, it depends on what kind of revenue generates and so on. So, usually the rate of interest that is if when be the rate of interest is depends on the risk of the project.

So, this risk of the project is again depends on the financial health of the municipality, if the municipality has got a very good financial health, then the risk is less. So obviously, the rate of interest is also low. So that is why credit rating is very, very important that has to be determined for this municipality and for that there is specific agencies which provide this kind of services.

Then there are banking institutions, which in addition to providing long term infrastructure financing, some banks do that, but not all banks do that, but other banks can also provide short to medium term loans to ULB's. That means working capital loans, bridge loans, loans, again, some property so short term loans, which has to be repaid within a year or maybe a few years, that which can be also provided by some banking institutions. So, certain kinds of projects could be also taken up via this kind of loans.

Then in addition to loans from banks institutions from my own country, I can also take loans from institutions from foreign countries. So, for that there are bilateral institutions and multilateral institutions, so, usually we know them as bilateral and multilateral development agencies. So, bilateral agency means there is a 2 way relationship that means a foreign nonprofit bilateral organizations provide loans to developing countries that means, it is an organization which provides loan to a single country so, it is a one to one relationship.

So, for examples of that is USAID DFID. USAID is for from the US. DFID is from UK, JBIC and JICA is from Japan, Australia aid Aus Aid is from Australia and so on. So, these are the agencies which help in developing some developing countries and all and they provide one to one loan to these particular countries.

And in addition to that, there are multilateral organizations for example, World Bank, United Nations, Asian Development Bank, OECD, so, all this also like this is a group these agencies are formed by a group of countries which can pull money into some certain funds and all and this agencies using this funds actually can give some loans or grant in aids to other countries which actually required them.

So, this is also a loan, it is a long term loan. And usually the purpose of this kind of agency or this kind of loan is to support at projects which are not economically attractive. So, banks, financial institutions, FDI's are mostly for economically attractive projects, where there is a chance of return, then there are other projects where the chance of return is very less.

So, the municipality based on its finances will take 30 years to repay the loan, because this particular project may not give money, but overall the municipals, these financial health, the overall the quality of life in the municipality will improve that will increase other revenues and all and from there, the municipality will pay back the money.

So, in that way, that means unattractive projects also which we finance, so this is where this kind of agencies can actually help. So it is in this application processes a long, the fund dispersed main process is long and it is complicated, it requires detailed planning reports, compliance of safe environment, social safety policies, all this, this plan has to be created very, very thoroughly, and it really has to be a very plan which looks into all aspects the environment, the social safety and so on.

And this loans have to be also guaranteed by a government of India or sometimes even by the state government. So, that is how these kinds of loans are, money is also made available for some unattractive projects. But of course, you have to make sure that you have to create a proper project report for this and then you will get money for these particular services or this kind of infrastructure.

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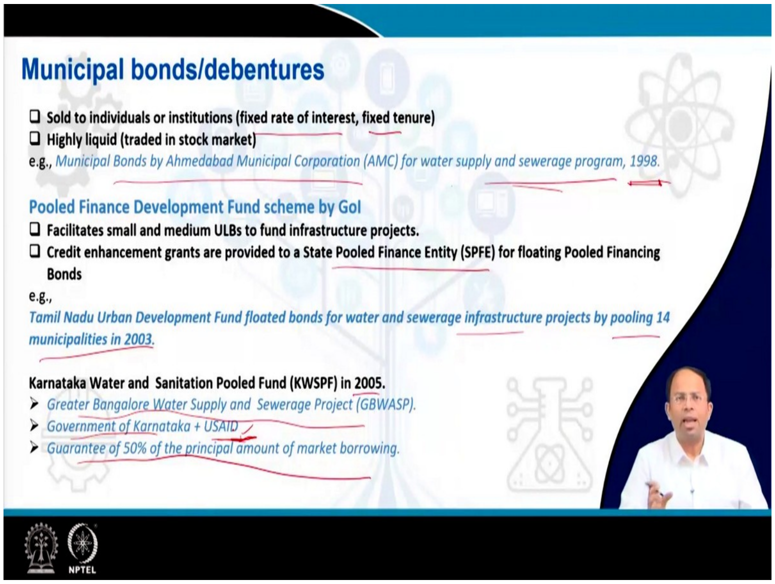

Then finally, comes the municipal bonds and debentures. So these are ways how the municipality can raise money on their own. So these bonds are like guarantees, which the municipality saying that after a certain period after a fixed tenure, fixed rate of interest, or the capital that would be invested for buying the bond that would be provided.

So that means it is a way of it is an instrument, it is a financial instrument, which is sold to both individuals and institutions and the individuals and institutions. For them, it is a investment where they will make some money, but because they are buying that they are giving the money now, so the municipality can use the money to execute some projects.

So it is a highly liquid, instrument it is can be traded in the stock market. And one example of this is the municipal bonds by Ahmedabad Municipal Corporation for water supply and sewerage program which was done in 1998. So, this was done even, almost 20 years back, but this is the first example, successful example of a municipal bond which has been floated for exit for developing water supply and sewerage infrastructure in that particular area.

Now, the problem is large municipalities which have a lot of resources, a lot of properties to backup this kind of bonds, for them it is possible but for small municipalities, it is not possible. So government of India has made this scheme which is known as the pool finance Development

Fund scheme, where the this facility for creation of this float of this bonds or for development projects and all is also made available for the smaller municipalities.

So, what it says is a group of municipalities are brought together and as a fund is created for this particular municipality, and this fund could be utilized for floating as this one is the guarantee which is there using which the municipality one particular municipality can float, some bond, or some municipal bond, which they can use for some infrastructure generation. If this pool fund was not there, then the municipality could not have floated because it does not have the guaranteed, the guarantee at the back which will guarantee that particular municipal bond.

So, facilitates, so pooled finance Development Fund scheme, this facilitated small and medium ULB's to fund infrastructure projects, and that credit enhancement grants are provided to a state pool finance entity. So, that means, the sum amount of money is given by the state government into this pooled fund, which is pooled by maybe 10 to 15 municipalities brought together and within that, the government will provide some money which is the common money, which could be utilized as the guarantee for all the municipal bonds floated by this individual municipalities.

So, one example of this is the Tamil Nadu Urban Development Fund they floated bonds for water and sewer infrastructure projects, and this was done by pooling 14 municipalities in the year 2003. So, another example is the Karnataka water and sanitation pool fund, which was done in 2005. And this was done for to take care of the greater Bangalore water supply sewerage project and the government of Karnataka pooled money into this and also USAID also pooled money into this particular fund.

Now, there was guarantee of 50 percent of the principal amount of market borrowing was provided from USAID. So, that means, the pooled finance that is made available that means this excess money that is required as guarantee that is made available by the government, but similarly, you can see that a agency a bilateral agency like USAID has also provided that guarantee.

So, they have put money into the fund, so, that the municipality can generate its own bond. So, that is another way of facilitating the finance availability for that particular municipality. So, these are the different various ways municipality may generate in finance to carry some different forms of infrastructure project. Now, some projects are long term some projects require a lot of capital accordingly we will go for some sources other projects are short term there does not require that much capital, we will use certain other financial mechanisms for those.

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Now, along with generation of funds, the other major important thing is public private partnership, that is, ULB can also work with a private sector entity or collaborate with a private sector entity to facilitate service provision and infrastructure development. So, in this case, the private entity can invest some amount of money or the entire amount of money, they can manage and operate the infrastructure service for some period of time, and eventually, they may return the infrastructure service or they may keep on managing it, and they can get the charges from the people to finance it as well.

So, this PPP efficiency that means, because it is a contract between the private sector and the government sector, so, that means, if we do not define the contracts properly, if the government policies, the regulatory framework, the government subsidies, the finance mechanisms, these are not defined properly, there is a chance that the finance this PPP project will fail, and there is a chance that this private entity will try to take benefit out of it, because private entities, motivated by the profit it makes.

So, it will always try to, find the loopholes. So that sometimes it can dig like the services that has to be done under this particular contract. So, the contracts, the policies, the regulatory framework, this has to be very, very strong to make the PPP model efficient.

So, the risk now to there are also problems for the private entity, there are a lot of because this PPP models are done for this service provision and these are sectors where there is less chance of making profit, there is chance of public protest, there are other problems. So, that means that we have to also facilitate the private entities to a certain extent as well.

So, for example, the risk of conducting or making this project that has to be shared between the private and the public entity, then there has to be some performance linked incentives, that means if the private entity does good work there has to be some performance linked incentives that means there has to be some extra money that has to be provided to those particular company.

Then service has to be as per the agreed contract and the service level benchmarks, that means there has to be some way to regulate or monitor the service. So, there are different varieties of PPP models and we have discussed this in detail in our utilities lecture in our utilities in detail course, but again, I will repeat like the one of these different models are, Divestitures, Concessions, Lease-affermages, Management contracts, Mixed-ownership companies, build operate transfer projects, Turnkey projects, so, these are different ways the contract could be done between private entities and a government entity.

So, Divestiture is where the infrastructure asset from the government is totally sold off to the private investor and then they can run that particular infrastructure or provide that particular service. Concession is where private operator is responsible for both operation and some amount of investment.

Lease-affermages is where the private operator operates a publicly owned system the ownership is public, that means the government owns the system, it collects revenues and share and some and for operation of the system, it will collect the revenue and shares some of this with the public authority and because the public authority also have to use this money for future investment at all, but the rest is utilized by this company to make both profit as well as to keep that particular service operational.

Then there are Management contracts, which are publicly owned utilities managed by a private operator, which is straight away. Then there is mixed ownership companies such as private investor, it becomes the minority share, it operates that particular company or that utility or that infrastructure and shares the financial gains that comes out of it with the government body.

And then there are build operate transfer projects or Turnkey projects, where the entire infrastructure is planned, maybe planning the government will also take part parties will also participate, but the entire construction operation is taken care by the municipality with this private entity. And after a certain years of operation, when it has made the profit or it has been it has generated the investment that it has put in they have recovered that particular about they can also transfer the project back to the government as well.

So these are the different ways PPP models can also operate.

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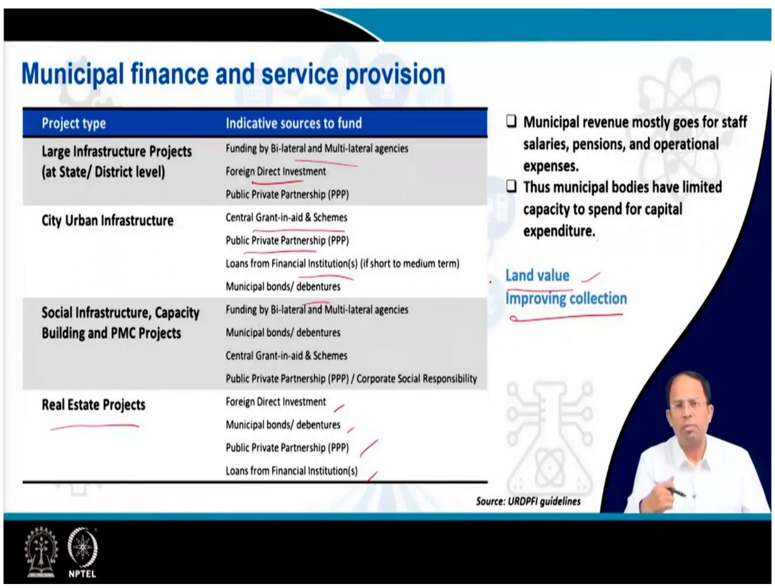

So this table is from your URDPFI guidelines, if you see that this table is such as that for different kinds of projects, what sort of finance mechanisms could be undertaken, for example, if I want to develop low cost housing for poor in the urban area, so it is a real estate project. So we can go for FDI we can go for municipal bonds, we can go for PPP models, we can go from loans from financial institutions.

Similarly, if it is like a city large scale infrastructure project at the state or the district level, then we can look for bilateral and multilateral agencies, because they fund for large scale projects, which goes on for 20 years 15 years or so on the foreign direct investment, public private partnerships could also be there. And for city urban infrastructure repair, maintenance, some provision then central grant in aid and schemes, private PPP models, loans, as well as municipal bonds can be also looked into.

So we can have a mix of different finance sources, which could be undertaken to conduct different kinds of social and physical infrastructure in urban areas or to provide those kinds of infrastructure. So in most cases, we see that municipal revenue, mostly the revenue that the money that the municipality make goes for staff salaries, pensions and operational expenses. Thus municipal bodies, because most of the money goes into these recurring expenses, it has not much money to spend for capital expenditure.

So the only way to generate money for this is to have, we can make loans but eventually we have to also we can take loans or we can get money from other sources, but we have to return the money that means you have to generate revenue. So one way to do that is to improve the collection that means the user charges and all these things, we have to improve quite a bit like for example, water supply, or for sanitation, we only may be able to collect from 50 percent of the urban residents.

So we have to improve the collection process we have to also improve the tariff mechanisms and so on. Similarly, land value is another area that means how we can monetize the land in the municipality. In many cases, we can give certain permissions or we can put certain charges or we can develop certain lands so that we can get more money out of it. So land value has to be enhanced and land value capture or there has to be some way to monetize land in an urban area because that is the primary resource that the urban area has got.

So, these are the ways we can improve municipal finances for provision of different services or for provision or construction of different infrastructure for service provision in municipal areas.

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So, these are some of the references you can look at.

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So, to conclude, ensuring financial and organizational health of an urban local body requires efficient fiscal management and adoption of innovative mechanisms to generate funding for capital intensive projects. On the other hand, municipalities should gradually improve collection of user charges through innovative public private partnerships, which are going to be sustainable in the long run. Thank you.