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## India: Urban Finance and Governance Review Volume II: Case Study Annexes

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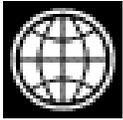
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## ABBREVIATIONS AND ACRONYMS

BATF	Bangalore Agenda Task Force	KAS	Karnataka Administrative Service
BDA	Bangalore Metropolitan Region Development Authority	KHB	Karnataka Housing Board
BMC	Brihan Mumbai Corporation ("Mumbai")	KMA	Karnataka Municipalities Act
BMP	Bangalore City Corporation	KMAS	Karnataka Municipal Administrative Service
BWSSB	Bangalore Water Supply and Sewerage Board	KMCA	Karnataka Municipal Corporation Act
CAA	Constitution Amendment Act	KTCP	Karnataka Town and Country Planning Act
CAS	Country Assistance Strategy	KUIDFC	Karnataka Urban Infrastructure Development Finance Corporation
CC	City Corporations (Karnataka)	KUWSDB	Karnataka Urban Water Supply and Drainage Board
CCF	City Challenge Fund	LG	Local Government
CMC	City Municipal Councils (Karnataka)	MDF	Municipal Development Fund
CMWSSB	Chennai Metropolitan Water Supply & Sewerage Board	NGO	Non-Governmental Organization
DA	Development Authorities	PWD	Public Works Department
DFID	Department for International Development	SCB	Slum Clearance Board
DMA	Directorate of Municipal Administration	SFC	State Finance Commissions
EFC	Eleventh Finance Commission	SWM	Solid Waste Management
ESW	Economic Sector Work	TA	Technical Assistance
GDP	Gross Domestic Product	TMC	Town Municipal Councils (Karnataka)
GOI	Government of India	TNUDF	Tamil Nadu Urban Development Fund
GOK	Government of Karnataka	TP	Town Panchayats
GOM	Government of Maharashtra	UDD	Urban Development Department
GOTN	Government of Tamil Nadu	ULB	Urban Local Body
HDFC	Housing Development Finance Corporation Ltd.	UNCHS	United Nations Centre for Human Settlements
HUDCO	Housing and Urban Development Corporation	UNDP	United Nations Development Programme
IAS	Indian Administrative Service	UDPA	Urban Development and Poverty Alleviation (Ministry)
IBRD	International Bank for Reconstruction and Development	URIF	Urban Reform Incentive Fund
IDFC	Infrastructure Development Finance Company	USAID	United States Agency for International Development
IDSMT	Integrated Development of Small and Medium Towns	UWSS	Urban Water Supply and Sanitation

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## **FOREWORD**

This report was prepared by a team consisting of: Dana Weist, Roy Bahl (property tax reform), Somik Lall (urban economic analysis), Lars Sondergaard (economic and fiscal analysis), Ajit Karnik (Maharashtra analysis), Abhay Pethe (Maharashtra analysis), Christine Wong, and Kirida Bhaopichitr. The team is grateful to many counterparts in Karnataka, Maharashtra, and Tamil Nadu for their assistance. Helpful comments were provided by Sonia Hammam, Patricia Annez and Soraya Goga. Peer reviewers include William Dillinger, Robert Ebel, and George Peterson.

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## **ANNEX I. BACKGROUND INFORMATION ON MUNICIPAL FINANCE AND GOVERNANCE IN KARNATAKA**

### **GOVERNMENT STRUCTURE AND ORGANIZATION**

Karnataka has four categories of Urban Local Bodies (ULBs): 6 City Corporations (CC), 40 City Municipal Councils (CMC), 91 Town Municipal Councils (TMC), and 87 Town Panchayats (TP). These ULBs are spread across 26 districts. Categorization of ULBs is based on population, revenue generation, and employment.<sup>1</sup> City Corporations are governed by the Karnataka Municipal Corporations Act, 1974 (KMCA). Other ULBs are governed by the Karnataka Municipalities Act, 1964 (KMA).

### **ULB STRUCTURE AND COMPOSITION**

The Council is the legislative and decision making body of the ULB. Council members are comprised of elected representatives from each ward in the ULB and nominated persons. Councils are elected every 5 years. In Mysore Corporation, for example, there are 65 wards and 76 council members; each ward has 8-9,000 voters.

One-third of council seats are reserved for women, and 25 percent for under-privileged groups; these seats are filled on a rotational basis. This implies that a representative from a ward who is not female nor from an under-privileged group cannot serve as a council member for more than 2 consecutive terms.<sup>2</sup>

Council members perform specific duties and responsibilities prescribed under the municipal acts and those delegated by the Council. Council members typically convene once a month although they may meet more frequently in corporations (e.g., Bangalore's council meets bi-monthly). They may also be elected to serve on Standing Committees, which typically meet once a fortnight. Standing Committees in City Corporations have a term of 1 year. According to the KMCA and KMA, the Bangalore City Corporation is designated 8 standing Committees while other ULBs are restricted to 4 standing committees. For example, the Standing Committees in Mysore City Corporation are Finance and Appeals Committee, Health, Education and Social Justice Committee, Works and Town Planning Committee, and Accounts and Audit Committee.

In CCs, a President heads the council and serves a term of 2.5 years. In MCs, the Mayor heads the elected body. Mayors and Deputy Mayors are elected from the membership of the Council, and serve a one-year term. Presidents and Vice Presidents in other ULBs are the equivalent of the Mayors and Deputy Mayors in MCs.

Chief Executives head the executive arm of ULBs - Commissioners in the case of CCs and Commissioners or Chief Officers in the case of other ULBs, depending on population size. The Chief Executive is the chief of the municipal administrative staff and is supported by a team of staff on functional and service departments. He or she administers the day-to-day operations of ULBs, and makes most budget decisions.

### **RELATIONSHIP BETWEEN THE COUNCIL AND THE CHIEF EXECUTIVE**

The Chief Executive carries out the resolutions of the Council in accordance with the Municipal Acts and serves as the Secretary to the Council. At the request of the Mayor or President, the Chief

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<sup>1</sup> CCs have populations exceeding 3 lakh; CMCs have populations between 50,000 and 3 lakh; TMCs have populations between 20,000-50,000, and TPs have populations below 20,000.

<sup>2</sup> Council members of CCs are called Corporators while those of other ULBs are called Councilors.

Executive may prepare the agenda for Council meetings in consultation with the Mayor or President. He or she is also responsible for obtaining approval from the District Deputy Commissioner for proposals over a certain sum of money (Rs. 500,000 in the case of CMCs).

In smaller ULBs, personal relationship between the Chief Executive and the Council members are important in carrying out the functions of the ULBs. For example, in Hassan CMC, where 35 councilors make up the Council, the Commissioner has strong ties with the majority of the councilors. He, therefore, not only assists in preparing the agenda for the meeting, but also provides close advice and recommendations to the Council at the Council meetings.

### **FISCAL DECENTRALIZATION**

While the fiscal status of ULBs in Karnataka was assessed in detail in the 1<sup>st</sup> State Finance Commission Report (see Box 1), few of its many recommendations have been implemented. The 2<sup>nd</sup> State Finance Commission has been convened, and its recommendations are expected to be issued shortly.

#### **Box 1: Karnataka's First State Finance Commission Recommendations**

The 1<sup>st</sup> State Finance Commission (SFC) made a number of recommendations covering the period 1996-97 to 2000-01 related to the fragmentation of functions, control of revenue powers, accounting, administrative organization, and other fiscal issues:

- Bring existing urban development authorities (including BDA and excluding KUWS&DB and BWSSB) under purview of their respective elected municipal bodies
- KUWS&DB should be responsible *only* for construction and bulk water supply, whereas ULBs should be responsible for distribution and collection of water rates
- Transfer town planning departments to municipalities
- Enact one common legislation for all ULBs
- Encourage uniformity for budget and accounting systems, adopt CAG's budget classification
- Rationalize the administrative structure of ULBs
- Create a Central Valuation Authority
- Abolish cesses (i.e., library, beggary, education, health and water)
- Appoint an Administrative Reforms Commission
- Redesign property tax to enhance its elasticity
- State government should not determine local tax rate structures, exemptions or other details
- Index license fees
- Fully recover costs through charges
- Abolish the Department of Municipal Administration and replace it with a finance cell in the Finance Department
- Improve the quality of local fiscal data

### **EXPENDITURE ASSIGNMENT**

ULBs are required by the KMCA and the KMA to perform obligatory and discretionary functions. In addition, ULBs have undertaken additional functions that are suggested by the 74th CAA. At present, major obligatory functions include the maintenance of roads, street lights, sanitation, water supply, registration of births and deaths, public immunizations, and regulation of buildings. Discretionary functions include formation and maintenance of layouts, parks, schools, libraries, and hospitals.

While ULB responsibilities and functions are defined by the Acts, authority and financing are not congruent with these assignments, which impedes accountability and performance. Municipal decision-making authority is extremely limited even for devolved functions, since state agencies retain critical roles in planning, financing, and sometimes managing infrastructure and services.

As shown below in Table I.1, Boards and Development Authorities (DAs) generally develop infrastructure and then transfer it to ULBs, along with responsibility for operation and maintenance, and billing and collection.<sup>3</sup> Regulation of service provision is typically a state function. Boards and DAs typically finance these infrastructure projects from GoK grants, state-guaranteed loans from state financial institutions, or “surpluses” from past projects. Boards and DA are typically composed of officials from state urban development agencies, the ULB Commissioner, and non-government officials. Consultation between Boards, DAs and ULBs in designing projects is often limited, which may result in a mismatch between the supply of infrastructure services and ULB needs, leading to low cost recovery and poor maintenance of the transferred infrastructure.

**Table I.1: Public Service Provision Arrangements in Karnataka**

Sector	Planning	Design	Implementation	O&M	Billing & Collection	Regulation
Water and Sewerage*	KUWSDB	KUWSDB	KUWSDB	ULB / KUWSDB	ULB	GoK / PCB
Municipal Roads and Bridges	ULB	ULB/ PWD (Technical Sanction)	ULB	ULB		Deputy Commissioner (Traffic Safety)
Solid Waste Management	ULB	ULB	ULB	ULB	ULB	Pollution Control Board
Street Lighting	ULB	SEB	SEB	ULB		
Buildings and Structures	ULB	ULB with concurrence of PWD	ULB	ULB		
Slum Improvement and Upgradation	SCB	SCB	SCB	SCB/ULB		
Site and Service Development	DA	DA	DA	ULB	DA collects site fees ULB collects property taxes**	
Housing, Site and Service Development	KHB	KHB/ULB	KHB/Beneficiaries	KHB		
Public Health	DPH/ ULB	DPH/ ULB	ULB	ULB		DPH

Note: Water O&M: In certain cases Board maintains Bulk Supply and ULB the Distribution

\*With the exception of Bangalore City where the BWSSB does everything from planning to billing and collection.

\*\* In some cases such as in Mysore, the Mysore DA collects property tax on behalf of the Mysore CC.

<sup>3</sup> Table adjusted from World Bank, *Karnataka Urban Sector Technical Note*, 2002

## Water Supply and Drainage

For ULBs except Bangalore, the design, planning and investment decisions for providing water supply services are taken by the Karnataka Urban Water Supply and Drainage Board (KUWSDB). KUWSDB formulates projects, receives state-guaranteed loans from government financial institutions and/or grants from GoK, implements projects, and transfers the infrastructure to ULBs. ULB responsibilities are confined to the operation and maintenance of the systems, setting water tariffs (often below state guidelines) and collecting charges to be remitted to KUWSDB for servicing their capital costs. With the exception of 11 projects which ULBs have requested KUWSDB to operate and maintain, the remaining projects are managed by the ULBs.

ULB councils must pass a resolution to establish water tariffs. The water cess is set by the State. ULBs are responsible for collecting the water cess and remitting those funds to KUWSDB to repay their loans. However, ULBs often do not remit the cesses collected to the KUWSDB, resulting in the GoK often bailing out ULBs. There have been instances where a second water supply project has been prepared when the loan for the first project has not been repaid. Despite lack of repayment, KUWSDB continues to provide the services and thus create a disincentive for ULBs to collect and remit the cess or to develop their own water supply systems.<sup>4</sup>

The lack of consultation or coordination between KUWSDB and ULBs appears to have resulted in instances where ULBs have added extensions to the water supply system within six months of its completion, thereby reducing pressure and diminishing the performance of the whole system. It would be more efficient if the level of government providing water services – in this case, ULBs – were responsible for investing in infrastructure. Such an arrangement would potentially provide incentives to pay attention to the financial sustainability and O&M implications of new investments.

In contrast, the Bangalore Water Supply and Sewage Board (BWSSB) which provides water supply and sewerage services for the Bangalore urban area not only builds the infrastructure, but also operates and manages the system and sets tariff rates and collect tariffs. The BWSSB has devised innovative ways to collect tariffs enhanced by information and technology systems and are able to achieve cost recovery of up to nearly 100 percent.<sup>5</sup> It is the only water board in India that meters each of its 370,000 connections. It has strong collection enforcement; 106 percent of billing is collected. Bills can be paid by cash, bank account, credit card, and online in the spring of 2003. Water service is disconnected within two months of non-payment, and a Recovery Officer on deputation from the Revenue Department auctions moveable and immovable property (i.e., cars, motorcycles) if payment isn't received by the third notice.

BWSSB has fully computerized its revenue billing and its fund-based financial accounting system, and its accounts are externally audited. It has outsourced five sewage treatment plants, its leak repair squad, and the operation and maintenance of its water treatment and pumping stations. BWSSB has established a customer charter, and has an active public relations campaign.

## Sites and Services and Housing

In the area of site and services and housing development, the Town Planning Department (TPD), the Karnataka Housing Board (KHB), the Slum Clearance Board (SCB), and the Development Authorities (DA) have similar and potentially overlapping responsibilities. The Town Planning Department is responsible for preparing the outline and comprehensive development plan for urban areas.

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<sup>4</sup>ULBs are allowed to do so under the municipal acts and the 74<sup>th</sup> CAA

<sup>5</sup>Its current average cost of production is R 15.2 per 1,000 liters; it is recovering R 14 per 1,000 liters, or a cost recovery rate of 92 percent.

The DA implements the master plan and is responsible for developing sites and services. After the development is complete, the DA collects site fees from purchasers and transfers the operation and maintenance of the site to the respective ULB. ULBs would typically collect the property taxes from the site once it is registered. There have been instances in Mysore where the DA has collected property taxes from sites, a clear instance of abrogating ULB authority.

The SCB, on the other hand, administers national or state schemes in slum upgradation. This involves the development of serviced sites and housing to be sold at highly subsidized rates. SCB relies on central schemes and loans from HUDCO. After the completion of the project, the sites and houses are transferred to the ULBs for maintenance, unless requested otherwise by ULBs. For example, the Bangalore City Corporation (BMP) requested that the sites and houses be transferred to the KHB.

Like the DA, the KHB and the SCB acquire land for development under the Land Acquisition Act. Land can be acquired by: (i) notification, (ii) negotiation, and (iii) voluntary sale under a fixed price. However, land owners often seek redress through the court when an agreement on land prices is not reached, especially when notification and negotiation are used.

The Bangalore Metropolitan Region Development Authority (BDA) has conducted a willingness-to-sell survey to estimate an average market price for the land to be developed. “Incentive site programs” have also been established to provide incentives for landowners to sell land at the average market price. Under the program, for every plot of land sold, the land owner gets a plot of land in the scheme up to a maximum of 10 plots. The owners only pay the development cost for the plot of land.

Although the products and target clients of the KHB, the SCB, and the DA differ, there is clear overlap in responsibility particularly in developing serviced land, and there has not been visible collaboration between the agencies. For example, the KHB has not acquired any sites from the DA nor vice versa. When asked whether this overlapping of responsibility creates a conflict between the agencies, the KHB explained that the demand for serviced land and houses is so high that there is no competition between the agencies in developing them.<sup>6</sup>

## REVENUE MOBILIZATION

Under Section 94, ULBs are required to obtain sanction from the State Government to revise tax rates, and to levy taxes at rates below the specified maximum.

### Property Tax

The GoK has amended the KMCA and KMA to replace Annual Rental Value (ARV) of property with the capital value of land and buildings. The capital value is determined according to Section 45 B of the Karnataka Stamp Act (1957). The capital value of buildings is determined on the basis of the estimated cost of erecting the building at the time of assessment, according to the method adopted by the Public Works Department. It provides for depreciation according to a prescribed schedule.

The capital value of land is periodically notified in all towns and cities in order to levy the Stamp Duty. The notified capital value forms the basis for imposition of the Stamp Duty. Note that this capital value is a *notional* value, and not the market driven value. Distortions in land markets caused by rent control provisions,<sup>7</sup> FSI and other distortions, the prevalence of black market property transactions, and disincentives for property registration such as the 12.5 percent stamp duty (which is very high in comparison to other states) impede the measurement of true market values. The Commissioner of Stamps

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<sup>6</sup> Discussion with the Principal Secretary of the Karnataka Housing Department, 19 July 2002

<sup>7</sup> While rent control statutes have been formally repealed in Karnataka, their effects are estimated to last another 7 years.

in Karnataka estimates that the guidance values calculated by his Department are about 60 percent accurate. Recent analysis by the World Bank, based on detailed survey data from Bangalore residents, showed that the market value of residential properties is probably 18 percent higher than respondents stated property values based on annual rents.<sup>8</sup>

The administration of property taxes has historically been poor, especially in recording property values. Many ULBs are in the process of improving their administrative systems, especially with regard to updating the valuation roll and introducing information management systems. Self assessment schemes have been introduced in Bangalore (see accompanying report on *Urban Property Tax Reform in Selected Indian States*) as well as Hassan, among other ULBs. In Hassan's case, a physical survey of one ward revealed that 90,000 square feet of property were missing from the official registry, with an associated increase in property value of 80 lakh.

### FINANCIAL ANALYSIS

Lack of accurate and up-to-date fiscal data preclude detailed assessment of the fiscal position of ULBs. The most recent data are from the Department of Economic Statistics, and cover the years 1996-97 through 2000-01, although detailed fiscal data were only available through 1998-99. These data are used for the summary figures reported below; their accuracy is suspect, especially with regard to the consistency of data over time, and frequent misclassifications among revenue and expenditure accounts. ULBs in Karnataka do not use fund-based accounting systems.

As expected, larger ULBs have higher per capita revenues and expenditures.<sup>9</sup> As shown below in Table I.2, in 2000-2001, CCs had per capita revenues (including grants) of Rs. 784, and expenditures (including current and capital expenditures) of Rs. 997. In contrast, CMCs had per capita revenues of Rs. 644 and expenditures of Rs. 415, less than one-half the levels for CCs. Per capita revenues and expenditures for TMC's were one-third the values for CCs. The substantial increase in revenues and expenditures between 1996-97 and 2000-01 reflects the first payment of State Finance Commission grants. Table I.2 also shows that in larger ULBs – especially CCs and CMCs – expenditures are growing more rapidly than revenues, and that growth in per capita revenues and expenditures is highest in CMCs.

**Table I.2: ULB Fiscal Indicators, Per Capita (in Rupees)**

	Total Revenue			Total Expenditure			Avg. Annual Growth	
	96/97	98/99	00/01	96/97	98/99	00/01	1996/97-00/01 Rev.	Exp.
Corporations	455	1009	784	676	997	944	14.6%	14.5%
City Municipal Councils <sup>10</sup>	270	414	644	188	415	583	24.3%	29.5%
Town Municipal Councils	193	329	371	185	284	330	17.7%	16.0%

Source: Municipal Statistics, GoK, 1996-97, 1998-99, and 2000-01.

A simple comparison of the difference between total revenues and total expenditures (see Table I.3) shows that about one-third of all ULBs incurred overall deficits in 1998/99.<sup>11</sup> An analysis of

<sup>8</sup> See for example, World Bank Development Economics Group, Bangalore Urban Household Survey, 2001.

<sup>9</sup> Note that population values are only available for 1991, so the figures likely overstate the true per capita revenues and expenditures. Because of high variation across years, fiscal data are not reported for Town Panchayats.

<sup>10</sup> ULBs have been divided into Corporations, City Municipal Councils and Town Municipal Councils using the 1998/99-definitions.

<sup>11</sup> These calculations follow Karnataka's classification of "loans" as a source of income. Alternatively, if loans are classified as a source of financing, the number of CMCs and TMCs in deficit increases to 45 and 30 percent, respectively.

borrowing capacity included below shows that *current* revenues exceed *current* expenditures for most ULBs in Karnataka.

**Table I.3: Share of ULBs with Overall Deficit<sup>12</sup>**

	Share of ULBs with Overall Deficit (in percent)		
	1996/97	1997/98	1998/99
Corporations	50%	0%	33%
City Municipal Councils	24%	29%	42%
Town Municipal Councils	34%	42%	29%

*Source:* Municipal Statistics, GoK, 1996-97, 1997-98 and 1998-99

### TYPES OF ULB SPENDING

ULB expenditure data are generally reported by six major heads of expenditure: (i) general revenue expenditure, (ii) capital expenditure, (iii) wage and salary expenditure, (iv) repayment of loans, (v) expenditure on commercial enterprises, and (vi) other expenditure. Within general revenue expenditures, expenditure data were available for street lighting, water supply and drainage, hospitals and dispensaries, and public instruction (education). Capital spending data were reported for roads and other investments.

As shown in Table I.4, CCs appear to spend more per capita on core services (i.e., obligatory functions) such as water and sanitation, street lighting, and roads than CMCs and TMCs. On average in fiscal year 1998/99, CCs spent Rs. 249 on core services per capita while CMCs and TMCs spent Rs. 216 and Rs. 86, respectively. Moreover, when per capita health and education expenditures are added to these core services to measure “local public goods,” CCs spent the most (Rs. 262 per capita). These figures are consistent with the notion that CCs have assumed more discretionary responsibilities than CMCs or TMCs.

**Table I.4: Spending on Core Services and Local Public Goods (Rupees per Capita)**

	Core Services			Local Public Goods		
	Water and Sanitation, Street Lighting, and Roads, per capita			Core Services, Education, and Health per capita		
	1996/97	1997/98	1998/99	1996/97	1997/98	1998/99
Corporations	130	..	249	132	..	262
City Municipal Councils	39	52	216	40	52	217
Town Municipal Councils	42	46	86	42	46	88

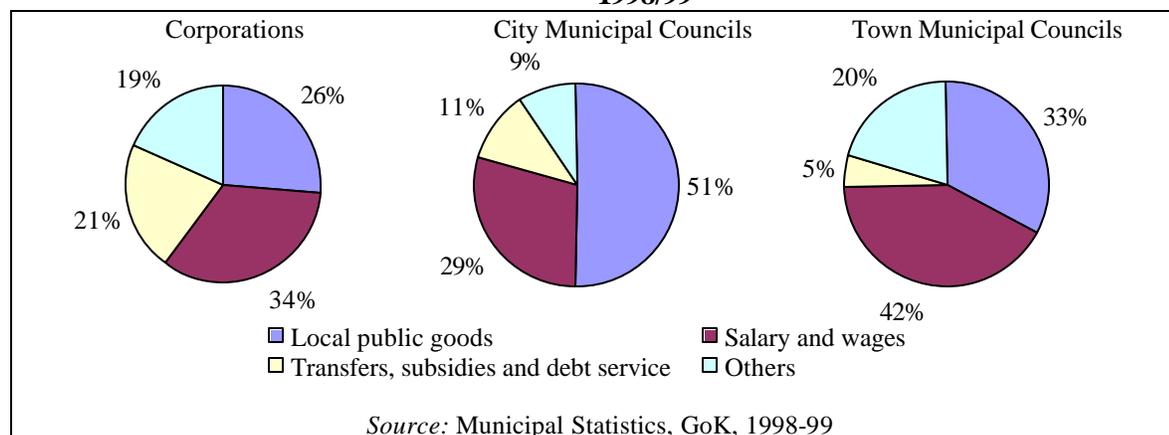
*Source:* Municipal Statistics, GoK, 1996-97, 1997-98 and 1998-99

However, as a share of total expenditures, CCs spend less on local public goods (26 percent) than CMCs (51 percent) and TMCs (33 percent) (see Figure I.1). Debt service, subsidies and transfers account for a considerably larger share in CCs (21 percent) than other ULBs in the sample. Wage and salary

<sup>12</sup> Overall deficits are defined as total revenue (including loans) minus total expenditures (including capital expenditures and loan repayments, among other categories).

payments account for about one-third of CC total expenditures, 29 percent of CMC total expenditures and 42 percent of TMC total expenditures.

**Figure I.1: Expenditure Profiles of Karnataka Corporations, City and Town Municipal Councils, 1998/99**



### ULB STAFFING

There is a general perception that ULBs are overstaffed, especially with regard to lower-level (i.e., Grade D) employees (see Table I.5). On average in Karnataka, CCs have 5.1 staff per 1000 population, and staff salaries account for about one-third of CCs' expenditures (see Table and Figure I.1). Smaller ULBs have fewer staff per inhabitants but the wage bill accounts for a larger share of their total expenditures. Staff are disproportionately concentrated in the lowest skill grade --Group D staff account for three-quarters of ULB staff. "Special groups" (SC and ST) account for almost 50 percent of the total staff hired in Group D.

A careful analysis of pension payments is warranted. Currently, it is unclear whether the data on salary and wages include pension payments, and how many pensioners are currently receiving pensions.

**Table 1.5: ULB Staffing Patterns**

	Staff/1000 population			Administration staff (per 1000 pop.)			Share of Type D employees
	96/97	97/98	98/99	96/97	97/98	98/99	1998/99
Corporations	5.52	5.14	5.14	0.50	0.49	0.27	72%
City Municipal Councils	2.23	2.51	2.53	0.31	0.36	0.38	81%
Town Municipal Councils	2.36	2.27	2.22	0.35	0.40	0.41	79%

Source: Municipal Statistics, GoK, 1996-97, 1997-98 and 1998-99

The current administration of three of the six City Corporations in Karnataka is headed by Commissioners who are from the Indian Administrative Service (IAS); this is common for CCs with populations exceeding 10 lakh. Two of the remaining three CCs are headed by Commissioners belonging to the Karnataka Municipal Administrative Service (KMAS). Commissioners are appointed by the Government of Karnataka (GoK) and serve for 1-3 years. In Mysore Corporation (the second largest corporation in the state), 29 commissioners have served since 1977 – implying an average tenure of less than one year.

Chief Executives of ULBs with populations not more than 300,000 may also come from the KMAS. KMAS is a state service set up in 1971 and it currently has 150 staff members. In addition to Chief Executives from the IAS or the KMAS, ULB administration may be headed by either a Commissioner Grade 1 or 2 (for ULBs with populations between 50,000 and 300,000) or a Chief Officer Grade 1 or 2 (for ULBs with populations less than 50,000) who are from the KMAS.

There has been no recruitment of Grade 2 Chief Officers since 1982. In 1992, by GoK Executive Order, municipal employees became eligible to be promoted to the KMAS cadre based on their years of service in the ULB. They are therefore eligible to be Chief Office Grade 2 without meeting any basic qualifications. As a result, 109 ULBs are headed by officers (promoted municipal employees) who have insufficient qualifications to carry out their tasks.

Vacancies are common across ULBs; some ULBs are reportedly run by three staff members. There has not been a systematic effort by DMA to define the work load and skills needed for ULBs, and to recruit staff accordingly.

The Chief Executives of the ULBs are supported by a team of staff on functional and service departments. Some senior officials in the departments are appointed by the GoK from the IAS or the KAS while many of the technical staff are recruited from the state administrative services, engineering, planning, and health services as well as seconded from state level departments. For example, the Chief Accounts Officer/ Accounts Officer/Accounts Superintendent (depending on the population size of the ULB) is generally on deputation from the Karnataka State Accounts Department. The operating staff of most of the ULB departments, however, is composed of employees who are directly recruited by the ULBs. Officials in the municipal administration are divided into 4 grades – A, B, C, and D – with A being the highest grade and D being the lowest. The State appoints officials in Grades A, B, and C, including the Chief Executives of the ULBs. Until 1997, ULB councils could appoint Group D officials. In 1997, Deputy Commissioners were given this authority instead. However, many Councils continue to appoint daily wage workers, who are not subject to staffing limits. By court order, workers who have worked for 240 consecutive days cannot be terminated; many daily workers pass this threshold and become Grade D officials. This has caused Grade D officials to increase rapidly in number and wages paid. In some ULBs such as Mysore, Grade D officials are 80 percent of the total number of officials in the municipal administration.

Larger ULBs such as Corporations like Bangalore are reducing the number of Grade D officials by retaining only core Grade D employees and outsourcing many of the functions originally performed by these officials such as park cleaning and garbage collection. Nevertheless, 73 percent of officials in Bangalore Corporation are Grade D staff. Approximately 10 percent of ULBs have outsourced staff. In general, outsourcing specifies the number of posts (i.e., number of sweepers) to be outsourced rather than an outsourcing of complete tasks (i.e., office cleaning.)

The GoK determines the number of staff for all categories of ULBs. However, it has imposed a hiring freeze on government officials since 1997. With the exception of compassionate employees<sup>13</sup>, recruitment of new officials has not occurred since 1997. As a result, compassionate employees now comprise approximately 40 percent of total officials in ULBs. Most compassionate employees are appointees from Grade D as they are the largest group of officials in ULBs.

Wages and salaries of ULBs are governed by state guidelines. The Pay Commission, Finance Department, Cabinet and Department of Public Administrative Reform determine personnel guidelines.

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<sup>13</sup> Compassionate employees are dependents of former employees who have died in office. They can be recruited for any position depending on their qualification. Generally, they do not have high qualifications.

Wages and salaries currently account, on average, for 33 percent of ULBs' total expenditure.<sup>14</sup> Wages and salaries are typically paid out of the State Finance Commission grants. There is no other significant allowance for government officials in Karnataka.

Key staffing challenges for ULBs are the significant number of vacancies, poor qualifications of many staff, the declining pool of experienced staff due to looming retirements over the next five years and lack of direct recruitment, and significant mismatch of skills, especially in technical areas.

### Explaining Variations in Current Expenditure<sup>15</sup>

Current expenditures per capita also differ widely, even among similar types of ULBs. Within CCs, the mean of current expenditures per capita is Rs. 389 with a standard deviation of 181. The range of current spending per capita in CCs in 1998/99 varies from Bangalore (Rs. 706) to Gulbarga (Rs. 162).<sup>16</sup>

Annex Table I.A.3 provides the regression equations used to explain variations within Karnataka ULBs in current expenditures per capita. Differences in current expenditures per capita can be explained well by the size of the ULB (population is positively correlated), and per capita grants (positively correlated.) Surprisingly, the number of industrial properties per capita, which is a proxy for income, is not significant in explaining the variation in current expenditures. Combined, these factors explain approximately 44 percent of the variation in current expenditure per capita.

Some outliers merit more detailed analysis. For example, *Pattanagere*, a CMC in the Bangalore Urban District, is quite average in its population size and per capita spending, yet it only spends 28 percent of its current expenditures on its wage bill; significantly less than the 70 percent share spent by the average CMC.<sup>17</sup> Seven ULBs like Pattanagere have expenditure patterns that are not easily explained.<sup>18</sup>

## REVENUE MOBILIZATION

Table I.6 shows ULB revenue sources by type. The property tax is the mainstay of ULB finance, accounting on average for 53 percent of own revenues. (*Octroi* was abolished in Karnataka in 1976.) Property taxes are relatively more important for CCs (62 percent of own revenues) than for smaller ULBs (ranging from 30 percent of own revenues in CMCs to 28 percent of own revenues in TMCs). Other own revenues include user charges and fees (e.g., market and license), rents, advertising taxes (especially in large corporations like Bangalore), and miscellaneous receipts. Cesses are included in own revenues, even though these are collected on behalf of the State (although not always remitted to the State.) Asset sales are very low, accounting on average for less than 1 percent of own revenues. Loans are relatively small in terms of financing, and are concentrated within CCs.

<sup>14</sup> World Bank, *Karnataka Urban Sector Technical Note*, 2002

<sup>15</sup> Although data in Karnataka are not separated into current and capital expenditures, we define "current expenditures" as total expenditures minus "capital expenditure on roads" and "capital expenditures on others", "grants to others", "expenditure on commercial enterprises, "savings and subsidies" and "others" (a residual category).

<sup>16</sup> When using 2001 population figures, the per capita figures are R438 for Bangalore and R115 for Gulbarga. For the entire sample, per capita expenditure figures exhibit much greater variation when using 1991 rather than 2001 population figures.

<sup>17</sup> On the revenue side, Pattanagere also seems worthwhile studying in more details. It raises only half of the mean own source revenue per capita (for CMC) and it is the largest recipient of grants per capita in Karnataka.

<sup>18</sup> The seven ULBs are (listed in declining population size): (i) Pattanagere, (ii) Chik Ballapur (a CMC in the Kolar District), (iii) Shorapur (a TMC in the Gulbarga District), (iv) Malavalli (a TMC in the Mandya District), (v) Shikaripur (in the Shimoga District), (vi) Kengeri (a TMC), and (vii) Channarayapatna (a TMC in the Hassan District)

**Table I.6: ULB Revenues, 1998-99(Rupees in millions)**

	Prop erty Tax	Total Taxes	Own Source Rev.	Total Grants	Total Curr. Rev.	Loans/ Sales of assets and Others	Total Rev.	% Proper ty Tax/ OSR	% OSR/ Total Rev.
Corporations	1,137	1,564	1,835	2,148	3,983	752	4,735	62%	39%
City Municipal Councils	157	445	519	1,058	1,577	42	1,620	30%	32%
Town Municipal Councils	55	147	197	513	710	30	740	28%	27%
Total ULB	1,349	2,156	2,551	3,720	6,271	825	7,096	53%	36%

Source: Municipal Statistics, GoK, 1996-97, 1997-98 and 1998-99

More recent fiscal data were collected from selected ULBs during field visits. In Mysore, as is the case in most CCs, the property tax and related surcharges comprise virtually all receipts from taxes and cesses, and their rates and bases are determined by higher levels. Indeed, many of the cesses (such as the library cess) are earmarked and often passed on to state agencies. Water charges comprise the dominant source of user charges. In Mysore they accounted for nearly 10 percent of revenues (Table I.7). The rates are set by the municipality but the receipts are to be remitted to the Water Board for use in servicing the capital costs of the system. In all cases the receipts are very small: in Mysore tax receipts were only Rs. 80 per capita; water charges were roughly the same amount. Altogether including transfers and external assistance the available revenue per capita in Mysore is only Rs. 842.

<b>Table I.7. Revenue Composition, Mysore Corporation 2001-2002</b>		
	<b>Actuals (Rupees)</b>	<b>Shares</b>
Tax receipts	64,339,705	9.5%
Cesses and fees	23,706,730	3.5%
Stamp duties	31,917,444	4.7%
Water charges	63,742,956	9.5%
Income from corp. farms	1,013,360	0.2%
Other user charges	442,623	0.1%
License fees	19,673,152	2.9%
Rents from corp. property	14,795,342	2.2%
Other	18,592,990	2.8%
Tax shares	NA	0.0%
Grants/contributions*	259,228,530	38.5%
Funds for schemes	13,092,283	1.9%
Loans and advances	67,310,464	10.0%
Sale of assets	7,927,827	1.2%
ADB assistance	87,957,248	13.1%
Total	673,740,654	100%
* partial.		

Source: Mysore Mahanagara Palike Budget Estimates 2002-2003.

According to Bangalore's Performance Budget 2002-2003, revenues are estimated to derive from the following sources, listed in descending order of importance: non-tax revenues (21 percent), own taxes (20 percent), miscellaneous (20 percent), grants (12 percent), borrowing (18 percent), grants (12 percent), and cesses and taxes (6 percent.)

Relative to their population size, CCs appear to receive a disproportionately large share of grants: they receive 58 percent of total grants even though they account for only 44 percent of the ULB population (see Table I.8). On a per capita basis, CCs receive nearly twice as much in grants as TMCs. Even though they receive less per capita, smaller ULBs are more dependent on grants; TMCs only generate 27 percent of their own revenues, whereas CCs generate 39 percent of own revenues (see

**Table I.8: ULB Grants**

	Grants per Capita				Share of Total Grants			Share of
	(Rupees)							Pop.
	96/97	97/98	98/99		96/97	97/98	98/99	1999
Corporations	230	262	458		66%	65%	58%	44%
<i>of which: Bangalore</i>	324	304	484		53%	43%	35%	25%
City Municipal Councils	108	106	278		25%	21%	28%	35%
Town Municipal Councils	67	114	228		9%	13%	14%	21%

Source: Municipal Statistics, GoK, 1996-97, 1997-98 and 1998-99

Table I.6). There is no clear relationship between a ULB's economic base and grants received per capita.<sup>19</sup> It seems worthwhile to explore if grants per capita are correlated with measures of poverty in the ULBs. [If the actual number of poor people is not available by ULB, one could proxy this figure by the share of population living in slum areas, a figure which is available by the Census of India].

### Explaining the Variation in Own-Source Revenue

Own-source revenue per capita exhibits much heterogeneity among the ULBs, even within the three classifications used in the tables above. For example, among the six CCs, the mean own-source revenue per capita is Rs. 403 with a standard deviation of 201<sup>20</sup>. At the top, Mysore Corporation raised Rs. 615 per capita in 1998/99 while Gulbarga Corporation, at Rs. 129 per capita, raised less own source revenue than the average CMC.

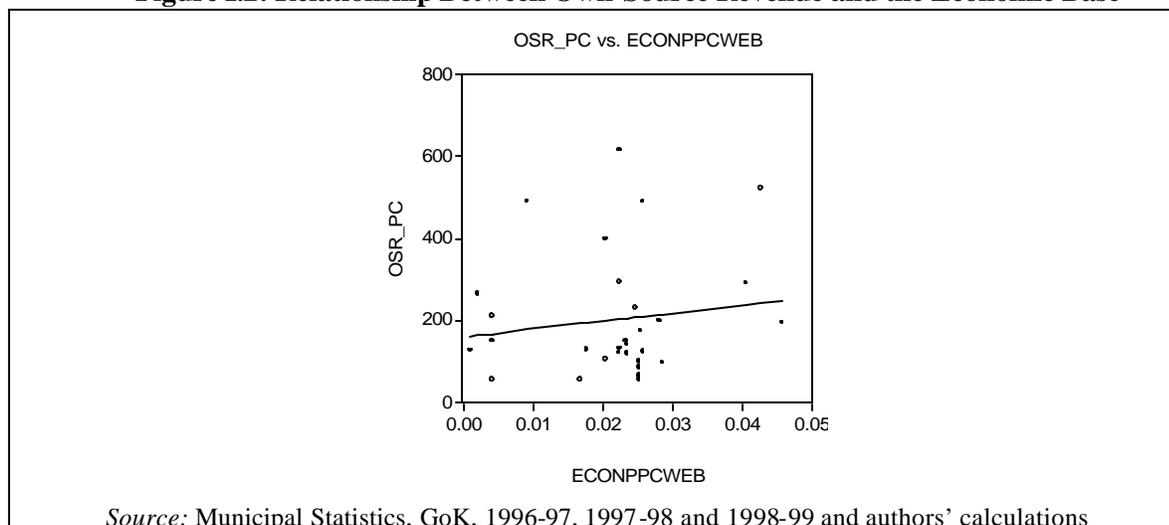
Explaining the variation in own source revenue per capita with the limited data available is difficult. Standard regression analysis explains less than 20 percent of the variation in the entire sample of 124 ULBs, but explains somewhat more when the 79 small TMCs are excluded. Despite the limited ability to explain the variation, some variables seem to be important driving forces. Specifically, own-source revenue is positively correlated with population, as is a proxy for the economic base of the ULB (or income). Grants do not appear to substitute for local own-source revenue mobilization, as they are not statistically significant. The correlation coefficient between own source revenue and income is well below one, ranging from 0.4-0.6, depending on whether the small ULBs are included or not.<sup>21</sup>

<sup>19</sup> No relationship was found between the number of industrial properties per capita in the ULB (a proxy for the economic base) and the amount of grants received per capita, both when considering the sample of 124 ULBs and within sub-samples.

<sup>20</sup> Own source revenue = Total tax revenue (including water receipts) + Income from commercial enterprises + other revenue

<sup>21</sup> The correlation coefficient mentioned here is the correlation coefficient on the log of the proxy for income estimated using ordinary least squared.

**Figure I.2: Relationship Between Own-Source Revenue and the Economic Base**<sup>22</sup>



### INTERGOVERNMENTAL TRANSFERS

ULBs receive significant transfers from other governments; on average about 40 percent of their revenues are accounted for by transfers. In 2001-02, the most significant transfers in descending magnitude of funding are: state plan schemes (R685.8 crore); State Finance Commission grants (R590 crore); and central schemes for urban development and urban water supply (R57.6 crore). While the state plan schemes are largest in magnitude of funding, most of these schemes flow to autonomous bodies rather than ULBs. In fact, ULBs have limited say in how most of these funds are used. And while SFC grants are “untied,” they are closely linked to salary payments, which means that their discretion to use these funds is also limited.

#### State Plan Schemes

As shown below in Table I.9, in 2001-02, state plan schemes were dominated by KUIDFC projects (R204.7 crore) and BWSSB projects (R284.5 crore). Appendix Table I.A.1 shows the details of individual state plan schemes. There are 7 KUIDFC schemes, including two loans from the ADB; BMRDA has 3 schemes; Town Planning has 6 schemes; Municipal Administration has 10 schemes, including SJSRY; BMRTS has 1 scheme; 5 schemes are found in Other Urban Development Programme; KUWS&DB has 5 schemes; and BWSSB has 14 schemes.

<sup>22</sup> The graph shows scatter plots of OSR and a proxy for the economic base and OSR for the Corporations and City Municipal Councils. While a statistical relationship between these variables was also found for the entire sample (including Town Municipal Councils), the scatter graphs are visible less pleasing.

**Table I.9**  
**Karnataka Urban Development Plan Schemes**  
**(Rupees in crores)**

	9 <sup>th</sup> 5 Year Plan Outlay	Annual Plan 2001/2 Outlay (RE)	10 <sup>th</sup> 5 Year Plan Outlay
Urban Development			
KUIDFC	473.2	204.7	1819.9
BMRDA	2.7	0.5	0.2
Town Planning	4.5	2.7	67.8
Municipal Administration	196.6	79.4	313.5
BMRTS	117.0	45.5	244.1
Other Urban Development Programme	1.5	20.6	78.0
Urban Water Supply			
KUWS&DB	460.9	47.8	549.1
BWSSB	200.0	284.5	1027.9
Grand Total	1504.5	685.8	4314.7

Source: GoK, Urban Development Department

### State Finance Commission Grants

The SFC defined the distributable pool for grants to local governments as the “Non-Loan Gross Own Revenue Receipts” (NLGRR) of the State Government.<sup>23</sup> These receipts include: gross yields from all taxes, duties and fees levied and collected by the State Government, as well as interest receipts. They exclude grants in aid from the Central Government, and the State share in the net yield from the income tax and union excise duties. The SFC further recommended that ULBs and PRIs receive 36 percent of this pool, with 15 percent allocated to ULBs and 85 percent to PRIs. It was recommended that SFC grants be allocated according to a formula with five elements:

$$\text{SFC grant} = 0.33\text{Population} + 0.33\text{Area} + 0.11\text{Illiteracy} + 0.11\text{Road Density} + 0.11\text{Persons/Hospital Bed}$$

The recommendations of the SFC were discussed by the Cabinet in February 1997, and the Chief Minister, in consultation with the Deputy Chief Minister, Minister for Rural Development and Minister for Urban Development, decided that funds would be devolved to local bodies according to the following:

- 36 percent of non-loan gross revenue receipts would be devolved to ULBs and PRIs, as recommended by the SFC, effective from 1998-99
- R290 crore would be devolved to ULBs in 1997-98
- the recommended ratio of 15:85 (urban to rural, respectively) would be phased in by 2001-02, rather than 1999-2000, as originally recommended by the SFC.

As shown below in Table I.10, SFC grants have increased from Rs. 320 crore in 1997-98 to Rs. 590 crore in 2001-02. The ULB portion of the NLGRR has increased from about 8 percent in 1997-98 to about 14.4 percent in 2001-02, roughly equivalent to the SFC recommended share of 15 percent.

<sup>23</sup> Report of the State Finance Commission Relating to Urban Local Bodies, Government of Karnataka, January 1996.

**Table I.10: Karnataka SFC Grants**  
(Rupees in crores)

Year	NLGORR	Budget Provision	Actual Release*	Grants as a % of NLGORRs
1997-98	7676.3	290.0	319.6	4.2
1998-99	8413.0	359.0	341.1	4.1
1999-2000	9355.6	461.0	416.2	4.4
2000-01	10702.6	534.2	560.2	5.2
2001-02	11327.8	625.5	590.0	5.2
2002-03		592.0	--	

\*Includes development grants in 2000-01, and 2001-02,  
Source: GoK, UDD, Department of Municipal Administration

Besides the delay in fully implementing the 15 percent share of the NLGORR for ULBs, it is notable that the actual release of state grants often falls short of the budget provision, thereby lessening the predictability of flows to ULBs.

The actual allocation of SFC grants does not adhere to the formula recommended by the SFC because of at least three “moderations” to the formula. In applying the proposed formula, the initial allocation for Bangalore would have declined from Rs. 80 crore to Rs. 30 crore in one year. It was decided that Bangalore should be “held harmless” in its funding (i.e., the Rs. 80 crore level was retained). The second moderation was in response to the “mayhem” and potential employee strikes that would have arisen if the formula were implemented. As a result, ULB government salaries were protected from any change caused by the formula. Finally, arrears in payment to state utilities (e.g., KUWS&DB) or loan repayments (e.g., HUDCO, KUIDC) are intercepted by the Urban Development Department. These intercepts are significant in magnitude, and they exacerbate the non-transparency of the allocations. In the month of September 2002, 20 ULBs had arrears averaging 20 percent of their SFC grant that were intercepted by the UDD (see Table I.A.2). Accounting for these arrears is very difficult and an Accounting Commission has been established.

Octroi was abolished in Karnataka in 1976. Currently, the State compensates loss at an enhanced rate of 10 % per annum over the base year (since 1989 the rate of increase in compensation was 7%). This has been combined as part of the SFC devolution.

### Centrally Sponsored Schemes

Four centrally sponsored schemes for urban development and urban water supply are being implemented in Karnataka:

- Bangalore Megacity Project
- Integrated Development of Small and Medium Towns (IDSMT) scheme
- Swarna Jayanthi Shahari Rojgar Yojana (SJSRY)
- Accelerated Urban Water Supply (AUWS)

In 2001-02, Rs. 57.6 crore was released for these schemes (see Table I.11). Except for SJSRY, most schemes are funded to their budget target. Generally speaking, the central government is responsible for defining the policy framework for these schemes; financing is shared among the central, state and ULB governments (see Table I.11 below for central vs. state shares); ULBs are responsible for implementing the schemes; and the state is responsible for monitoring performance.

**Table I.11. Centrally Sponsored Schemes for Urban Development, Annual Plan 2001-02**  
(Rupees in crores)

	Target			Releases		
	CS	SS	Total	CS	SS	Total
<b>Urban Development</b>						
Mega City Project (50:50)	16.6	16.6	33.2	21.2	16.6	37.8
IDSMT (60:40)	4.2	2.8	7.0	4.1	2.8	6.9
Rojgar Yojana (75:25) (USEP & UWEP)	30.4	10.1	40.5	4.4	1.5	5.9
<b>Urban Water Supply</b>						
Accelerated Urban Water Supply	5.0		5.0	7.1		7.1
<b>Grand Total</b>	56.2	29.5	85.7	36.8	20.8	57.6

The Bangalore Megacity Project includes 18 sanctioned projects, which are being implemented through various agencies (i.e., BMP, BDA, BWSSB, BMTC, Karnataka Slum Clearance Board, and Karnataka Compost Development Corporation.) It is the largest of the centrally sponsored schemes, with R37.8 crore released in 2001-02. Data are not available to assess its performance.

The IDSMT scheme finances infrastructure (i.e., remunerative schemes, water supply, roads and drains, street lighting, sites and services, civic amenities) for cities and towns up to 5 lakh population. In 2001-02, R6.9 crore were released. Central and state governments finance 80 percent of project costs, and towns provide the remaining 20 percent. Of the 80 percent funded, the central and state governments share in a ratio of 60 percent central financing and 40 percent state financing. At present, 29 towns are implementing projects, and there is a queue of about 30 additional towns who would like financing from the scheme. This scheme is monitored by various state agencies, and the quality of monitoring is believed to be poor.

The SJSRY scheme is targeted to the urban poor, especially people below the poverty line. In 2001-02, Rs. 5.9 crore were released. It includes an Urban Self Employment Programme (USEP), and Urban Wage Employment Programme (UWEP), and Community Structure Program. Central and state governments finance 100 percent of programme costs, with the central government providing 75 percent of financing and the state government providing 25 percent of financing. Funds are allocated in part based on ULBs' ability to disburse scheme funds. Since its inception in 1997, USEP has given assistance to 20,175 beneficiaries to start micro enterprises, 425 Development for Women and Children in urban areas were established, and 45,996 beneficiaries received training in various skills. Benefits of the UWEP program include completion of 7,050 works and generation of 52 lakh man days of employment.<sup>24</sup>

KUWSSB is implementing the AUWS scheme, which is funded by the central government. In 2001-02, Rs. 7.1 crore were released. At present, 29 schemes have been technically cleared by GOI. Of these, 13 schemes have been commissioned and 12 schemes are in various stages of progress.

### **BORROWING CAPACITY OF ULBS**

As mentioned above, loans are relatively small in terms of financing, and are concentrated within CCs. In fact, loans (which are classified as "revenues" in Karnataka) accounted for 14.5 percent of total revenues for CCs but only a negligible share for CMCs and TMCs. However, as Table I.12 shows, the share of ULBs that borrowed in 1998/99 was around 16 percent of ULBs, regardless of their classification. Moreover, as suggested by the large share of ULBs with debt service expenses, half of CMCs and almost one-third of TMCs have borrowed in the past.

<sup>24</sup> Performance statistics from GOK, UDD.

**Table I.12: Share of ULBs with Debt Service Expenses and Share that Borrowed in 1998/99**

	Share of ULBs with debt service expenses	Share of ULBs that borrowed during the year	Share of ULBs that are (or were) borrowers	Loans (share of rev.) 1998/99
	(1998/99)			
Corporations	83.3%	16.7%	83.3%	14.5%
City Municipal Councils	47.4%	15.8%	50.0%	0.5%
Town Municipal Councils	23.8%	16.3%	31.3%	0.4%

*Source:* Municipal Statistics, GoK, 1996-97, 1997-98 and 1998-99 and authors' own calculations

Unfortunately, data limitations preclude a more detailed description of existing debt profile. Given the large share of ULBs with outstanding debt, further investigation of these liabilities should be undertaken, especially with regard to the composition of debt, potentially overdue debt, and the decomposition of debt service into interest and principal payments. It is troubling that the GoK does not collect these data readily available given that the State is probably either directly or indirectly the lender, or at least providing guarantees.

Despite these data limitations, the total borrowing capacity of ULBs in Karnataka has been estimated. First, only those ULBs that have a revenue surplus after meeting current revenue expenditures (including debt servicing) have been considered to have capacity to borrow, due to their being in a position to service debt out of such surplus. To arrive at a suggestive amount available to borrow, the current levels of surplus have been assumed to continue over 15 years, and it is assumed that only half of these surpluses would be available for fresh debt servicing obligations. These "surplus cashflows" have then been discounted at an assumed rate of 12 percent per annum to arrive at a Net Present Value (NPV); the total amount a ULB would be able to borrow today and be able to comfortably service over the next 15 years.

The results of the indicative assessment of the borrowing capacity of all 124 ULBs in Karnataka based on 1998/99 data, summarized in Table I.13, suggests that almost all ULBs are in capacity to borrow additional funds.<sup>25</sup> In fact, all Corporations and more than 90 percent of smaller ULBs were deemed capable of borrowing additional funds.

<sup>25</sup> Once again, this result is consistent with Table since we are considering "revenue surpluses" here. In practice, little is being changed on the revenue side while capital expenditures are being subtracted from the expenditure side.

**Table I.13: Borrowing Capacity Assessment<sup>26</sup>**

ULB Category	Excluding loans taken during the year			After including loans taken during the year		
	Number of ULBs with borrowing capacity	As a % of number of ULBs	Aggregate Borrowing Capacity (millions Rupees)	Number of ULBs with borrowing capacity	As a % of number of ULBs	Aggregate Borrowing Capacity (millions Rupees)
Corporations	6	100%	3,441.2	6	100%	2,752.3
City Municipal	35	92%	1,833.4	34	89%	1,831.0
Town Municipal	73	91%	931.1	73	91%	928.2
<b>Total</b>	<b>114</b>	<b>92%</b>	<b>6,205.7</b>	<b>113</b>	<b>91%</b>	<b>5,511.5</b>

### GOVERNANCE ASPECTS

Municipal administration falls under two functional state departments: the Urban Development Department (UDD) and the Housing Department (HD). Agencies under the departments and their responsibilities and coverage are presented in Table I.14 below.<sup>27</sup>

<sup>26</sup> Water receipts have been included as revenue and expenditures on water, sewage and drainage (we only have the current expenditures) have also been included. When excluding water receipts and expenditures, slightly more ULBs are capable of borrowing.

<sup>27</sup> Table taken from World Bank, *Karnataka Urban Sector Technical Note*, 2002 with small modifications

**Table I.14: Municipal Administration Institutions in Karnataka**

Agency	Responsibilities	Coverage
<b>Under Principal Secretary of Urban Development Department</b>		
Urban Development Department (UDD)	Policy, Planning and Administration of all urban departments, Corporations and Development Authorities. Directly oversee Bangalore based urban agencies City Corporations and Development Authorities.	Karnataka
Directorate of Municipal Administration (DMA)	Urban Policy, supervision of municipalities, redressal of public grievances and coordination of select state and national programs, and projects.	City and Town Municipal Councils and Panchayats
Municipalities and Corporations	Delivery and maintenance of obligatory, special and discretionary services and functions stipulated under the Act. Obligatory functions include O&M of services, capital investments other than water and sanitation and providing building permissions.	Local Area
Town Planning Department (TPD)	Enforcement of Karnataka Town and Country Planning Act 1961 (KTCP): Preparation of outline and comprehensive development plan for towns, regional development plans and advise the State Town Planning Board on matters relating to planning.	Urban Karnataka
Karnataka Urban Water Supply and Drainage Board (KUWSDB)	Created by an Act of the government in 1972, responsible for creation of water supply and sanitation in urban Karnataka, and O&M in areas based on request from the local body (through the state government)	Urban Karnataka
Karnataka Urban Infrastructure Development Finance Corporation (KUIDFC)	Formulation and preparation of infrastructure projects Mobilization of finance for infrastructure Management of State, National and Donor aided Urban Development programs Capacity Building on urban development issues	Urban Karnataka
Bangalore Metropolitan Region Development Authority (BDA)	Constituted under BMRDA Act 1985, Strategic Planning for Bangalore Metropolitan Region.	Area encompassing Bangalore District & parts of Kolar Dist.
Bangalore Water Supply and Sewerage Board (BWSSB)	Constituted in 1965, responsible for creation and maintenance of water supply and sanitation	Bangalore Urban Area
Bangalore Mass Rapid Transport Limited (BMRT)	Design, implementation and management of the proposed elevated railway system	
Development Authorities (DA)	Implementation of KTCP Act 1961 in designated areas in terms of preparing outline and comprehensive development plan, implement plan (scrutiny and	Corporations and All district headquarters

Agency	Responsibilities	Coverage
	approve) and land development	
<b>Under Principal Secretary, Housing Department</b> <sup>28</sup>		
Karnataka Housing Board (KHB)	Development of urban housing	Karnataka
Slum Clearance Board (SCB)	Implementation of slum improvement programs	Karnataka

### DELEGATION OF POWERS

Historically, ULBS faced very low thresholds for procurement and hiring approvals, with considerable involvement of the DMA and UDD. A typical approval hierarchy would include the Assistant Commissioner, Deputy Commissioner, Divisional Commissioner, Director of Municipal Administration, and then Urban Development Department. Such low limits compromised the autonomy of ULBs and often delayed service provision considerably. In the past, any approval above R25,000 came to the DMA, and it sometimes took 8 months to clear tenders.

Recently, the UDD has delegated more powers to ULBs. For example, financial authorization limits have been increased in line with general delegation of powers from 1 lakh to 5 lakhs for ULB's and 5-20 lakhs for Deputy Commissioners.

### BUDGETING AND FINANCIAL MANAGEMENT<sup>29</sup>

The Municipal Budget is the only strategic planning tool and control instrument available at the local level. Typically, budgets provide annual statements of receipts and expenses, and are drafted by the Commissioner and reviewed by the Standing Committee (Accounts and Taxation) or the Board for CMCs, TMCs and TPs. Generally, budgets are estimated incrementally based on previous year's values, rather than based on an objective analysis of the cost of delivering a service, or outcomes to be achieved, or the liability accrued from long-term investments. Most budgeting processes are top-down, estimates are really "guesstimates," and proposed budgets are inevitably higher than previous years' values. Budget controls are generally lacking – Bangalore recently introduced a variance system. State and ULB budgets are not linked, despite the fact that state transfers account for a substantial portion of ULB funding.

<sup>28</sup> Housing was bifurcated from Urban Development in 1995.

<sup>29</sup> This section draws heavily upon the World Bank's Karnataka Urban Sector Note, September 2002, and NCRCL, *Public Financial Accountability in Urban Local Bodies in Karnataka*, July 2002.

**Box 2: Bangalore/GOK Memorandum of Understanding**

Bangalore Corporation entered into a 3 year Memorandum of Understanding with the Government of Karnataka in June 2001. Improved performance in fiscal, financial and operational areas are tied to grants for capital works (Rs. 250 Crores) linked to reforms. Key actions include:

- Computerization of accounts
- Establishment of expenditure monitoring systems
- Corpus fund for public private partnerships
- Freezing vacant positions
- Decentralize administration
- Audit of three year backlog of accounts

BMP has achieved 90 percent of its MOU commitments on time. The property tax Self Assessment Scheme has been well received by the public and generated more revenues, municipal accounts have been computerized, and the capital expenditure allocation to municipal wards have been rationalized and linked to revenue enhancements.

Source: World Bank, Karnataka Urban Sector Note, September 2002

An exception is Bangalore, which has introduced a performance budget with the assistance of the Bangalore Agenda Task Force (BATF). In addition, movements such as JANAGRAHA promote participatory budgeting and disclosure of municipal performance. In partnership with the BATF, Bangalore also negotiated a performance agreement with GoK for increased grant funding in return for improved performance in defined areas.

ULB accounts are kept on a cash basis. Not surprisingly, ULBs do not have a clear sense of their liabilities. Municipalities are governed by the Karnataka Municipal Accounting Rules 1965 (KMAR), whereas corporations can adopt their own systems. Among corporations, Bangalore is the only city to have notified its accounting regulation (BMP Accounts Regulation 2001). Considerable variation exists in how transactions are posted; revenue and capital expenses are not always posted uniformly, and State intercept of fund flows are typically unaccounted for. While KMAR specifies the reporting format for accounts, corporations follow their own standards of presentation. Accounting staff in corporations are drawn from the State Accounts Department, whereas in smaller bodies, local staff manage accounts, often without sufficient training nor skills to manage accounts. Other weaknesses in accounting include: non-uniformity in accounting formats, incomplete accounting, lack of self-balancing accounting systems, ineffective reconciliation, and lack of trained staff.<sup>30</sup> BMP and BDA, as well as Tumkur City Municipal Council are undergoing accounting reforms and are beginning to move to fund-based (i.e., modified accrual accounting), implemented with support from BATF and technical assistance from the ADB. Work is underway by USAID/FIRE in developing ULB accounting standards.

ULB accounts are performed by employees of the Karnataka State Accounts Department (KSAD). Audit in Corporations is concurrent and in municipalities it is post audit, conducted by the Local Audit Circle of KSAD. Audit is reported to be fairly regular in the State, although backlogs of up to three years are not uncommon. This issue had been raised by the 1st Finance Commission and regularity is primarily linked to quality of accounting, a function dependent on skilled staff in local bodies. The audit is of transactions (financial) and does not cover technical aspects/ quality issues. There is very little legislative or public oversight of municipal accounting. However recent moves in Bangalore are a first step with regard to disclosure of municipal accounts.

<sup>30</sup> NCRCL, *Public Financial Accountability in Urban Local Bodies in Karnataka*, July 2002

## **CAPACITY AND ACCOUNTABILITY OF COUNCIL MEMBERS AND ULB STAFF**

There are no minimum qualifications nor educational requirements for council members.<sup>31</sup> This has resulted in weak capacity of council members especially in smaller ULBs. Their capacity must be strengthened in order to effectively manage their ULBs, represent the interests of their constituencies, and scrutinize proposals brought forward by the council members and Standing Committees. Training programs do exist for Council members at the beginning of their term. For example, training courses for Council members are offered at the Urban Institute in Mysore.

The one-year term of the Mayors, Deputy Mayors, and Standing Committees in Corporations reduces their ability to carry out their duties effectively. Mayors appear to be ceremonial heads of the ULBs and the Councils, while substantive work in the ULBs is carried out by Commissioners or Chief Officers who are mostly quite capable individuals but whose accountability is to the GoK as the majority of them are from state administrative services. They report to their immediate superior, the District Deputy Commissioner, who is from either the IAS or KAS and also appointed by the GoK. He or she reports to the District Commissioner who in turn reports to the Directorate of Municipal Administration under the Urban Development Department (UDD). Furthermore, Commissioners and Chief Officers are rotated to other Corporations in Karnataka or other state agencies within 1 to 3 years. This impedes continuous implementation of work in ULBs and incentives for Commissioners and Chief Officers to focus more on short-term activities, which could be recognized as their accomplishment while they are in office. Other than the Chief Executives, the municipal administration staff is made up of those who are appointed from the GoK or seconded from the departments at the state level. Most of the management staff is from the IAS or the state services (KAS or KMAS) while a large proportion of the technical staff such as engineers and accountants is recruited from technical services or are seconded from state-level departments. Other officials are municipal staff who are recruited directly or promoted from lower levels or are compassionate employees.

Capacity of local staff is mediocre as staff training opportunities are limited and many of them are compassionate employees. Moreover, there is a mismatch of technical skills at the ULBs. As mentioned by the KUWSDB, ULBs lack engineers with expertise in water supply systems. Hence, engineers with expertise in roads and building have been given the responsibility of maintaining the water supply system.<sup>32</sup> Similar skill deficiencies have been noted in financial management and accounting.

Only larger corporations such as the Bangalore City Corporation (BMP) where efforts have been focused on improving the quality of staff by having a dedicated Human Resource Director and training courses for staff. In the BMP, initiatives have been made to recognize exceptional performances of officials through non-monetary rewards such as publishing recognition in Corporation's newsletter.

## **MONITORING AND EVALUATION OF PUBLIC SERVICE DELIVERY**

There seems to be no systematic monitoring and evaluation for either the performance of the ULBs nor for the projects developed by the Boards and Development Authorities (DA). The Annual Administration report, a report that summarizes ULB performance has not been prepared for many years. The only source of consolidated municipal information is the publication by Bureau of Economics and Statistics. This document provides data, of limited validity, but without analysis or direction on municipal functions. Monitoring conducted by DMA is limited to a review of tax realizations. The use

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<sup>31</sup> The Commissioner of Mysore estimated that about 40 percent of council members are well educated and well informed.

<sup>32</sup> However, it is also mentioned that ULBs can request technical assistance from KUWSDB. However, most ULBs are hesitant to do so and prefer to perform the tasks themselves. (Discussion with the Chairperson of KUWSDB, July 22, 2002).

of the SFC grants are monitored by the SFC. However, they do not monitor service delivery of ULBs, in part because of the paucity of information.

Monitoring of ULBs by state agencies are mainly done through the chain of command, that is, by the Commissioners or Chief Officers reporting to the District Deputy Commissioner to the District Commissioner to the Directorate of the Municipal Administration to the Secretary of the UDD to the Principal Secretary of the UDD and ultimately to the Chief Secretary of Karnataka. In water supply and sewerage development, after the KUWSDB transfers the infrastructure to the ULBs, the formal responsibility for monitoring of the quality of service provision rests with the ULBs.

The Bangalore City Corporation (BMP) has established a task force comprised of stakeholders from different sectors, and has promoted the role of the civil society and academic centers in monitoring public service delivery. The Bangalore Agenda Task Force (BATF) has stakeholders from seven sectors including the private sector.<sup>33</sup> The BATF holds a conference every six months whereby each stakeholder spells out their urban development objectives and how they are to be achieved. This has not only provided collaboration among the stakeholders on urban development efforts, but also created accountability and established clear milestones, which can be publicly monitored.

Academic centers such as the Public Affairs Center issue scorecards on public service delivery. Daily neighborhood surveys of basic public services are done by volunteers (Sumichitra), who are appointed with authority by the BMP. They are not civil servants and do not get paid but there is a status associated with being a Sumichitra.

The media has traditionally been strong in India. For example, in Mysore City Corporation (CC), the media attend Council meetings and report the meetings.

Community based organizations are also important monitoring bodies. In Mysore CC, they work with agencies to develop special programs such as consumer awareness building. They hold the administration accountable for these programs and can bring pressure on the administration

### **TRANSPARENCY OF ULB ADMINISTRATION**

Important actions to improve the transparency of the government administration in Karnataka are the enactment of the Karnataka Transparency Act and the Procurement and Purchase Act. These Acts define new behavioral standards for bureaucrats and are accompanied by strong sanction mechanisms.

The Bangalore City Corporation (BMP) and the Bangalore Metropolitan Region Development Authority (BDA) are in the forefront in terms of promoting transparency of their administrations. The BMP has a Citizen's Charter that outlines the provisions of public services and what citizens can expect from the BMP.

The BDA has long advertised its tenders to contractors both in and outside Karnataka. This competitive bidding process reduced the civil cost from R1.5 million per acre to R1 million per acre. The matching of land allotment to applicant qualification has been computerized. The allotments are made based on the information of applicants for the past 10 years, which have been input into the application database. Successful and unsuccessful applicants' names are posted on a web site. This not only improves the efficiency of the allotment, but also reduces official discretion, which often leads to corrupt practices.

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<sup>33</sup> The seven stakeholders include BMP, the police, metropolitan transportation corporation, WSB, Power, BDA, and Telecomm. Before BATF's efforts, it was uncommon for these stakeholders to work together in solving common problems.

In smaller ULBs, however, there are still concerns of non-transparent actions on part of the municipal administration, Boards, and DA particularly in accounting and procurement procedures.

**Annex Table I.A.1 Karnataka Urban Development Plan Schemes**  
(Rupees in crores)

	9th 5 Year Plan	Annual Plan 2001/02	10th 5 Year Plan
	Outlay	Outlay (RE)	Outlay
<b>Urban Development</b>			
<b>KUIDFC</b>			
1 Karnataka Infrastructure Project (ADB) GIA	80.4	105.0	
2 Karnataka Infrastructure Project (ADB) Loan	229.7	45.0	125.6
3 Karnataka Infrastructure Development & Finance Corp. (Investment)	1.0	0.5	1.3
4 Bangalore MegaCity Project	162.0	33.2	128.5
5 Karnataka Coastal Management & Urban Development		20.0	896.0
6 Karnataka Municipal Development Project (WB)		1.0	666.8
7 Project Development Fund			1.7
Subtotal	473.2	204.7	1819.9
<b>BMRDA</b>			
1 Establishment Charges of BMRDA	2.5	0.5	
2 Preparation of Shelf of Projects	0.2		
3 Bangalore Local Urban Observatory		0.1	0.2
Subtotal	2.7	0.5	0.2
<b>Town Planning</b>			
1 Opening of Town Planning Units	4.1	1.3	
2 Buildings	0.4	0.4	2.8
3 Urban Mapping		1.0	42.8
<b>New Schemes</b>			
4 Traffic Cell (Outsourcing)			4.1
5 Computerisation			1.0
6 Opening of New ADTP offices/additional staff			17.1
Subtotal	4.5	2.7	67.8
<b>Municipal Administration</b>			
1 CSS of Integrated Development of Small and Medium Towns	34.2	7.0	21.4
2 IDSMT - Engineering Cell	0.3	0.1	0.4
3 Grants to ULBs under TFC/EFC recommendations	52.7	25.0	123.7
4 Swarna Jayanthi Shahari Rojgar Yojana (USEP & UWEP)	99.5	40.5	56.5
5 Repayment of Loan & Interest to HUDCO Toward DMA portion	10.0	5.5	23.6
6 Solid Waste Management		1.0	42.8
7 Prevention & Control of Water Pollution			21.4

	9th 5 Year Plan	Annual Plan 2001/02	10th 5 Year Plan
	Outlay	Outlay (RE)	Outlay
8 Computerisation of ULBs			12.9
9 Introduction of Double Entry Accounting System		0.3	4.3
10 Mechanical Cleaning of UGDs of ULBs			6.4
Subtotal	196.6	79.4	313.5
<b>BMRTS</b>			
Transfer of BMRTS Cess to Bangalore Mass Rapid Transit System Fund	117.0	45.5	244.1
<b>Other Urban Development Programme</b>			
1 Bangalore Urban Arts Commission	0.5		
2 Urban Land Ceiling		0.1	0.9
3 Bangalore Metropolitan Task Force	1.0	0.5	
4 BDA Repayment of Loan		20.0	77.1
5 Formation of Ring Roads in Bangalore			
Subtotal	1.5	20.6	78.0
<b>Urban Water Supply</b>			
<b>KUWS&amp;DB</b>			
1 Piped water supply scheme	115.4	15.0	29.0
2 Grants to Urban Water Supply Schemes	186.5	21.8	163.8
3 CSS of Accelerated Urban Water Supply Scheme	62.8	5.0	17.1
4 Plan programmes to be financed by State undertakings out of their own resources outside Budget	48.2		214.2
<b>Sewerage &amp; Sanitation</b>			
1 LIC Sewerage schemes in municipalities/municipal corporations	48.2	6.0	125.1
Subtotal	460.9	47.8	549.1
<b>BWSSB</b>			
1 Cauveri Water Supply Stage IV	134.0	270.0	310.4
2 Replacement of Corroded Pipes at TG Halli	10.0	1.3	4.3
3 Maintenance of borewells in Bangalore	10.0	1.3	12.9
4 Rehabilitation of ground level reservoirs	25.0	0.6	12.9
5 Augmentation of water supply & sewage system in Bangalore with French assistance	16.0	10.0	30.0
6 Scheme for water audit		0.6	0.2
7 Integrated water management to meet additional needs of Bangalore			17.1
8 Improvement of sanitation in newly added areas	5.0	0.8	2.6
<b>New Schemes of X Five Year Plan</b>			
9 Cauveri Water Supply Stage IV - Phase II			85.7
10 Water Rehabilitation projects			264.7

		<b>9th 5 Year Plan</b>	<b>Annual Plan 2001/02</b>	<b>10th 5 Year Plan</b>
		<b>Outlay</b>	<b>Outlay (RE)</b>	<b>Outlay</b>
11	Water Expansion Improvement projects			190.2
12	Sewer conditions surveys & cleaning projects			11.1
13	Sewer rehabilitation projects			86.0
14	IEBR			
	Subtotal	200.0	284.5	1027.9
	<b>Grand Total</b>	1504.5	685.8	4314.7

**Annex Table I.A.2 Monthly Release of SFC Funds to ULBs, September 2002**  
(Rupees in lakhs)

ULB	SFC Amount Released	Arrears Deducted	%
Tumkur	1,363,000	455,000	25.0%
Shidlaghatta	231,000	77,000	25.0%
Chitradurga	1,500,000	365,000	19.6%
Davanagere	5,500,000	1,062,000	16.2%
Bhadravathi	1,400,000	286,000	17.0%
Bannur	274,000	47,000	14.6%
Mandya	927,234	309,000	25.0%
Hassana	1,466,000	489,000	25.0%
Holenarasipura	297,000	99,000	25.0%
Chikkamagalur	1,100,000	275,000	20.0%
Ranibennuru	796,476	265,000	25.0%
Gadag-Betegari	2,900,000	712,000	19.7%
Gajendragad	210,000	70,000	25.0%
Lakshmeshwar	241,000	81,000	25.2%
Indi	150,000	50,000	25.0%
Raichur	2,500,000	634,000	20.2%
Bellary	3,600,000	726,000	16.8%
Hospet	1,800,000	391,000	17.8%
Hubli Dharwad	18,667,000	1,250,000	6.3%
Gulbarga	3,625,000	3,208,000	46.9%
<b>Average</b>			22.0%

Source: Government of Karnataka, Urban Development Department

### Annex Table I.A.3 Regression Estimates to Explain Variation in Expenditures and Revenues Per Capita

Karnataka EXPENDITURE Estimation

Dependent Variable: LOG(EXP\_PC)

Method: Least Squares

Sample: 1 124

Included observations: 95

Excluded observations: 29

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(POP1991)	0.214354	0.040013	5.357166	0.000
LOG(ECONBASE)	0.161905	0.099327	1.630026	0.107
LOG(GRANTS_PC)	0.271489	0.050856	5.338332	0.000
C	2.016653	0.50125	4.023249	0.000
R-squared	0.441682	Mean dependent var		5.499954
Adjusted R-squared	0.423276	S.D. dependent var		0.469078
S.E. of regression	0.356229	Akaike info criterion		0.814708
Sum squared resid	11.54783	Schwarz criterion		0.92224
Log likelihood	-34.69865	F-statistic		23.99651
Durbin-Watson stat	2.641009	Prob(F-statistic)		0

Karnataka REVENUE Estimation

Dependent Variable: LOG(OSR\_PC)

Method: Least Squares

Sample: 1 124

Included observations: 93

Excluded observations: 31

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(POP1991)	0.307031	0.065523	4.685814	0
LOG(ECONBASE)	0.48605	0.160041	3.037031	0.0031
LOG(GRANTS_PC)	0.022637	0.085082	0.266064	0.7908
C	1.654028	0.81907	2.019397	0.0465
R-squared	0.264325	Mean dependent var		4.252785
Adjusted R-squared	0.239527	S.D. dependent var		0.656313
S.E. of regression	0.572338	Akaike info criterion		1.763885
Sum squared resid	29.15383	Schwarz criterion		1.872814
Log likelihood	-78.02067	F-statistic		10.6591
Durbin-Watson stat	1.412774	Prob(F-statistic)		0.000005

## ANNEX II. BACKGROUND INFORMATION ON MUNICIPAL FINANCE AND GOVERNANCE IN MAHARASHTRA<sup>34</sup>

### GOVERNMENT STRUCTURE AND ORGANIZATION

Maharashtra has four categories of Urban Local Bodies (ULBs): 15 Municipal Corporations (MCs), 18 'A' Class Municipal Councils (MC-A), 48 'B' Class Municipal Councils (MC-B), and 163 'C' Class Municipal Councils (MC-C).<sup>35</sup> These ULBs are spread across 6 divisions and 35 districts. Categorization of ULBs is based on population, as shown below in Table II.1. ULBs vary considerably in their population; the largest corporation (Mumbai) has a population of 9.9 million, whereas the smallest C-class municipal council (Panhala) has a population of only 2,968, which would not qualify as a Town Panchayat in Tamil Nadu.

**Table II.1: Population for Maharashtra ULB Categories**

ULB Category	Population Range
Municipal Corporations	Over 300,000
'A' Class Municipal Councils	100,001 - 300,000
'B' Class Municipal Councils	40,001 - 100,000
'C' Class Municipal Councils	25,001 - 40,000

ULBs are governed by four Acts: (i) the Bombay Municipal Corporation Act (1888), (ii) the City of Nagpur Corporation Act (1948), (iii) the Bombay Provincial Municipal Corporations Act (1949), and (iv) the Maharashtra Municipal Councils, Nagar Panchayats and Industrial Townships Act (1965).

As mentioned, Maharashtra's largest ULB -- Brihanmumbai Corporation (BMC) -- has a population of almost 10 million according to the 1991 Census and close to 12 million based on 2001 data. The second largest ULB, Pune Corporation, has approximately 2.5 million inhabitants (based on 2001 Census data). Given its outlier status, to the extent possible, BMC is reported and analysed separately in this chapter.

Municipal administration follows a hierarchical pattern: including the Director of Municipal Administration (DMA), Divisional Commissioners and Ex-officio Regional Directors of Municipal Administration (RDMA) and the District Collectors, who also serve as Deputy Directors of Municipal Administration (DDMA) in districts.

### POLITICAL DECENTRALIZATION

In Maharashtra, the State Election Commission is considered to be reasonably strong, and most ULBs have held second, and in some cases, third local elections since the 74th CAA. Local election processes were subject to litigation regarding the division and reservation of wards shortly after the CAA was passed, but they have grown and matured in the interim. Recently, however, the State Government has dismissed elected local bodies, eg. Dhule MC-A, Bhivandi MC-A, Nagpur MC.<sup>36</sup>

<sup>34</sup> This annex draws heavily on materials provided by Profs. Karthik and Pethe, based in part on their work for the UNDP.

<sup>35</sup> According to the 2001 Census, it has 22 Municipal Councils, 18 'A' Class Municipal Councils, 62 'B' Class Municipal Councils, and 141 'C' Class Municipal Councils (MC-C). However, since the 2001 Census has not yet been officially released, this analysis uses the classification of ULBs prior to the 2001 Census. There are also two Town Panchayats, but these local bodies will not be analyzed in this annex.

<sup>36</sup> UNDP 2002, p.

## ULB STRUCTURE AND COMPOSITION

The Council is the legislative and decision making body of the ULB. Council members are comprised of elected representatives from each ward in the ULB and nominated persons. Councils are elected every 5 years. One-third of council seats are reserved for women, and 25 percent for under-privileged groups; these seats are filled on a rotational basis. This implies that a representative from a ward who is not female nor from an under-privileged group cannot serve as a council member for more than 2 consecutive terms

## FISCAL DECENTRALIZATION

While the fiscal status of ULBs in Maharashtra was assessed in detail in the 1<sup>st</sup> and 2<sup>nd</sup> State Finance Commission Reports, few of its many recommendations have been implemented.

### Expenditure and Revenue Assignment

ULBs are required by their governing Acts to perform obligatory and discretionary functions. At present, major obligatory functions include: Public hospitals and dispensaries, vaccination, epidemic control and prevention of dangerous diseases, medical relief, family planning and welfare etc.:

- Solid waste management
- Drainage and sewerage systems
- Water supply
- Roads, markets, slaughter houses, washing places, drinking fountains, tanks, wells, etc.
- Fire Brigade
- Street Lights
- Disposal of dead bodies
- Primary Schools
- Welfare measures for scheduled casts and tribes, etc.
- Planning for economic and social development
- Urban forestry, protection of the environment and promotion of the ecological aspects
- Discretionary functions include:
- Provision of grants and donations to privately run primary and secondary schools
- Treatment of sewerage and waste
- Transport
- Destruction of harmful animals
- *Slum improvement and up gradation*
- *Urban poverty alleviation*
- *Cattle pounds and prevention of cruelty to animals*
- *Regulation of slaughter houses and tanneries*
- Sanitary dwellings for the poor

In practice, only the six functions listed above in italics have been systematically devolved to ULBs (UNDP Report). The dual assignment of responsibility results in a lack of clarity regarding power of ULBs

### Water Supply and Drainage

ULBs frequently borrow to provide water supply and drainage services, and they are rarely in position to repay those loans. In order to enforce recovery, GoM deducts loan installments from grants admissible to local bodies. Despite this history of weak repayment, there is also typically a substantial deficit between operation and maintenance expenditures for water supply systems and income received. Except for Mumbai and Pune, other ULBs typically operate water supply systems at a loss (see Box 3).

**Box 3: Indicators of Water Supply Efficiency, Selected Corporations in Maharashtra**

Navi Mumbai (“New” Mumbai), Pimpri Chinchwad and Thane generate more water than their prescribed norms, with Mumbai generating the most water. Metering of water supply is uniformly poor in the corporations; Navi Mumbai has the highest ratio of metered to total connections (10 percent), which is low by international standards. Without meters, water charges are collected with the property tax on the basis of rough estimates of water consumption. Despite the fact that Navi Mumbai corporation has the highest per capita expenditure on water as well as the highest per capita revenues collected from water charges, it also exhibits the highest deficit (Rs. 506.)

	Navi Mumbai	Pimpri Chinchwad	Thane
Per capita water availability (liters per day)	255.7	188.8	221.9
Norms adopted for water supply (liters per capita per day)	200	180	180
Number of users per connection	11.9	16.0	20.0
Proportion of metered connections to total (%)	10.5	2.8	4.8
Proportion of total revenue to total expenditure (%)	40.7	16.4	54.7
No. of municipal employees per MLD of water supplied	0.3	2.1	1.6
Number of connections per employee	981.4	158.1	141.1
Total expenditure on water supply per capita (Rs.)	852.3	332.0	402.3
Revenue collected from water charges per capita (Rs.)	346.6	59.3	220.1
(Total expenditure – revenue) per capita (Rs.)	505.7	272.6	182.2

Source: Karnik and Pethe, UNDP Report, Part C.: *Assessment of Revenue and Expenditure Patterns in Local Bodies of Maharashtra*

## Local Revenues

ULBs’ taxing powers include:<sup>37</sup>

- Octroi or Cess on lieu of octroi (only municipal corporations)
- Property Tax
- Vehicle tax, tax on boats or animals
- Sanitary tax upon private latrines cleaned by municipal agency
- Drainage tax
- Water tax
- Educational tax

In practice, ULBs have a very limited autonomy regarding these taxes. Non tax revenues are limited to: parking fees, permit fees, service fees and user charges, rent from buildings and commercial complexes, development fees for granting permission to construct buildings on vacant plot, and other fees and charges etc.

<sup>37</sup> As defined in Section 139 of the BMC Act 1888, Section 127 of the BMC Act 1949, and Section 108 of the Councils Act 1965.

MCs in Maharashtra can levy property tax as a percentage of annual ratable value of the property, and ceilings for such percentages are laid down by the State in three different Acts, as described in Table II.2 below.

Property Tax Component	BMC Act	NMC Act	BPMC Act
General Tax	26	12 – 31	Maximum 12
Fire Brigade Tax	4	1	Maximum 12
Water Tax	65	10 – 15	ULB sets
Water Benefit Tax	12.5	--	ULB sets
Sewerage Tax	39	12 %	ULB sets
Sewerage Benefit Tax	7.5	--	ULB sets
Education Tax	12	2 - 12	Maximum 5
Street Tax	15	--	Maximum 10
BMC=Bombay Municipal Corporation NMC = Nagpur Municipal Corporation BPMC=Bombay Provincial Municipal Corporation Source: UNDP Report, 2002			

BMC has no autonomy regarding the components of the tax nor the property tax rate, while Nagpur has limited autonomy. Other MCs (governed by BPMC) have autonomy in setting tax rates only for water supply and sewerage component of the property tax. No ULB can include new components or redefine the property tax base.

For Municipal Councils, the property tax is levied as a *consolidated* property tax, with different floors and ceilings for the tax rate, defined as a percentage of the annual ratable value, as prescribed in the Maharashtra Municipal Councils, Nagar Panchayats and Industrial Townships Act, 1965. These ceiling are listed in Table II.3.

Council Type	Minimum	Maximum
A	23 %	28 %
B	22 %	27 %
C	21 %	26 %

Though systematic information is not available for the rate of property tax being actually levied by various councils, many of them have reached or are close to the maximum limit.

### State Grants

ULBs receive financing from about 30 state grants, which are listed in different major and minor heads in the State budget. Most of these grants are for specific purposes, although incentive grants are

provided to encourage better performance in collecting water charges and property taxes. The most important of these grants are listed in Table II.4 below:

**Table II.4: Typology of State Grants**

Grant	Recipient	Terms and Conditions
Dearness Allowance Grant	100 percent for MC-B and MC-C 90 percent for MC-A MCs ineligible	100 percent of grant payable if recovery of total demand (including arrears) is 85 percent or more
Grant for reimbursement of salary and leave salary of Chief Officers		Salaries and leave salaries of chief officers are compensated by the State, since chief officers are employees of the State and not of the ULB.
Land revenue and non agriculture assessment grant	All MCs and Councils	75 percent of land revenue 75 percent of non-agricultural revenue collected in their area.
Entertainment Grant	All local bodies; based on entertainment tax collections in area	10 percent for MCs 30 percent for MC-A 35 percent for MC-B 40 percent for MC-C
Stamp Duty Grant	All local bodies	1 percent surcharge on value of sale or mortgage deed
Pilgrim Tax	Trimbak, Alandi, Jejuri, Pandharpur, Tuljapur and Ramtek	Compensation for elimination of local tax
Minor Mineral Grant	MC-Cs	Maximum limit Rs. 500,000
Profession Tax Grant		Compensates those ULBs that levied local profession tax before it was repealed
Road Grant	Local Bodies who collected motor vehicle tax prior to 1958	17.75 percent of net motor vehicle taxes collected in jurisdiction distributed based on population
Octroi Compensation Grant	Non MCs	Octroi for nonMcs was abolished 30 April 1999; 1998-99 collections plus 10 percent annual growth paid as compensation; Paid through March 2004
Primary Education Grant	ULBs	MC-C receive 100 percent of education expenditure MCs receive 50 percent of education

**Table II.4: Typology of State Grants**

		expenditure
Slum Improvement	Some cities	Rs. 800 per capita
Incentive Grant	MCs - Rs. 1 crore each MC-As - Rs. 40 lakhs each MC-Bs - Rs. 25 lakhs each MC-Cs - Rs. 15 lakhs each	MCs and MC-As: Meeting defined targets for water tax coverage of revenue expenditure on operation and maintenance of water supply  MC-Bs: recover 80 percent of total demand (including arrears) of property tax  Increase income other than taxes by 25 percent per year

Many of these grants (e.g., octroi, profession tax, pilgrim, road etc.) *compensate ULBs* for local taxing powers that were repealed. The principles upon which they are distributed are not uniform, and often times are *ad hoc*. This lack of predictability affects the planning the expenditure strategies of ULBs. A Chief Officer from one C Class Council noted that these grants are typically paid at 12 pm on 30 March (i.e., at the last moment of the fiscal year). If a particular ULB does not present its bills to the Treasury, then allocations lapse.

### FISCAL ANALYSIS OF ULBS

The quality of available fiscal data in Maharashtra is poorer than in both Karnataka and in Tamil Nadu, with substantial variation across different data sources.<sup>38</sup> In light of these data limitations, all tables and conclusions drawn below should be interpreted with caution. Where possible, lessons learned from working with the more detailed data in Tamil Nadu are used to shed light on what might be happening in Maharashtra.

**Table II.5: ULB Fiscal Indicators, Per Capita (in Rupees)**

	Per capita revenue			Per capita exp.			Average growth from 1995/96-99/00	
	95/96	97/98	99/00	95/96	97/98	99/00	Rev.	Exp.
	Corporations, excl. BMC	1,059	1,431	1,786	1,101	1,576	2,310	14.0%
Brihanmumbai (BMC)	1,548	1,974	2,763	2,073	2,967	3,811	15.6%	16.4%
Municipal Councils – ‘A’	715	875	1,033	832	1,149	1,590	11.0%	17.6%
Municipal Councils – ‘B’	578	729	912	667	905	1,123	11.7%	13.9%
Municipal Councils – ‘C’	455	597	778	553	661	870	14.3%	12.0%

Source: Data supplied by Profs. Karthe and Pethik

<sup>38</sup> Data sources include: (i) two different data sets covering all 244 ULBs from Profs. Karnik and Pethe, the authors of a widely quoted UNDP report on ULBs in Maharashtra; (ii) data with aggregate categories of Municipal Councils obtained from MMRDA; (iii) Kirloskar Consultants Limited Report (Dec 1998) on Maharashtra’s Urban Infrastructure Fund; and (iv) data collected in Corporations visited by the study team.

As expected, Municipal Corporations and larger Municipal Councils have higher per capita revenues and expenditures. As shown above in Table II.5, in 1999-00, Municipal Corporations (excluding BMC) had per capita revenues (including grants but excluding loans and “other income,” most likely financing items<sup>39</sup>) of Rs. 1,786, and expenditures (including current and capital expenditures) of Rs. 2,310. In contrast, MC-As had per capita revenues of Rs. 1,033 and expenditures of Rs. 1,590 in 1999/00. The small MC-Cs raised only Rs. 778 per capita revenues and spent Rs. 870 per capita in 1999/00. The substantial increase in revenues and expenditures between 1995-96 and 1997-98 reflects the first payment of State Finance Commission grants. Table 18 also shows that in larger ULBs – especially MCs and MC-As – expenditures are growing more rapidly than revenues, and that growth in per capita revenues and expenditures is highest in MCs.

Despite the requirement for a balanced budget, a simple comparison of the difference between total income and total expenditures (see Table II.6) shows that many Municipal Corporations and most Municipal Councils incurred overall deficits between 1995/96 and 1999/00. A significant share of ULBs also incurred *current account* deficits, as shown in the last column.

	Share of ULBs with Overall Deficit (in percent)			# ULBs (prior to 2001 census)	Share of ULBs with Current Deficits
	1995/96	1997/98	1999/00		1999/00
	Municipal Corporations	36%	64%	93%	14
Brihanmumbai (BMC)	100%	100%	100%	1	0%
Municipal Councils ‘A’	89%	83%	78%	18	67%
Municipal Councils ‘B’	77%	85%	90%	48	71%
Municipal Councils ‘C’	79%	66%	71%	163	59%

Source: Data supplied by Profs. Karthe and Pethik

## Types of ULB Spending

ULB expenditure data are generally reported by 12 heads of expenditure; the five most significant of these are: (i) general administration, salaries and pension benefits, (ii) education, (iii) sanitation and solid waste, (iv) water supply, and (vi) other expenditure, which includes, but unfortunately does not list separately, debt service payments.

<sup>39</sup> Based on our experience in working with data from TN, there are some indication that “other income” is “advances and deposits”, and possible also an “opening balance,” and, therefore, should be treated as “financing items.” Moreover, when subtracting both “loans” and “other income”, we are able to get in the proximity of another estimate of our data sources’ “grand total of income from other sources.” In the case of Corporations, there are no entries for “other income” and, thus, our sum total of income sources exceed “total income from all sources.”

As shown in Table II.7, Municipal Corporations (excluding BMC) spend nearly three times as much per capita as Municipal Councils on core services such as water, sanitation, street lights, and roads. Expanding these core services to include education, sanitation, fire brigade, and health generates a category of “local public goods.” BMC also spends the largest per capita amount on local public goods -- Rs. 1,489.

**Table II.7: Spending on Core Services and Local Public Goods (Rupees per Capita)**

	Core services			Local public goods		
	(Water, Street Lights, Roads, Sanitation)			(Education, Sanitation, Fire Brigade, Water, Health, Roads)		
	1995/96	1997/98	1999/00	1995/96	1997/98	1999/00
Corporations, excl. BMC	433	672	966	530	789	1,101
BMC	719	1,087	1,360	781	1,178	1,489
Municipal Councils – ‘A’	310	383	419	366	457	580
Municipal Councils – ‘B’	207	284	370	270	361	463
Municipal Councils – ‘C’	170	189	240	216	248	317

Source: Data supplied by Profs. Karthe and Pethik

However, as a share of total expenditures, BMC spends the most on administration costs and the least on local public goods (Table II.8). Most likely, BMC also spends the largest share on debt service payments.

**Table II.8: Expenditure Profiles of Municipal Corporations and Municipal Councils in 1995/96 and 1999/00 (as a percent of total expenditure)**

	1995/96			1999/00		
	Local public good	Adm.	Others	Local public good	Adm.	Others
	Corporations, excl. BMC	48	19	32	50	18
BMC	37	51	13	40	49	10
Municipal Councils – ‘A’	44	29	27	36	25	39
Municipal Councils – ‘B’	40	33	26	41	30	29
Municipal Councils – ‘C’	39	33	28	36	32	31

Source: Data supplied by Profs. Karthe and Pethik

### Explaining Variations in Current Expenditure<sup>40</sup>

Similar to our analysis in Karnataka and Tamil Nadu, we tried to explain the large variation in current expenditure per capita across ULBs (see Figure II.1). We examined to what extent the variation could be attributed to the following four factors: size, economic base, poverty, and grants per capita. Our prior expectations were that all factors should be positively correlated with expenditure per capita (see

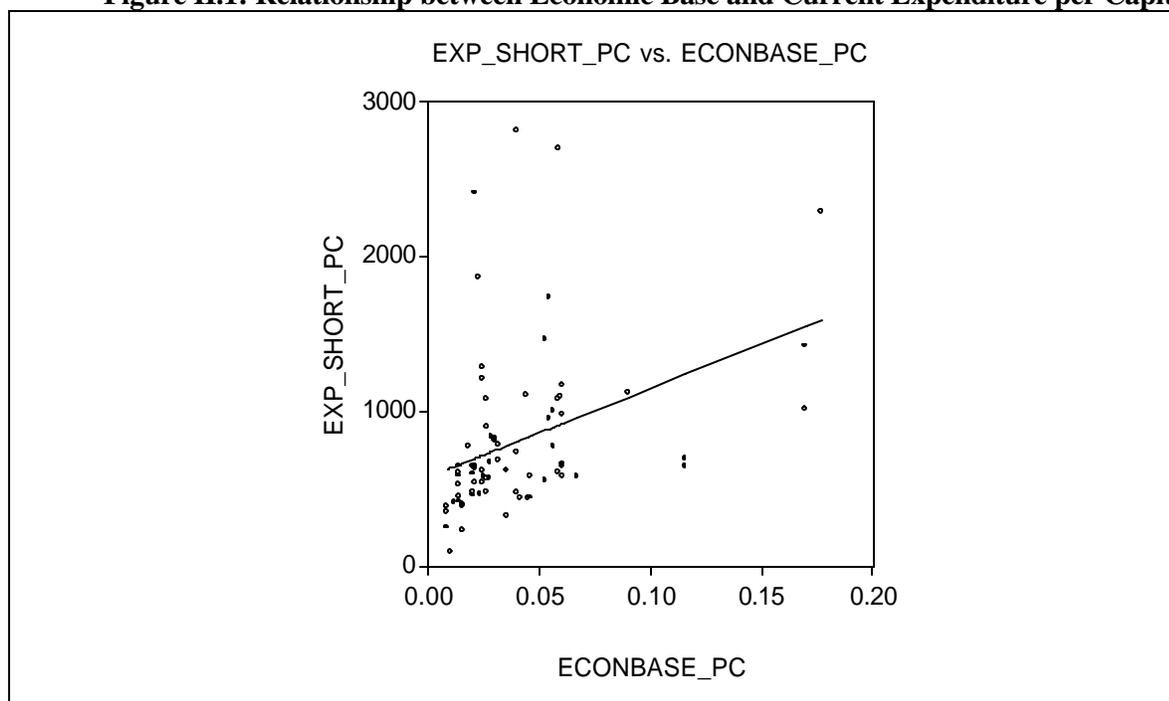
<sup>40</sup> Although data in Maharashtra are not separated into current and capital expenditures, we define “current expenditures” as total expenditures minus expenditures on “roads”, “sanitation and solid waste” and “other expenditures.”

discussion elsewhere). The regression analysis excluded the small Municipal Councils ‘C’, which lack poverty data on those 163 Municipal Councils.<sup>41</sup>

We found a positive and significant relationship between expenditure per capita the economic base (see Figure II.1) and the population size of the ULB. However, we only found weak evidence that the size of the slum population (our measure of poverty) had any relationship to expenditure per capita. In addition, grants per capita also seem to play an insignificant role in explaining the variation in expenditure per capita.

Moreover, when we included dummies for various types of ULBs, the size affect disappeared, suggesting that the size affect may have picked up differences across different types of ULBs.<sup>42</sup> When including ULB classification-dummies, we were able to explain 52 percent of the total variation in current expenditure.

**Figure II.1: Relationship between Economic Base and Current Expenditure per Capita**



## Revenue Mobilization

Table II.9 shows ULB revenue sources by type. *Octroi* is the main source of MC finance, accounting on average for 50 percent of own revenues. Property taxes generate about one-fifth of revenues for all ULBs. Property tax collections account for 49 percent of own source revenue for MC-As compared to only 19 percent for MCs (excl. BMC). State Grants are much more significant for Municipal Councils than Municipal Corporations, and account for 78 percent of current revenue. Loans are relatively small (about 10 percent) in terms of financing, especially for smaller ULBs. For example, loans as a share of current account were only 1.5 percent for MC-Cs in 1995/96.

<sup>41</sup> Specifically, we used census 2001 figures for the total slum population.

<sup>42</sup> Including a dummy for BMC yielded an insignificant coefficient.

**Table II.9: ULB Revenues, 1999-00 (Rupees in millions)<sup>43</sup>**

	Octroi	Prop-erty Tax	Own Source Rev.	Total Grants	Total Curr. Rev.	Loans	% Prope-rtty Tax/ OSR	% OSR/ Total current revenue
Corporations, excl. BMC	10,195	2,906	15,326	1,655	16,982	446	19%	90%
Brihanmumbai (BMC)	13,200	7,461	25,952	1,238	27,190	6,452	29%	95%
Municipal Councils 'A'	175	418	857	2,958	3,816	724	49%	22%
Municipal Councils 'B'	103	358	751	1,889	2,640	38	48%	28%
Municipal Councils 'C'	96	262	642	2,050	2,692	40	41%	24%

As shown below in Table II.10 and II.11, the *octroi* is the most significant source of revenue for Municipal Corporations, accounting for half of own source revenue in the case of BMC and even more for other Corporations.<sup>44</sup> The property tax is the second most important own revenue source, accounting on average for about 20 percent of corporations revenues and almost 30 percent of own source revenue for BMC. Water charges are also significant, and represent about 10 percent of revenues. State grants are notably low in their importance, especially for BMC, where grants only account for 5 percent of total revenue. Since 1995-96, loans have grown in importance and, once again, BMC is in a category by itself. In 1999/00 loans as a share of current revenue was 23.7 percent, compared with only 2.6 percent for the 14 other MCs. Interestingly, for MC-A, loans are playing an increasingly important role. In 1995/96 loans were only 4.8 percent as a share of current revenue but this figure had grown to 19.8 percent by 1999/00.<sup>45</sup>

<sup>43</sup> Current revenue is the sum of "Grant from State Government", "Octroi", "Property tax", "Water charges", "Conservancy and Sanitation", "Street lights", "Licence Fees and Entertainment" and "Building rents". Thus, it excludes "loans" (since they are a financing item), and "other income", presumably consisting of "advances and deposits" (also financing items) and potentially also an "opening balance".

<sup>44</sup>This analysis considers 15 Corporations, as defined prior to the 2001 Census.

<sup>45</sup> However, this is almost entirely due to lending by Jalgaon which was reclassified as a Municipal Corporation in the 2001 Census.

**Table II.10: Distribution of Revenue Sources in Municipal Corporations (excluding BMC)**

Income Source	1995/96	1996/97	1997/98	1998/99	1999/00
Octroi / Own-Source Revenue	72%	75%	71%	69%	67%
Property Tax / Own-Source Revenue	16%	14%	17%	18%	19%
Water Charges/ Own-Source Revenue	9%	8%	9%	10%	11%
Other Revenues*/Own-Source Revenue	72%	75%	71%	69%	11%
Own Source Rev. /Total Revenue	88%	91%	91%	89%	90%
State Govt. Grants /Total Revenue	12%	9%	9%	11%	10%
Loans / Total Revenue	2%	2%	2%	2%	3%

\* Other own revenues include: Conservancy and Sanitation, License Fees & Entertainment, and Building Rents

**Table II.11: Distribution of Revenue Sources in BMC**

Income Sources	1995/96	1996/97	1997/98	1998/99	1999/00
Octroi / Own-Source Revenue	58%	55%	52%	52%	50%
Property Tax / Own-Source Revenue	29%	30%	32%	33%	29%
Water Charges/ Own-Source Revenue	11%	13%	14%	13%	19%
Other Revenues*/Own-Source Revenue	58%	55%	52%	70%	19%
Own Source Rev. /Total Revenue	97%	95%	96%	96%	95%
State Govt. Grants /Total Revenue	3%	5%	4%	4%	5%
Loans / Total Revenue	9%	12%	14%	21%	24%

\*Other Own Revenues include: Conservancy and Sanitation, License Fees & Entertainment, and Building Rents

### Explaining the Variation in Own-Source Revenue

Table II.9 showed that current revenue per capita ranged from Rs. 34 per capita in Patur (MC-C) with a population of 17,398 (1991 Census) to Rs. 3,303 per capita in Pimpri Chinchwad, a MC (in Pune) which has doubled its population size from 517,000 in 1991 to 1 million, according to the 2001 Census. The figures reported in Table II.11 are based on 1991 figures. Once again, since slum population figures for the MC-Cs are not available, the regression analysis focuses on other factors.

In trying to explain the variation in own source revenue per capita (OSR\_PC) we examine a simple model that postulates the following factors as determining own source revenue:

$$OSR\_PC = f(\text{size, economic base, poverty, grants})$$

We expect own source revenue per capita to be positively correlated with size. Moreover, we expect that as the economic base expands, own-source revenue should expand. Finally, we expect ULBs with a large share of poor people to collect less revenue, and that large levels of grants from the state might substitute for own source revenue mobilization (negative coefficient).

Municipal Councils in Maharashtra have a higher degree of autonomy when setting property tax rates. Depending on whether they are a class A, B, or C Municipal Council, they have different ranges in which they can set their rate (see Table II.3). Given the large role property tax revenue plays in own source revenue, part of the variation we are trying to explain comes from Municipal Councils potentially setting different rates.

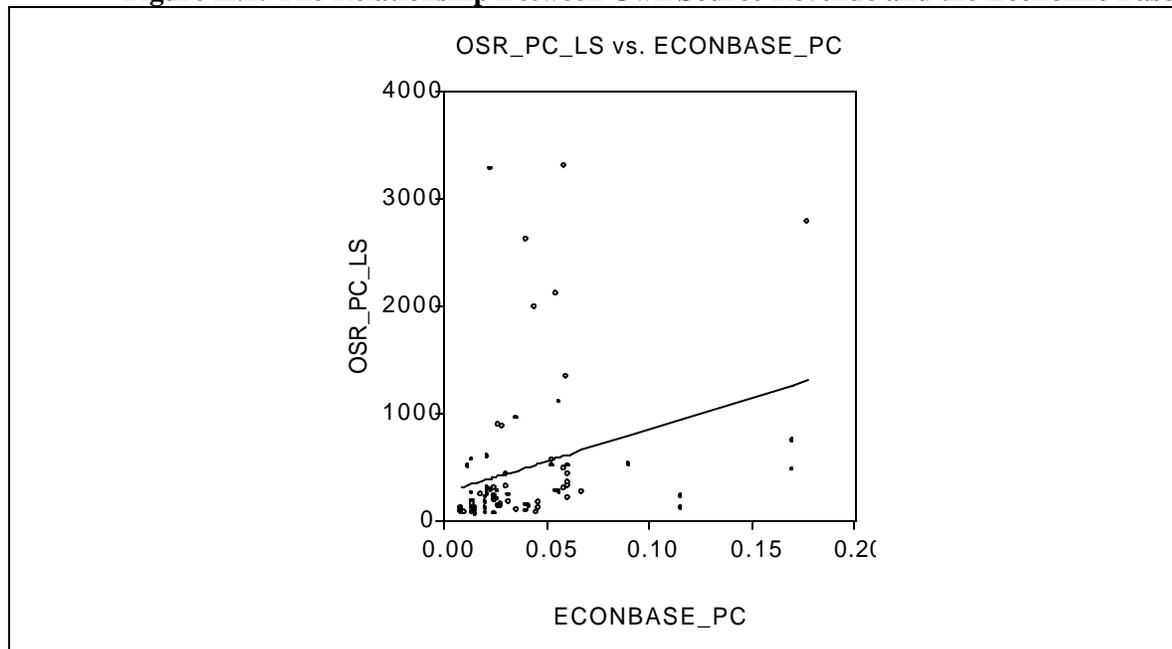
Once accounting for differences in ULB classification (by adding dummies), we find that the model does a good job at explaining the variation in own-source revenues. Specifically, we are able to explain 66 percent of the total variation with all variables affecting own source revenue in accordance

with our prior expectations.<sup>46</sup> Furthermore, only four ULBs (out of our sample of 56) are not well explained in the regression.<sup>47</sup> „<sup>48</sup>

Not surprisingly, three dummies for MC-A, MC-B and BMC are all significant and exhibit the expected signs: MC-As and MC-Bs both collect less than the “control group” (the 14 remaining MCs) with MC-Bs collecting the least per capita. And, as already shown, BMC has a higher per capita revenue than most other MCs. Given that only MCs have access to *octroi*, it is not surprisingly that, on average, they collect more than MC-A and MC-Bs.

More interesting, though, is the findings of a positive statistical relationship between own source revenue and our measure of the economic base, namely, the number of industrial workers per capita.<sup>49</sup> While the visual impression in Figure II.2 may not be the most convincing, the regression analysis suggests that cities with a higher economic base also collect more revenue per capita.

**Figure II.2: The Relationship Between Own Source Revenue and the Economic Base**



### Intergovernmental Grants

Unlike in Tamil Nadu and Karnataka, Municipal Corporations in Maharashtra receive a smaller share of total state grants given to ULBs than their population share. As Table II.12 shows, while Municipal Corporations (excluding BMC) account for 32 percent of the total ULB population, they only

<sup>46</sup> Although the results should be taken with some caution, given the poor data, and sensitivity to which denominator is used (pop 1991 or pop 2001). Moreover, the sample size in Maharashtra is smaller (obs) than in TN and Karnataka, and although we cannot reject that the residuals are normally distributed (using Jarque-Bara’s test), we will replace our asymptotically-based standard errors with bootstrapped ones.

<sup>47</sup> Namely, Navi Mumbai, a MC whose population has more than doubled since the 1991 survey, and Jalgaon, a MC-A which was reclassified as a MC based on 2001 census figures. Both ULBs collected more own source revenue than was predicted by the model. However, it is not surprising given the high population growth in Navi Mumbai which would reduce own source revenue per capita, and given that Jalgaon has been reclassified as a MC (which are controlled for by a dummy with a positive coefficient)

<sup>48</sup> The outliers have been identified as having residuals that lie outside of the 95 percent confidence interval of the residual distribution.

<sup>49</sup> Lacking a proper measure of “income”, we hope that there is a strong correlation between the income of a city and the number of industrial workers in the city. Obviously, one can think of numerous counter examples to this line of thought but it is the best we have been able to find data for.

received 17 percent of total grants in 1999/00. However, the Table also shows that the MCs share of total grants corresponded to their population share in 1995/96. Their declining share of total grants is most likely due to the abandonment of the *octroi* revenue for Municipal Councils, and the subsequent increase in grants to Municipal Councils to compensate them for this loss. However, another factor at work is that we are presenting our analysis in terms of the classifications based on population figures prior to the unreleased 2001 Census. Especially the last column in Table II.12 is distorted by the fact that the largest Municipal Councils 'A' recipient of grants (seven out of 18) have been reclassified as MCs. Thus, the drop in MCs' share of total grants will not be as pronounced as shown in the Table 12.

The fact that Maharashtra is an outlier in this context is perhaps not surprising given that it was the only state covered in this analysis that still allows Corporations to use *octroi*. As a result, as can be seen in Tables II.10 and II.11, Corporations raise more than 90 percent of their resources from own sources (compared with less than 40 percent in Karnataka and 57 percent in Tamil Nadu).

**Table II.12: ULB Grants**

	Grants per Capita (Rupees)			Share of Total Grants			Share of Pop.
	95/96	97/98	99/00	95/96	97/98	99/00	1991
Corporations, excl. BMC	122	132	175	33%	28%	17%	32%
Brihanmumbai (BMC)	51	84	125	14%	18%	13%	34%
Municipal Councils 'A'	146	197	801	15%	16%	30%	13%
Municipal Councils 'B'	211	258	652	17%	17%	19%	10%
Municipal Councils 'C'	205	272	592	20%	21%	21%	12%
Total	120	153	333	100%	100%	100%	100%

### Central Finance Commission Grants

Following the passage of the 73rd and 74th CAA, one of the first important steps towards creating more autonomy for local bodies was taken by the Tenth Finance Commission (TFC). The TFC issued the recommendation to transfer a total of Rs. 53,809 million in four yearly grant installments to local bodies in India. For ULBs, Rs. 10,000 million were set aside out of these funds. The inter-state distribution of this amount was to be based on the ratio of slum population to the total urban population. Maharashtra received the highest allocation on this count of Rs. 1,329.5 million, i.e., 13.3 percent.<sup>50</sup> The State was to receive these funds in yearly installments (of Rs. 332.4 million) from the Central government starting in 1996/97 (see Table II.13)

**Table II.13: Devolution of TFC grants to ULBs (millions)**

Fiscal Year	Grants Received from Central Government	Matching Grants	Total Grants available for ULBs	Actual Release to ULBs	Funds Retained by the State Government (cumulative)
1996-97	332.4	0	332.4	63.2	269.2
1997-98	332.4	0	332.4	308.8	292.8
1998-99	332.4	0	332.4	43.5	581.7
1999-00	0	0	0	354.3	227.3
2000-01	0	0	0	227.3	0
<b>Total</b>	<b>997.2</b>	<b>0</b>	<b>997.2</b>	<b>997.1</b>	<b>0</b>

The TFC's recommendations were accepted by the Central Government subject to the following conditions: first, the funds were not to be withheld by the State for any reasons. Second, the TFC funds had to be matched by either the State or by the ULB. In case of inability of any ULB to provide for matching contribution, the State Government was expected to provide for the balance of funds.

In 1996/97, the first installment was transferred from the Central Government to the State of Maharashtra. The State failed to raise matching grants, and did not transfer the grants to ULBs. Because of the accumulated funds with the State government for previous years and its reluctance to provide matching grants to ULBs, the Central government did not release the committed grant of Rs. 332.4 million for the year 1999-2000, the last year of Tenth Finance Commission (TFC).

<sup>50</sup> UNDP (2002), p. B-5

Karthik and Pethe (UNDP, 2002) show that, despite the predictable allocations from the Central Government, the devolution of TFC grants to ULBs was “haphazard,” rather than timely and predictable. Surprisingly, TFC releases were made directly from the State to the ULBs without the involvement of intermediate institutions; this may have strained the absorptive capacity of ULBs.<sup>51</sup>

BMC, Thane, Nagpur and Pune did not receive any TFC allocation. Similarly, many small ULBs did not receive any allocations either.

### **State Finance Commission Grants**

The First Maharashtra State Finance Commission (MSFC) classified the needs of ULBs as current (or “revenue”) and capital needs. Revenue needs consist of committed expenditure, expenditure on maintenance, and repair of existing services and infrastructure and loan repayment, while capital needs refer to the need to create, improve and expand infrastructure, public amenities and services.

The grants earmarked to help ULBs meet their current expenditure needs are numerous and not straightforward to calculate and predict (see Table II.14.) Data are not available to demonstrate the extent to which a ULB in Maharashtra can or cannot predict the amount of grant funding it will get. However, Municipal Council officials complained about liquidity problems and noted that transfers were often made at the end of the fiscal year after expenses had been incurred.

### **BORROWING CAPACITY OF ULBS**

As mentioned, loans are relatively small in terms of financing, and are concentrated within Corporations. Still, as Table II.14 shows, approximately half of the ULBs in Maharashtra have borrowed since 1995/96.

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<sup>51</sup> Karthick and Pethe (UNDP report) note that most funds were released in the last month of each financial year. While delays could have been due to pending information from the ULBs about utilization of earlier funds, matching contributions (from the ULBs) etc., they may also reflect a lack of state credibility in releasing the funds in a timely and predictable way.

**Table II.14: Share of ULBs that Borrowed in 1995/96, 1997/98 and 1999/00<sup>52</sup>**

	Share of ULBs with “loans” recorded as a source of income			Loans (% of current rev.)
	1995/96	1997/98	1999/00	1999/00
Corporations, excl. BMC	50%	50%	36%	3%
Brihanmumbai (BMC)	100%	100%	100%	24%
Municipal Councils ‘A’	56%	67%	56%	19%
Municipal Councils ‘B’	60%	58%	44%	1%
Municipal Councils ‘C’	46%	43%	30%	1%
Total	50%	48%	35%	14%

Unfortunately, data limitations preclude a more detailed description of existing debt profile. Given the large share of ULBs with outstanding debt, further investigation of these liabilities should be undertaken, especially with regard to the composition of debt, potentially overdue debt, and the decomposition of debt service into interest and principal payments. Given the large amount of debt and non-debt liabilities (such as yearly amounts of salaries withheld, cesses collected but not remitted, or arrears on debt service payments) reported in data in Tamil Nadu, it would be worthwhile to assess these liabilities in Maharashtra as well.

The total borrowing capacity of ULBs in Maharashtra has been estimated as follows. First, only those ULBs that have a revenue surplus after meeting current revenue expenditures (including debt servicing) have been considered to have capacity to borrow, since they could service debt out of such surpluses. To estimate borrowing potential, current surplus levels were assumed to continue for 15 years, and it was further assumed that only half of these surpluses would be available for fresh debt servicing obligations. These “surplus cashflows” have then been discounted at an assumed rate of 12 percent per annum to arrive at a Net Present Value (NPV); the total amount a ULB would be able to borrow today and be able to comfortably service over the next 15 years.

This analysis for Maharashtra is greatly complicated by the fact that data are not clearly separated into current and capital expenditures. The results of the indicative assessment of the borrowing capacity of all 244 ULBs in Maharashtra based on 1999/00 data are summarized in Table II.15. Interestingly, by these criteria, BMC would be unable to borrow, whereas more than half of municipal corporations have some borrowing capacity, and about one-third of municipal councils have some borrowing capacity (see Table II.15).

<sup>52</sup> In the analysis on Karnataka and Tamil Nadu, we were also able to get a sense of how many ULBs were borrowing by looking at the share of ULBs with debt expenditures. In both cases, we found that the share that reported borrowing (i.e., they reported “loans” as a source of income) were much less than the share of ULBs who reported having debt service expenditures. Thus, it is likely that if we had access to debt service expenditures, we would find that more ULBs in Maharashtra have borrowed in the past.

**Table II.15 Borrowing Capacity Assessment**

Category of ULBs based on Grade	Number of ULBs	After including loans taken during the year		
		Number of ULBs with borrowing capacity	As a % of number of ULBs	Aggregate Borrowing Capacity (thousands Rupees)
Municipal Corporations	14	8	57%	6,376,654
Brihanmumbai (BMC)	1	0	0%	0
Municipal Councils 'A'	18	5	28%	797,892
Municipal Councils 'B'	48	14	29%	1,093,184
Municipal Councils 'C'	163	63	39%	1,354,041
Total	244	90	37%	8,267,730

Of the 63 ULBs deemed capable of borrowing additional funds, 40 would be able to borrow \$100,000 and 26 would be able to borrow \$1 million.

**Table II.16 Number of ULBs who Could Borrow above Threshold Values**

	Number of ULBs	(\$100 thousand)		(\$1 million)
		Rs. 1	Rs. 4,716 thousand)	Rs. 47,158 thousand)
Municipal Corporations	14	8	8	8
Brihanmumbai (BMC)	1	0	0	0
Municipal Councils 'A'	18	5	5	4
Municipal Councils 'B'	48	14	14	7
Municipal Councils 'C'	163	63	40	7
<b>Total</b>	<b>244</b>	<b>90</b>	<b>67</b>	<b>26</b>

## BUDGETING AND FINANCIAL MANAGEMENT

ULB accounts are kept on a cash basis. Not surprisingly, ULBs do not have a clear sense of their liabilities. Moreover, already in 1998, the Maharashtra Urban Infrastructure Fund report (Kirkoskar Consultants, 1998) noted as a major issues relating to municipal accounting that “there is a general mix up of current and capital works, especially in municipalities.” Also, they noted that the “absence of information on liabilities constrains assessment of credit worthiness of the local body, as the current [overall] surpluses are mandatory surpluses.”<sup>53</sup>

Given the present disarray in ULBs' accounts and financial procedures, it is urgent that the State government formulate an ordinance and make provision regarding practical implementation of uniform practices vis-à-vis the maintenance of accounts and their survey and audit. Apart from changing and/or making rules and regulations in this regard, it is also necessary to train ULB staff to improve their accounts, and until they are trained, perhaps even private parties may be contracted.

<sup>53</sup>In our data set, a large number of ULBs have overall deficits.

## ADMINISTRATIVE DECENTRALIZATION

### ULB STAFFING

Wages and salaries of ULBs are governed by state guidelines. The Pay Commission, Finance Department, Cabinet and Department of Public Administrative Reform determine personnel guidelines. Wages and salaries currently account, on average, for 25 percent of total expenditure for Municipal Council 'A', and slightly more for the other types of Municipal Councils (see Table II.17). As mentioned earlier, BMC spends the largest share of total expenditures on administrative costs while the remaining Corporations spend the least, only 18 percent of total expenditure is spend on administrative costs. Wages and salaries are typically paid out of the State Finance Commission grants.

**Table II.17: ULB staffing<sup>54</sup>**

	Per capita Adm. Costs			Adm. costs/total exp.		
	95/96	97/98	99/00	95/96	97/98	99/00
Corporations, exc l. BMC	210	284	389	19%	18%	18%
Brihanmumbai (BMC)	1,067	1,449	1,836	51%	49%	49%
Municipal Councils – 'A'	244	316	392	29%	28%	25%
Municipal Councils – 'B'	221	280	336	33%	31%	30%
Municipal Councils – 'C'	182	233	280	33%	35%	32%

Key staffing challenges for ULBs are the significant number of vacancies, poor qualifications of many staff, the declining pool of experienced staff due to looming retirements over the next five years and lack of direct recruitment, and significant mismatch of skills, especially in technical areas.

### MONITORING AND EVALUATION OF PUBLIC SERVICE DELIVERY

There seems to be no systematic monitoring and evaluation for either the performance of the ULBs nor for the projects developed by the Boards and Development Authorities (DA). The Annual Administration report, a report that summarizes ULB performance has not been prepared for many years. The only source of consolidated municipal information is the publication by Bureau of Economics and Statistics. This document provides data, of limited validity, but without analysis or direction on municipal functions. Monitoring conducted by DMA is limited to a review of tax realizations. The use of the SFC grants are monitored by the SFC. However, they do not monitor service delivery of ULBs, in part because of the paucity of information.

Monitoring of ULBs by state agencies are mainly done through the chain of command, that is, by the Commissioners or Chief Officers reporting to the District Deputy Commissioner to the District Commissioner to the Directorate of the Municipal Administration to the Secretary of the UDD to the Principal Secretary of the UDD and ultimately to the Chief Secretary.

### TRANSPARENCY OF ULB ADMINISTRATION

An important action to improve the transparency of the government administration in Maharashtra are introduction of the Right to Information Bill to the State Assembly.

<sup>54</sup> Total administrative costs equal "General Administration, Salaries, Pension & Pensionary Benefits etc."

## Annex

## Expenditure analysis

## List of data used

EXP\_SHORT\_PC: Current expenditure defined as total expenditures minus “roads” and “sanitation”, most likely mostly capital expenditures.

ECONBASE\_PC: Number of industrial employees per capita (from the Annual Survey of Indian Industries).

POP1991: Census 1991 population figures

PROP\_PC: Number of assessed properties per capita

SLUM\_PC: Slum population per capita, census 2001 figures

GRANTS\_PC: Grants per capita

Annex Table II.A.1 Descriptive statistics of data used in expenditure regression

	Dependent				
	Expend.	Econbase	Slum	Grants	Pop91
Mean	623.4	0.045	0.317105	607.9729	120471.5
Median	559	0.03	0.302378	535.7199	27692
Maximum	2812	0.404	1.003078	2257.059	9910000
Minimum	88.11	0.008	0.021117	28.40704	2968
Std. Dev.	401.3	0.044	0.191485	320.1948	655871.8
Skewness	2.427	3.616	0.925996	1.279328	13.82233
Kurtosis	11.42	23.61	4.193572	5.98255	205.3195
Jarque-Bera	959.7	4493	12.54076	156.9969	423923.5
Probability	0	0	0.001892	0	0
Observations	244	226	62	244	244

**Correlation Matrix**

	Econbase	Slum	Grants	Pop91
Expend.	0.38	0.00	-0.12	0.53
Econbase	1.00	-0.06	0.07	0.02
Wage	-0.01	0.19	0.29	0.12
Slum	-0.06	1.00	-0.06	0.20
Grants	0.07	-0.06	1.00	-0.26
Pop91	0.02	0.20	-0.26	1.00

**Annex Table II.A.2 Expenditure Regressions**

Maharashtra EXPENDITURE Estimation

Dependent Variable: LOG(EXP\_SHORT\_PC)

Method: Least Squares

Sample(adjusted): 1 243

Included observations: 56

Excluded observations: 187 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(POP1991)	0.215142	0.067153	3.203758	0.0023
LOG(ECONBASE_PC)	0.356282	0.084297	4.226495	0.0001
LOG(GRANTS_PC)	-0.019944	0.095734	-0.20833	0.8358
LOG(SLUM_PC)	-0.024595	0.084639	-0.290585	0.7725
C	5.307088	1.320288	4.019644	0.0002
R-squared	0.447787	Mean dependent var		6.568936
Adjusted R-squared	0.404476	S.D. dependent var		0.551882
S.E. of regression	0.425889	Akaike info criterion		1.215768
Sum squared resid	9.250437	Schwarz criterion		1.396602
Log likelihood	-29.04149	F-statistic		10.33893
Durbin-Watson stat	1.703043	Prob(F-statistic)		0.000003

**With dummies**

Dependent Variable: LOG(EXP\_SHORT\_PC)

Method: Least Squares

Sample(adjusted): 1 243

Included observations: 56

Excluded observations: 187 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(POP1991)	0.271051	0.150335	1.802975	0.0778
LOG(ECONBASE_PC)	0.348249	0.076148	4.573309	0.0000
LOG(GRANTS_PC)	0.167638	0.118888	1.410053	0.1651
LOG(SLUM_PC)	0.019423	0.077547	0.250467	0.8033
ADUMMY	-0.247397	0.310119	-0.797747	0.4290
BDUMMY	0.126855	0.420190	0.301899	0.7641
BMC	0.547228	0.577131	0.948188	0.3479
C	4.378004	2.011314	2.176689	0.0346
R-squared	0.589089	Mean dependent var		6.568936
Adjusted R-squared	0.519147	S.D. dependent var		0.551882
S.E. of regression	0.382695	Akaike info criterion		1.063067
Sum squared resid	6.883404	Schwarz criterion		1.388570
Log likelihood	-20.76588	F-statistic		8.422510
Durbin-Watson stat	1.562588	Prob(F-statistic)		0.000001

## Large sample (dropping slum\_pc where obs are missing for MC-C)

Dependent Variable: LOG(EXP\_SHORT\_PC)

Method: Least Squares

Sample: 1 244

Included observations: 226

Excluded observations: 18

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(POP1991)	-0.006322	0.059888	-0.105570	0.9160
LOG(ECONBASE_PC)	0.186784	0.036575	5.106875	0.0000
LOG(GRANTS_PC)	0.596386	0.059805	9.972120	0.0000
ADUMMY	-1.491224	0.196588	-7.585513	0.0000
BDUMMY	-1.426491	0.212677	-6.707322	0.0000
CDUMMY	-1.724979	0.255069	-6.762781	0.0000
BMC	0.953456	0.446858	2.133690	0.0340
C	4.492371	0.915762	4.905610	0.0000
R-squared	0.531406	Mean dependent var		6.259548
Adjusted R-squared	0.514131	S.D. dependent var		0.561883
S.E. of regression	0.391657	Akaike info criterion		1.002145
Sum squared resid	33.28668	Schwarz criterion		1.138361
Log likelihood	-104.2424	F-statistic		30.76098
Durbin-Watson stat	1.792142	Prob(F-statistic)		0.000000

**REVENUE ANALYSIS****List of data used (log is the natural log (ln))**

OSR\_PC\_LS: Own source revenue per capita.

ECONBASE\_PC: Number of industrial employees per capita (from the Annual Survey of Indian Industries).

POP1991: Census 1991 population figures

PROP\_PC: Number of assessed properties per capita (as a potential candidate for the “economic base”)

SLUM\_PC: Slum population per capita, census 2001 figures

BMC: Dummy for BMC

ADUMMY, BDUMMY: dummies for MC-A and MC-B

**Annex Table II.A.3 Revenue regression (current revenue per capita)****Descriptive statistics**

	<b>Dependent</b>		<b>Regressors</b>		
	OSR_PC_LS	POP1991	ECONBASE per capita	SLUM_PC	PROP_PC
Mean	301	121,669	0.04	0.32	0.20
Median	177	27,659	0.03	0.29	0.19
Maximum	3303	9,910,000	0.40	1.00	0.40
Minimum	34	2,968	0.01	0.02	0.03
Std. Dev.	449	661,267	0.04	0.19	0.06
Skewness	5	14	3.72	0.96	0.65
Kurtosis	26	202	24.91	4.18	3.92
Jarque-Bera	6246	403,290	4,953	12.37299	25.46912
Probability	0	0	0	0.002057	0.000003
Observations	240	240	222	59	240

**Correlation matrix**

	OSR_PC_LS	POP1991	ECONBASE_PC	SLUM_PC	PROP_PC
OSR_PC_LS	1.00				
POP1991	0.46	1.00			
ECONBASE_PC	0.28	0.02	1.00		
SLUM_PC	0.01	0.19	-0.05	1.00	
PROP_PC	0.30	-0.36	0.15	0.02	1.00

Maharashtra REVENUE Estimation  
 Dependent Variable: LOG(OSR\_PC\_LS)  
 Method: Least Squares

Sample(adjusted): 1 243  
 Included observations: 56  
 Excluded observations: 187 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(POP1991)	0.443091	0.100955	4.388975	0.0001
LOG(ECONBASE_PC)	0.374297	0.12673	2.953508	0.0047
LOG(SLUM_PC)	-0.391543	0.127243	-3.07712	0.0034
LOG(GRANTS_PC)	-0.52386	0.143924	-3.63984	0.0006
C	4.3493	1.984875	2.191221	0.033
R-squared	0.661502	Mean dependent var		5.712654
Adjusted R-squared	0.634953	S.D. dependent var		1.059708
S.E. of regression	0.640266	Akaike info criterion		2.03118
Sum squared resid	20.90699	Schwarz criterion		2.212015
Log likelihood	-51.87305	F-statistic		24.9164
Durbin-Watson stat	1.760763	Prob(F-statistic)		0

#### Own source revenue and current expenditure per capita (1999/00)

# of ULBs		Own source rev./capita				Expenditure/capita			
		Mean	Std.	Min	Max	Mean	Std.	Min	Max
14	Corporations, excl. BMC	1,628	944	505	3,303	1,256	678	406	2,700
1	Brihanmumbai (BMC)	2,619				2,797			
18	Municipal Councils 'A'	232	174	88	732	752	505	320	2,411
48	Municipal Councils 'B'	263	162	53	741	701	303	88	1,460
163	Municipal Councils 'C'	195	134	34	966	519	269	101	1,906

## ANNEX III. BACKGROUND INFORMATION ON MUNICIPAL FINANCE AND GOVERNANCE IN TAMIL NADU

### GOVERNMENT STRUCTURE AND ORGANIZATION

Tamil Nadu has 6 Corporations and 102 Municipalities.<sup>55</sup> Municipalities are divided into four categories (Grade I, II, Selection Grade and Special Grade) based on the average of their total income in the past few years, as shown below in Table III.1. Moreover, municipalities must have a population above 30,000 but less than 1 million.

**Table III.1: Classification of ULBs in Tamil Nadu**

		Classification Criteria		
		Population	Average Annual Income (Rs. Thousands)	Average population <sup>56</sup>
102	Municipalities			
	25	Grade II	>30,000	>5,000
				37,132 (13,578)
	36	Grade I		>10,000
				63,871 (15,661)
	28	Selection Grade		>20,000
				109,351 (52,819)
	13	Special Grade		>50,000
				179,370 (93,028)
			>1,000,000	>500,000
				1,186,667 (1,325,728)
	6	Corporations		

Source: Second State Finance Commission, Tamil Nadu<sup>57</sup>

As a result of classifying municipalities by average income, population size varies largely within each class (the standard deviation is included in Table III.1 in parentheses). For example, the largest Grade I municipality, *Aruppukottai*, has 93,820 inhabitants while the smallest, *Sathyamangalam*, has only 34,000 inhabitants.

Municipalities are located within 27 districts. Districts differ widely in the average population and income of their municipalities. For example, *Madurai* Corporation, and three Grade II-municipalities with an average own-source revenue per capita of only Rs. 159, are located in *Madurai* District. In contrast, four large municipalities and a corporation are located in *Coimbatore* District, where the average own-source revenue for these municipalities is Rs. 519, more than three times that of the *Madurai* municipalities. The classification of municipalities seems to be of little relevance in terms of devolution of funds, independence, or numbers of Council members.

Prior to the passage of the 74<sup>th</sup> Constitutional Amendment Act (CAA), Urban Local Bodies (ULBs) in Tamil Nadu were governed by the provisions of District Municipalities Act 1920, and Madras District Local Boards Act 1920 (and amended in 1950). Local elections were not held for the 16-year period prior to 1986, and after these elections were held, they were not conducted again in 1991, the next

<sup>55</sup> The Second State Finance Commission (SSFC) suggests including Town Panchayats as part of “urban” Tamil Nadu. However, due to limited available data on Town Panchayats, our analysis focuses on 102 Municipalities and 6 Corporations.

<sup>56</sup> Population figures are estimates of the population in 2000 made by the Municipalities and reported in the SSFC report. For the 6 Corporations, population figures are from the 1991 Census.

<sup>57</sup> SSFC’s recommendations for new classification norms are discussed in Chapter IX of the SSFC report.

round of the election cycle. After passage of the CAA in 1994, the Government of Tamil Nadu (GoTN) amended the District Municipalities Act and the Municipal Corporations Acts. The first election of ULBs, as per the 74<sup>th</sup> CAA, was held in October 1996. Elections have been held at regularly scheduled intervals since that time.

Each ULB is divided into council wards, which are equivalent to administrative wards, with one elected councilor per ward. Chennai Corporation has the most wards – 155, whereas other corporations have about 60 wards, and municipalities have between 30 to 40 wards. The Mayor in each corporation is directly elected, and serves a five-year term. Commissioners of corporations are appointed by GoTN; and as is common in other states, Commissioners frequently rotate their positions. Over the past two years, Chennai Corporation, for example, has had five Commissioners.

The Tamil Nadu Urban Local Bodies (TNULB) Act (1998) integrates all of the previous ULB Acts, within one comprehensive legislation that would apply to all Corporations, Municipalities and Town Panchayats. The GoTN enacted the Act in 1998, and it was assented by the President of India in 1999. The Rules governing this Act were framed and approved in July 2000, however, the Act and Rules have not yet been notified by the Government, and are still being deliberated.

Many of the recommendations of the First State Finance Commission Report were implemented by the Government. GoTN is also one of the few states to have finalized and issued the report of the Second State Finance Commission, which was issued in May 2001 and is under deliberation.<sup>58</sup>

### **EXPENDITURE AND REVENUE ASSIGNMENT**

State-local relations in Tamil Nadu are described by the Second State Finance Commission (SSFC) as “inextricably intertwined and their respective roles are not clearly defined” (SSFC Report, p.9). For example, the Chennai Municipal Development Authority is responsible for designing, funding and implementing local civil projects that ULBs are then expected to operate, maintain and repay. This muddled nature impedes accountability in many ways. Concurrent expenditure assignments prevent the average citizen from understanding which body is responsible for which service, and thereby holding an entity accountable for its performance or the quality of public services provided. Joint responsibility across various entities, often without coordination, separates the decision maker (often a State entity), from the financier, the service deliverer, and the ultimate beneficiary, often resulting in infrastructure and services that do not match local preferences and needs. ULBs rely to a high degree on state revenues, which often are not paid on time nor in full, missing the opportunity to align local costs (i.e., taxes and fees) with local benefits.

In addition, most local revenue sources are controlled by the State Government, with little autonomy granted to ULBs.

The major expenditure responsibilities for ULBs include general administration, water supply and drainage, public works and roads, street lighting, public health and conservancy, town planning, education and other miscellaneous items. ULB responsibilities for education are predominantly in maintaining school buildings.

### **FINANCIAL ANALYSIS**

The most recent, detailed fiscal data are from Second State Finance Commission (SSFC) report, and cover the years 1995-96 through 1999-00.<sup>59</sup> As expected, larger ULBs have higher per capita

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<sup>58</sup> See *Report and Recommendations of Second State Finance Commission of Tamil Nadu*, May 2001.

revenues and expenditures, and, since Fiscal Year 1995/96, both municipalities and corporations have seen current expenditures grow more rapidly than current revenues (see Table III.2).

**Table III.2: ULB Fiscal Indicators, Per Capita (Rupees)<sup>60</sup>**

	Per Capita Revenue			Per Capita Expenditure			Average Growth from 1995/96-99/00	
	95/96	97/98	99/00	95/96	97/98	99/00	Rev.	Exp.
<b>Municipalities</b>	<b>250</b>	<b>415</b>	<b>520</b>	<b>229</b>	<b>316</b>	<b>482</b>	<b>20.1%</b>	<b>20.4%</b>
Grade II	156	312	359	159	253	365	23.1%	23.0%
Grade I	207	368	454	197	288	425	21.7%	21.2%
Selection	236	412	488	217	311	478	19.9%	21.8%
Special	348	506	691	304	375	589	18.7%	17.9%
<b>Corporations</b>	<b>484</b>	<b>699</b>	<b>949</b>	<b>314</b>	<b>484</b>	<b>743</b>	<b>18.3%</b>	<b>24.1%</b>

Source: Second State Finance Commission, Tamil Nadu

Table III.3 shows that, as a whole, the 102 municipalities in Tamil Nadu have been running surpluses on their current accounts. When capital expenditures are included, municipalities have been running deficits since 1998/99 (see “Overall balance” in Table III.3). Significant devolutions of funds under the First State Finance Commission created a large overall surplus in 1997/98 which was partly used to build up reserves in municipalities’ bank accounts, and possibly also to pay off arrears.<sup>61</sup> As expenditures -- especially for capital and debt service -- accelerated in the following years, deficits grew to Rs. 358 million and Rs. 643 million in 1998/99 and 1999/00, respectively.<sup>62</sup> All types of municipalities incurred deficits of about the same magnitude (approximately 13-16 percent) relative to current revenues.

<sup>59</sup> The report also contains preliminary budget estimates for 2000-01 and projection until 2006-07. In this analysis, we focus on the audited figures which include the figures for 1999-00.

<sup>60</sup> Total revenues are total current revenues and total expenditures are total receipts (current) expenditures. “Advances and deposits” and the “opening balance” are excluded (and counted as financing items, see Table 3). Municipalities’ estimates of the population in 2000 have been used and 1991 census figures for the Corporations. SSFC also contains a table with “annual per capita income and expenditure 99/00” (table 8 on page 97). However, it is unclear which categories of income and expenditure are included and which population estimates are used.

<sup>61</sup> As suggested by a large increase in the “opening balance” of their financial statements for 1998/99. The opening balance jumped from Rs. 747 million in 1997/98 to Rs. 1 billion the following year.

<sup>62</sup> Ideally, debt service expenditures should be divided into interest payments and principal repayments with interest payments counted as a current expenditure and principal repayments as a financing item (below the line). Unfortunately, the data do not allow splitting up “debt service payments.” As a result, the deficits reported above over-estimated. In fact, it is possible that the increase in “debt service payments” in 1998/99 was due to accelerated repayment of debt. Unfortunately, the stock of debt is only available as of 31 March 2000, so we cannot try to match stocks and flows.

**Table III.3: Fiscal Accounts, Tamil Nadu Municipalities (Rupees in millions)**

	95/96	96/97	97/98	98/99	99/00
Current Revenues	2,156	2,603	3,575	3,720	4,482
Own-Source	1,517	1,630	1,892	1,867	2,755
Current Expenditures	1,976	2,269	2,722	3,424	4,153
Establishment	1,025	1,139	1,330	1,712	1,862
<b>Balance of Current Account</b>	<b>180</b>	<b>334</b>	<b>854</b>	<b>297</b>	<b>328</b>
Capital Receipts	85	223	327	519	507
Capital Expenditures	372	485	878	1,174	1,478
<b>Balance of Capital Account</b>	<b>-286</b>	<b>-261</b>	<b>-551</b>	<b>-655</b>	<b>-971</b>
<b>Overall Balance</b>	<b>-106</b>	<b>73</b>	<b>303</b>	<b>-358</b>	<b>-643</b>
<b>Financing</b>	<b>106</b>	<b>-73</b>	<b>-303</b>	<b>358</b>	<b>643</b>
Loans	56	45	126	8	199
Others	51	-118	-429	350	444

Source: Second State Finance Commission data

Despite these overall surpluses, in more than 40 percent of the municipalities, current expenditures exceeded current revenues in 1999/00 (see Table III.4). The smallest ULBs (Grade II Municipalities) seem to have the most difficulty in generating current account surpluses.

**Table III.4: Share of ULBs with Current Account Deficits<sup>63</sup>**

	95/96	96/97	97/98	98/99	99/00
<b>Municipalities</b>	39%	21%	15%	35%	41%
Grade II	56%	28%	24%	40%	56%
Grade I	44%	17%	14%	42%	42%
Selection	25%	11%	7%	18%	39%
Special	23%	38%	15%	46%	15%
<b>Corporations</b>	0%	0%	33%	0%	17%

While limited data prevent an accurate understanding of how deficits were financed, it appears that new loans account only for 21 percent of total financing needs in 1998/99 and 1999/00.<sup>64</sup> Municipalities seem to have used three other ways of financing deficits: (i) running down bank reserves, as can be seen by looking at the dwindling "opening balances," (ii) building up substantial "non-debt liabilities" or ("Liabilities to Various Funds and Agencies") over the years, or postponing principal and interest payments on their debt. In fact, municipalities owe 1.3 million in "non-debt liabilities" compared to the 3.5 million they have incurred in debt.<sup>65</sup> As of 31 March 2000, municipalities owed Rs. 1.2 billion

<sup>63</sup> Deficits have been defined as total current revenue minus total current expenditures. For Corporations, Tirunelveli and Madurai ran deficits in 1997/98 and Madurai also had a deficit in 1999/00.

<sup>64</sup> As mentioned, we are overestimating the deficits by including debt repayments as a current expenditure, we do not have yearly debt stock figures, and a large part of the deficits are covered by positive "net advances and deposits" which we have no additional information about. The 21 percent figure mentioned in the text has been calculated as  $(8+199)/(358+643)$ , i.e., the share of loans in total financing needs.

<sup>65</sup> This "non-debt liability" includes 350,000 owed to "pension funds", and the rest owed to "Others" such as EC charges due to electricity board, arrears due to TWAD Board, arrears on salaries, library cess collected but not transferred. "Total outstanding debt" was reported by the 102 Municipalities to the SSFC. It has been collected separately but, in most cases, it can also be

in overdue interest and principal payments. Most of these liabilities reflect postponing interest and principal repayments on water supply loans to the GoTN (45.5 percent) and the Life Insurance Company (43.5 percent).<sup>66</sup>

Finally, there may be other ways in which municipalities finance deficits for which even less information is available. For example, *Arni*, a Grade-I municipality, reports that it has no outstanding debt but a substantial amount of non-debt liabilities (Rs. 13 million), mainly pension arrears arising from the Pay Commission's 1996 report, not remitting collected funds to the Provident Fund, and EC charges due to the Electricity Board. There is no indication that these liabilities carry any debt service payments. Nevertheless, *Arni* has been recording large annual debt service payments to the following loans: "roads", "medical relief", public health, "markets, cart stands and slaughter houses" and "lighting" which combined totaled Rs. 5.5 million in 1999/00. It seems worthwhile investigating further what other credit options are available to municipalities and how they have been using such facilities. Still, there are only five (Grade I or II) municipalities (like *Arni*) who report having no debt but still make debt service payments. Of course, it is possible that these payments were misclassified in reporting to the SSFC.

In comparison to data from Karnataka and Maharashtra, ULB fiscal data in Tamil Nadu are impressive. Still, the above analysis of municipalities' deficit financing mechanisms, and the significant unanswered questions underscore the importance of collecting and analyzing annual fiscal data on a more systematic basis. For example, available data show growing ULB deficits, but it is impossible to verify how these deficits have been financed. More importantly, without data on debt and non-debt liabilities collected for the Second SFC, it would be impossible to assess the financial stress that municipalities face now and could face in the future. For example, debt service payments have more than tripled since 1997/98, and, only with detailed information (past and current) on the stock of debt, non-debt and arrears, can future cash flows be projected, and the municipality's ability to borrow accurately assessed.

Like municipalities, corporations have current-account surpluses but deficits on their capital account. Moreover, their overall balance has been in deficit since 1997/98, and of roughly the same magnitude as municipalities. Unlike municipalities, however, corporations appear to be financing their deficits entirely by issuing new debt. Unfortunately, the SSFC data do not contain yearly debt stocks, nor do they report non-debt liabilities for corporations. Hence it is difficult to verify that this is the case. Total debt by lenders as of 31 March 2000 is shown in Table III.5.

It is unclear why corporations have relied more on new loans than municipalities. Nor is it possible to verify the extent to which corporations have also built up non-debt liabilities. Possible explanations include more oversight of their budgets and easier access to formal credit. Financing deficits formally via loans (with contractual agreements and transparency) is clearly preferred to the "back door" routes chosen by municipalities: deferring salary payments, retaining "library cesses", delayed payment of interest on past loans, and drawing down dwindling bank reserves.

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calculated as "loans drawn" minus "principal repayment" plus "amount due but not paid." In the SSFC report, on page 92, total outstanding debt of Municipalities total Rs. 3.66 million. The differences arise due to the treatment of Municipalities whose debt figures (loans drawn minus principal plus "due but not paid") do not add up to (their self-reported) "total outstanding debt."

<sup>66</sup> SSFC categorizes loans to GoTN and LIC as "water supply loans" (see section 2.2 on page 92) but otherwise, there is no way of identifying what loans have been used for.

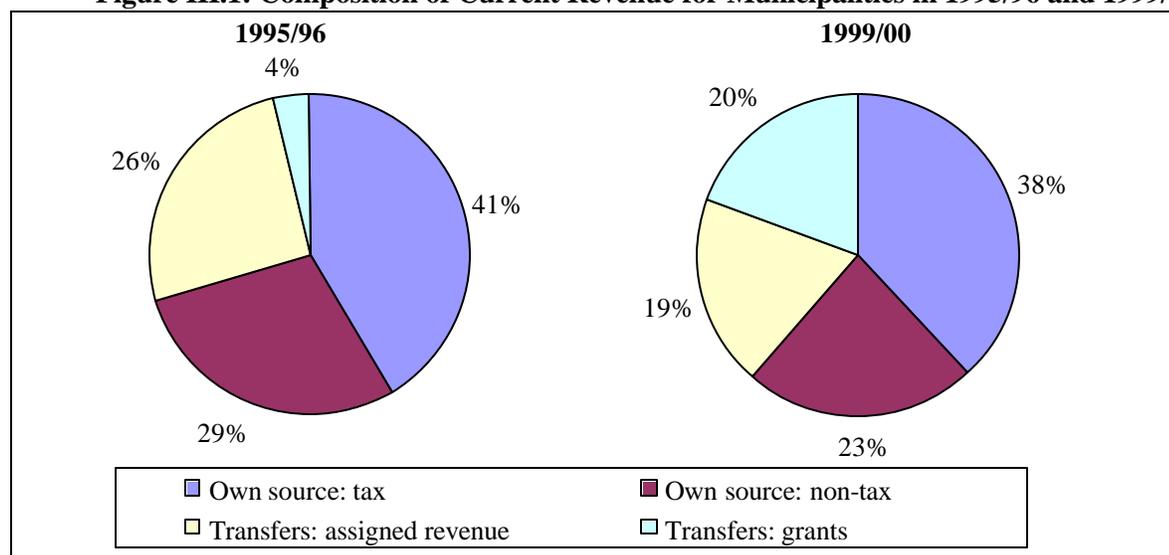
**Table III.5: Fiscal Accounts, Tamil Nadu Corporations (Rupees in millions)**

	95/96	96/97	97/98	98/99	99/00
Current revenues	3,443	3,882	4,975	5,866	6,754
Own-source	1,881	2,347	2,950	3,470	3,827
Current expenditures	2,232	2,538	3,444	4,330	5,287
Establishment	1,198	1,364	1,668	2,133	2,363
<b>Balance of Current Account</b>	<b>1,210</b>	<b>1,345</b>	<b>1,531</b>	<b>1,536</b>	<b>1,467</b>
Capital receipts	52	424	395	556	272
Capital expenditures	1,277	1,304	1,944	2,482	2,766
<b>Balance of Capital Account</b>	<b>-1,226</b>	<b>-880</b>	<b>-1,549</b>	<b>-1,926</b>	<b>-2,494</b>
<b>Overall Balance</b>	<b>-15</b>	<b>464</b>	<b>-18</b>	<b>-390</b>	<b>-1,027</b>
<b>Financing</b>	<b>15</b>	<b>-464</b>	<b>18</b>	<b>390</b>	<b>1,027</b>
Loans	65	375	131	585	1,086
Others	-50	-839	-113	-195	-59

Source: SSFC data

### REVENUE

ULBs in Tamil Nadu have four sources for current revenues: (i) taxes that they collect (property tax, professional tax); (ii) non-tax revenues and fees that they collect (income from renting out buildings, fees, including water fees); (iii) taxes and fees collected by other agencies (assigned or “shared” revenues); and (iv) grants from the State Government.

**Figure III.1: Composition of Current Revenue for Municipalities in 1995/96 and 1999/00**

The property tax is the most important own-source of revenue, accounting for 56 percent of own-source revenues and 34 percent of current revenues (see Table III.6). The profession tax accounted for 6-8 percent of own source revenue. While yearly increases in property tax did not keep pace with the growth in current expenditures, revenues from the profession tax did grow in line with current expenditures. According to the SSFC report, the profession tax has no penalties for non-compliance, and

ULBs have limited capacity to administer the tax, suggesting that more revenues could be collected if such penalties were put in place, and administration and enforcement improved.

ULBs may also levy an Advertisement Tax, which at present is used mostly by large corporations such as Chennai. The first State Finance Commission recommended levying a local tax on vehicles not under the purview of Motor Vehicles Act (e.g., mopeds, tractors etc.) but GoTN rejected that recommendation. Three years ago, and as part of the Entertainment Tax, ULBs were granted the right to collect the Cable TV tax. Previously, it was collected by the Registration Department and ULBs had no incentive to rely on the tax, which is levied on each connection made per cable tv operator. This is a potentially promising source of revenue for ULBs, and cable tv revenues in Chinnurli are reported to be nearly as lucrative as property tax revenues.

#### Box 4: Tamil Nadu Water Charges

The Chennai Metropolitan Water Supply & Sewerage Board provides water supply and sewerage services in the Chennai Corporation area. The Board collects water and sewerage taxes (levied as part of the property tax, up to 35 percent of the tax rate) and water charges. Twenty percent of the house service connections are metered, the remaining 80 percent are unmetered connections. Maintenance of water supply facilities is poor, and water supply is often erratic. CMWSSB has arrears exceeding Rs.150 crores from consumers. The Tamil Nadu Urban Local Bodies Act allows for revision of water charges once every three years. As shown below, deficits are common in financing water supply and sewerage in municipalities and municipal corporations.

#### Financing Water Supply and Sanitation in Municipalities

Revenue Receipts Item	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
	Actuals					Budget
<b>Receipts in Rs. Lakhs</b>						
Water Charges	1540.97	1591.32	1672.75	1720.34	2663.63	2716.02
Others Income	285.24	295.84	398.35	518.69	546.70	557.45
<b>Total Income</b>	<b>1826.21</b>	<b>1887.16</b>	<b>2071.10</b>	<b>2239.03</b>	<b>3210.33</b>	<b>3273.47</b>
<b>Expenditure in Rs. Lakhs</b>						
Establishment	854.70	994.77	1203.11	1466.89	1638.61	1916.20
Power Charges	802.45	1177.64	1279.62	1274.95	1529.50	1675.11
TWAD Board payments	40.16	74.52	235.58	204.06	202.01	221.24
Others	1050.36	1176.43	1003.00	1471.67	1959.10	2145.60
<b>Total Expenditure</b>	<b>2747.66</b>	<b>3423.37</b>	<b>3721.30</b>	<b>4417.57</b>	<b>5329.21</b>	<b>5958.15</b>

**Table III.6: ULB Revenues, 1999/00 (Rupees in Millions)**

	Prop. Tax	Total Taxes	Own Source Rev. (incl. water rev.)	Assign Rev.	Total Grants	Total Current Rev.	% Property Tax/ OSR	% OSR/ Total Rev.
<b>Municipalities</b>	<b>1,531</b>	<b>1,710</b>	<b>2,755</b>	<b>852</b>	<b>875</b>	<b>4,482</b>	<b>56%</b>	<b>61%</b>
Grade II	86	100	180	67	86	333	48%	54%
Grade I	295	329	599	188	256	1,043	49%	57%
Selection	536	604	930	295	269	1,494	58%	62%
Special	614	677	1,046	302	264	1,612	59%	65%
<b>Corporations</b>	<b>2,146</b>	<b>2,451</b>	<b>3,827</b>	<b>1,307</b>	<b>1,620</b>	<b>6,754</b>	<b>56%</b>	<b>57%</b>

Source: SSFC data

## Property Taxes

Property taxes in Tamil Nadu are general purpose taxes, based on zonal rates applied to carpet areas. ULBs have limited autonomy in property taxes; the State defines the zonal rate by category, as well as the frequency of revision and limits on revised values. The First State Finance Commission recommended that properties be revised every three years; the Second State Finance Commission recommended and enacted into law a revision once every five years for residential properties, and once every two years for other properties. Differences in the frequency of revision increases horizontal inequities between residential and other properties in the tax base.

Rationalizing the differentials between new-versus-old assessment values was attempted through a general revision in October 1998. The GoTN was sensitive to political opposition to the revision, and imposed ceilings on the assessed values of existing properties to limit increases to “reasonable limits.” For example, owner-occupied properties were limited to a 25 percent ceiling, rentals were limited to a 50 percent ceiling, commercial properties were limited to a 100 percent ceiling, and industrial properties were limited to a 150 percent ceiling. After the revision, property taxes for corporations increased by about 25 percent, and property taxes for municipalities increased by about 37 percent. In addition to limiting the overall tax base, the limits on the revision introduced substantial horizontal inequities in the property tax system, with commercial and industrial taxpayers bearing a disproportionate share of the increase in the property tax.

The property tax includes a general levy, as well as a series of specific levies (equivalent to cesses.) Property tax rates are not subject to a ceiling. In Tiruchirapali Corporation, for example, the Council levies a property tax of 32 per cent per year. This rate includes the following components:

- General Tax (4 percent),
- Water Tax (16.75 percent),
- Drainage Tax (2.50 percent),
- Scavenging Tax (1.75 percent),
- Education Tax (2.50 percent), and
- Lighting Tax (1.00 percent)

The Water Tax is to be levied in all ULBs (as per the TNULB Act), whereas the Education Tax component can be levied where educational institutions exist. The Education Tax may not exceed 5 percent of the property tax rate, and it is designed fund the maintenance expenses of schools.

As shown below in Table III.7, Chennai Corporation has the largest potential property tax base, as measured by an annual demand of Rs. 153 crores in 1999/2000. A substantial portion of corporations' property tax collections are in arrears, ranging from 62 percent in Salem to 77 percent in Trichy. Property tax administration in corporations is generally considered to be poor: tax maps are practically non-existent, delays in processing returns, incomplete data and poor records, and limited enforcement.

**Table III.7. Corporation Property Taxes (1999-2000)**

Characteristics	Chennai	Coimbatore	Madurai	Trichy	Tirunelveli	Salem
Assessments	449,737	170,663	117,824	113,621	107,430	135,912
Annual demand (Rs. in millions)	1532	310	232	150	70	115
Percent of Collections in Arrears	66	72	69	77	70	62
Property Tax per Capita (Rupees)	336	320	207	188	158	163
Growth in Assessments per year (percent)	4.9	9.7	2.0	6.0	9.6	6.3
Share of Non-Residential Assessment (percent)	17	11	19	11	15	9

Source: SSFC Report, Annex IV-1A

Similar statistics for municipalities are reported in Table III.8. Special Grade municipalities have the largest property tax potential (Rs. 6007 lakh), and also the highest property tax per property (Rs. 1651.) About one third of potential property taxes are in arrears in municipalities, substantially less than the arrears in corporations.

**Table III.8. Municipality Property Taxes (1999-2000)**

Characteristics	Special Grade	Selection Grade	Grade - I	Grade - II	Total	Average
No. of Municipalities	13	28	36	25	102	-
Annual Demand (Rs. in millions)	60,075	52,353	30,462	8,914	151,804	1,488
Percent of Collections in Arrears	32.4	34.1	32.3	30.6	-	32.4
Tax per property (in Rupees)	1651	1092	687	486	-	872

Source: SSFC Report, Annex IV-1A

Authorities have discussed introducing a Self Declaration Scheme for ULBs for property taxes as a means to simplify tax administration, enhance its transparency and reduce the compliance costs for taxpayers. This scheme has not yet been implemented.

## Grants and Assigned Revenue

ULBs receive grants from three central schemes which are funded by the GOI and GoTN on a 75:25 basis: *Swarna Jayanthi Sahari Rozgar Yojana* (SRSRY), which includes components for the Urban Self Employment Programme and Urban Wage Employment Programme; Development of Women and Children in Urban Areas; and Community Structure. These three schemes amounted to Rs. 15.1 crores in Fiscal Year 2001-02. ULBs also received Rs. 27.1 crores from the National Slum Development Programme. Six municipalities in Tamil Nadu participate in the Mega City Programme (at an estimated cost of Rs. 5.2 crore), municipalities have also received Rs. 491 lakh as part of the Integrated Development of Small and Medium Towns.

ULBs receive State transfers under two headings: (i) grants, a pool of money that is devolved according to various formulas; and (ii) assigned revenues, which are shared taxes that have traditionally been collected by the State. Overall, 3.6 percent of State revenues are passed on to ULBs as grants or assigned revenues.

**Table III. 9. State Grants in Tamil Nadu**

	Grants per Capita			Share of Total Grants			Share of Pop.
	95/96	97/98	99/00	95/96	97/98	99/00	
<b>Municipalities</b>	<b>9</b>	<b>110</b>	<b>101</b>	<b>40%</b>	<b>49%</b>	<b>35%</b>	<b>55%</b>
Grade II	5	116	93	2%	6%	3%	6%
Grade I	5	112	111	6%	13%	10%	15%
Selection	11	119	88	18%	19%	11%	19%
Special	11	93	113	13%	11%	11%	15%
<b>Corporations</b>	<b>17</b>	<b>138</b>	<b>227</b>	<b>60%</b>	<b>51%</b>	<b>65%</b>	<b>45%</b>

Similar to Karnataka, Table III.9 shows that corporations receive a larger share of total grants than their share of the total population. This is mostly due to the large grants that Chennai receives. If Chennai is removed as an outlier, corporations' share of total grants is closer to (but still larger than) their population share.

Since the First State Finance Commission's recommendations, grants have grown five-fold. In 1995/96, grants accounted for only 4 percent of current revenue; by 1999/00, current grants accounted for 20 percent of current revenue.<sup>67</sup> These grants are devolved according to a formula that first divides the distributable pool between a Rural and an Urban Fund. The Urban Fund is then divided among corporations, municipalities and town panchayats according to population, needs and resource potential. Finally, three Urban Funds are distributed among ULBs of similar classification according to yet another formula ("interse" allocation) that takes the following factors into account: population, SC/ST population as a share of the slum population, per capita own income, and asset maintenance. Moreover, municipalities that have salary and pension expenditures less than 49 percent of total revenue qualify for an additional share of the funds.<sup>68</sup> Fifteen percent of these grant funds are set aside for equalization and incentive purposes; incentives are designed to reward better performance in collecting taxes, repaying debt service, and promptly implementing schemes.

In accordance with SFC recommendations, ULBs use SFC devolution grants to fund operation and maintenance of local assets, and wage and salary payments. Deductions at source are made from these grants for outstanding debts of ULBs to other institutions or agencies. During the first two years of SFC award period (1997-98 and 1998-99), funds were released on a more or less timely basis. In subsequent years, releases have been much more erratic – often occurring in the final months of the fiscal year – with deleterious effects on local financial planning, and in some cases affecting the ability of smaller ULBs to pay their employees' salaries. For example, it was reported that in the past fiscal year, GoTN only paid one of the four quarterly installments for the SFC grants.

Assigned revenue mostly consists of two types of shared taxes: the entertainment tax and the surcharge on stamp duty (or "duty on transfer of property"). In 1999/00, the entertainment tax accounted for 46 percent and 36 percent of assigned revenues for municipalities and corporations, respectively, and surcharge on stamp duty transfers accounted for the remaining portion.

<sup>67</sup> In addition to current grants, municipalities and corporations also receive capital grants earmarked towards expenditures in Water Supply, Roads and Buildings, Storm Water Drains, Street Lighting, Solid Waste Management, Education, Others, or simply as "Finance Commission Grants."

<sup>68</sup> See Chapter XIII: "Devolution Mechanism" in Second SFC report for more details.

Based on recommendations from the First SFC, the State Legislative Assembly changed the amount of entertainment tax to be shared with local bodies (both rural and urban) from 65 to 90 percent in April 1997. However, the Second SFC reports that, despite the legislative change, the State continues to share only 35 percent of entertainment taxes collected. Moreover, data on “collected entertainment taxes” reported by various state agencies have significant inconsistencies.<sup>69</sup>

ULBs are entitled to receive a 5 percent surcharge of the Stamp Duty (the state rate is 13 percent). This surcharge is one of the largest components of assigned revenues, and discrepancies are regularly reported in amounts collected, and the assigned revenues are often delayed in being remitted to ULBs.

### Determinants of Own-Source Revenue<sup>70</sup>

While own-source revenues vary across municipalities, the dispersion is less pronounced than in Karnataka. For example, Karnataka had a “fat right tail” in the distribution of own-source revenues per capita, i.e. about 20 percent of the municipalities had more than twice the average own-source income. In Tamil Nadu, the Special Grade and Corporations constitute the “right tail” of the distribution (see Table III.10).

**Table III.10: Distribution of Own Source Revenue and Current Expenditure**  
(Rupees per capita)

	Own-Source Rev./Capita			Expenditure/Capita		
	Mean	Std.	[Min; Max]	Mean	Std.	[Min; Max]
<b>Municipalities</b>	<b>303</b>	<b>151</b>	<b>[92;748]</b>	<b>485</b>	<b>205</b>	<b>[212;1158]</b>
Grade II	214	117	[92;609]	392	719	[212;719]
Grade I	274	136	[136;592]	447	146	[250; 796]
Selection Grade	346	135	[195;675]	543	238	[257;1103]
Special Grade	464	189	[225;748]	647	252	[219;1158]
<b>Corporations</b>	<b>547</b>	<b>209</b>	<b>[421;967]</b>	<b>822</b>	<b>286</b>	<b>[534;1275]</b>

Source: SSFC data and own calculations

In trying to explain the variation in own source revenue per capita (OSR\_PC) we examine a simple model which postulates that the following factors explain variation in own source revenue:

$$\text{OSR\_PC} = f(\text{size, economic base, poverty, grants})$$

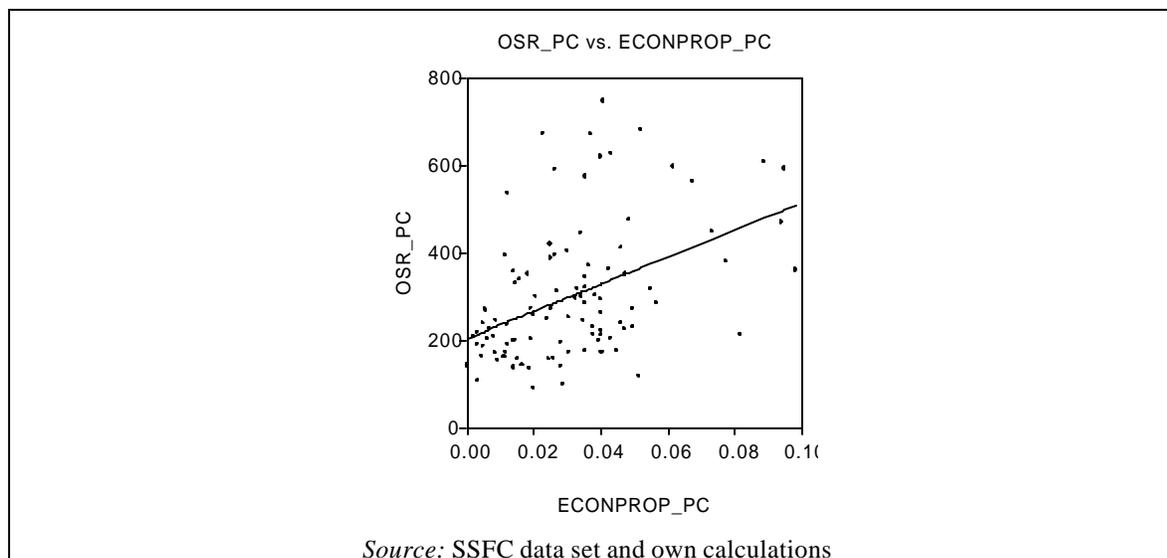
In recognition of the potential economies of scale in collecting taxes and running a municipality, we expect that own-source revenues per capita would be positively correlated with population size. The economic base is one measure of revenue capacity; as it expands, if local revenues are elastic, own-source revenue should also expand. We expect municipalities with a large share of poor people to collect less revenue, in part because a greater proportion of population in slums represents a lower tax capacity and is harder to tax. We also expect that grants might substitute for own source revenue mobilization (negative coefficient.) This equation was estimated for the 102 municipalities, with all variables entered in natural logarithmic form.

<sup>69</sup> See Annexure IV- 9 in SSFC report. Moreover, we have been unable to reconcile State-level data on “Amount actually transferred to LBs” (regardless of which source is used) with the actual amount transferred to LBs, according to our data from LBs.

<sup>70</sup> Unfortunately, data on slum population and details on staff are not available for Corporations so they have been excluded from the regression analysis discussed below.

The model explains about 26 percent of the variation in own-source revenue per capita among municipalities. The variables described above seem to explain differences in own-source revenue per capita as expected, except for the share of the poverty population and grants per capita, which have a positive coefficient, although both are statistically insignificant. Figure III. gives a visual impression of the relationship between the measure of the economic base and own-source revenue per capita and total staff per capita and own source revenue. As confirmed by the regression analysis, both factors positively affect own source revenue per capita.<sup>71</sup>

**Figure III. 2: Relationship Between Own-Source Revenue and Economic Base**



While the model explains some of the variation in own-source revenue, it does not fully account for the differences across municipalities. For example, *Kathivakkam* and *Nagapattinam*, two “Selection grade” municipalities, would be expected to have low own-source revenue per capita since they have a lower-than average economic base, a higher-than average slum population, and fewer staff per capita. Yet, both municipalities have a higher own source revenue per capita than the average of their peers.<sup>72</sup>

## EXPENDITURES

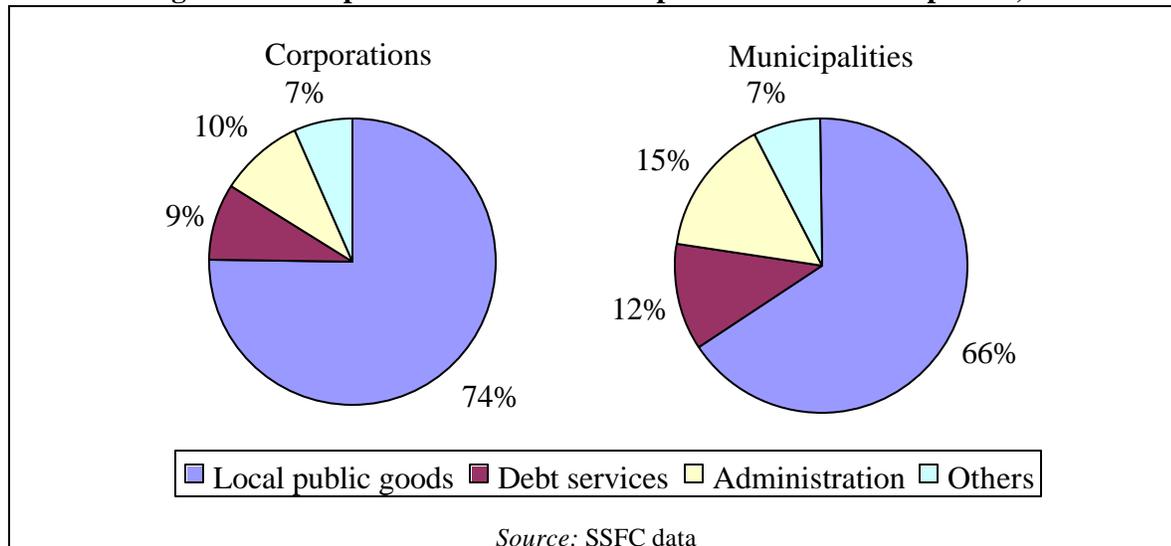
Corporations appear to spend relatively more on providing public services such as water, street light, roads, education and sanitation than municipalities. As Figure I.III.3 shows, corporations spent 74 percent of total expenditures (current and capital) on providing “local public goods” while municipalities only spent 66 percent. Municipalities spend more on “administration” and “debt service” which together account for 27 percent of their total budget but only 19 percent of corporations’ budgets. On a per capita

<sup>71</sup> Dummies for the various grades of municipalities were all found to be statistically significant (and negative for first, second and selection grade, and resulted in a slightly lower coefficient on “staff”, negative coefficient on population, but no change to the coefficient on the “economic base”).

<sup>72</sup> Nine municipalities seem not to be well explained by the regression. These municipalities have been identified since the residual associated with these observations fall outside of the 90 percent confidence interval of the residual distribution.

basis, corporations also spend considerably more on local public services but only slightly more on debt service and administration.<sup>73</sup>

**Figure III.3: Expenditure Profiles of Corporations and Municipalities, 1999/00<sup>74</sup>**



### ULB Staffing

When considered as a group, municipalities have 3.6 staff per 1000 population, and establishment expenditures account for slightly more than 40 percent of municipalities' current expenditures (see Table 9).<sup>75</sup> However, these shares differ significantly across municipalities. For example, the average Grade II Municipality spent 58 percent of current revenues on establishment expenditures; the average Special Grade Municipality spent 39 percent; and corporations spent 35 percent of current revenue on establishment costs. With the exception of *Virudhunagar*, a Selection Grade Municipality, all municipalities with establishment expenditures exceeding 70 percent of current revenue are Grade I or II Municipalities, suggesting that controlling salary expenditures is mainly a problem for smaller municipalities.<sup>76</sup> Based on other states' norms, the SSFC recommends the following norms for the various ULBs in Tamil Nadu:

- Chennai Corporation                      3.5 employees per thousand inhabitants
- Other Corporations                        3 employees per thousand inhabitants
- Municipalities                                2.5-3 employees per thousand inhabitants

<sup>73</sup> On a per capita basis, it is difficult to compare corporations and municipalities because the Municipalities have their own estimates of the population in 2000 but the corporations do not have such figure. Thus, for corporations we are using 1991 census figures. Still, the conclusions above appear robust to using the World Gazette's population 2001 estimates for corporations.

<sup>74</sup> Unfortunately, expenditure data across states are not easy to compare. In this figure, "administration" only includes the part of "establishment expenditure" that is categories as "General and taxes". With TN data it is possible to separate out what part of establishment goes to "education", "sanitation" etc. Therefore, local public goods include salary expenditures whereas in Karnataka it didn't since data in Karnataka only had one entry for "salaries".

<sup>75</sup> However, on average, establishment expenditures account for 47 percent of expenditures. The average value is higher than the "joint" because of the large number of Grade 1 and 2 Municipalities in the sample, and these Municipalities have a higher salary share than the average.

<sup>76</sup> This result is also emphasized in the SSFC's table "annexure-V-7".

Establishment expenditures only account for 43 percent of the cost of “wages and salaries” in 1999/00. Thus, “wages and salaries” exceed current expenditures and account for 77 percent of total (current and capital) expenditures in 1999/00.

**Table III.11: ULB Staffing Patterns**

	Staff/ 1000 populat ion	Avg. wage 99/00	Establishment Exp. Share of Cur. Exp.		Wage and Salary Share of Total Expenditure	
			98/99	99/00	98/99	99/00
<b>Municipalities</b>	3.6	140	46%	42%	84%	77%
Grade II	3.1	146	55%	55%	83%	89%
Grade I	3.7	148	53%	51%	99%	94%
Selection Grade	3.4	141	49%	42%	81%	77%
Special Grade	4.0	129	47%	41%	76%	63%
<b>Corporations<sup>77</sup></b>	6.9	NA	36%	35%	NA	NA

Wage and salary data for corporations were not available.

### **Determinants of Current Expenditure<sup>78</sup>**

As Table III.8 showed, current expenditure per capita ranges from Rs. 212 (in *Vandavasi*) to Rs. 1,275 (in Coimbatore), with a clear tendency for expenditures to grow by size of ULB. We postulate that the following factors explain differences across municipalities in current expenditures per capita:

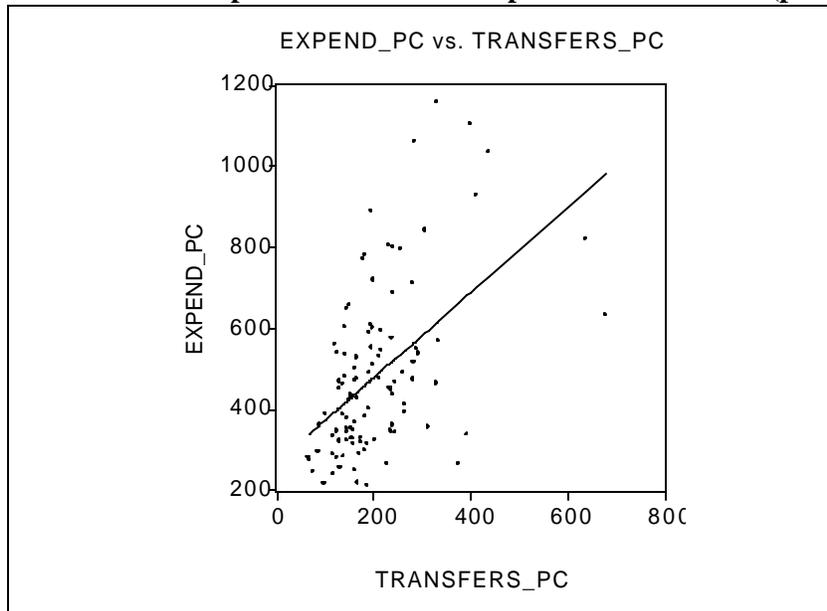
$$\text{EXPEND\_PC} = f(\text{economic base, grants, size, poverty})$$

We would expect that municipalities with more resources (as measured by the economic base and grants from the State), and greater “need” (as measured by population size, share of the population living in slums) would be associated with higher spending per capita.

This equation was estimated for the 102 municipalities, with all variables entered in natural logarithmic form. These variables explain differences in per capita spending as expected, with grants playing the most important role. Every 10 percent difference in transfers from the State Government is associated with a 2.1 percent difference in expenditures per capita. Notably, expenditures per capita do not appear to be targeted to the poor; the coefficient for the share of the population living in slum areas is not statistically significantly different from zero. The model explains only 26 percent of the variation in current expenditure per capita.

<sup>77</sup> In the case of Corporations, we do not have staff data for individual Corporations. However, the SSFC report reports the total number of staff in Corporations to be 48,997. This figure has been divided by the Census population estimate for 1991 at 7.1 million inhabitants. The resulting 6.87 staff per 1000 inhabitants is considerably larger than the 5.11 per 1000 population reported by the SSFC (implying that the total population in Corporations is 9.6 million).

<sup>78</sup> Although, data in Karnataka are not separated into current and capital expenditures, we define “current expenditures” as total expenditures minus “capital expenditure on roads” and “capital expenditures on others”, “grants to others”, “expenditure on commercial enterprises, “savings and subsidies” and “others” (a residual category).

**Figure III.4: Relationship between Current Expenditures and Staff (per capita)**

### LOCAL BORROWING AND BORROWING CAPACITY OF ULBS

Section 66 of TNULB Act (1998) grants ULBs the right to borrow: “the Municipal Council, with the prior sanction of Government, may borrow by way of debentures on security of taxes, duties etc. covered under the Act, by way of loans from public, etc.” The same Section allows ULBs to borrow from the public by issuing bonds for specific items of capital expenditure, provided that an independent evaluation of the financial position and operation of the ULB is provided (i.e., credit rating.) At present, the State Government guarantees the loan liabilities of local bodies. Section 68 of the same Act, allows ULB to establish and maintain a sinking fund for repaying debt; municipalities are required to pay quarterly installments to the sinking fund in an amount sufficient to pay debt service. Section 69 of the TNULB Act accords priority for payments of interest and repayment of loans over any other payment due from the ULB. In other words, escrow accounts are paid first, and are not contingent upon default.

As mentioned above, corporations and municipalities rely on loans to finance their deficits, as well as infrastructure investments. Every year, the size of loans as a share of current revenue varies widely. For example, the amount municipalities borrowed rose substantially from 1998/99 to 1999/00 (see annex tables and Table ) and as a result, loans as a share of revenues rose from 0.2 to 4.4 percent.

As Table III.12 shows, the high shares of ULBs with debt and with debt service payments reveals that almost all municipalities and corporations in Tamil Nadu have borrowed in the past.

**Table III.12: Share of ULBs with Debt Service Expenses and Borrowing in 1999/00**

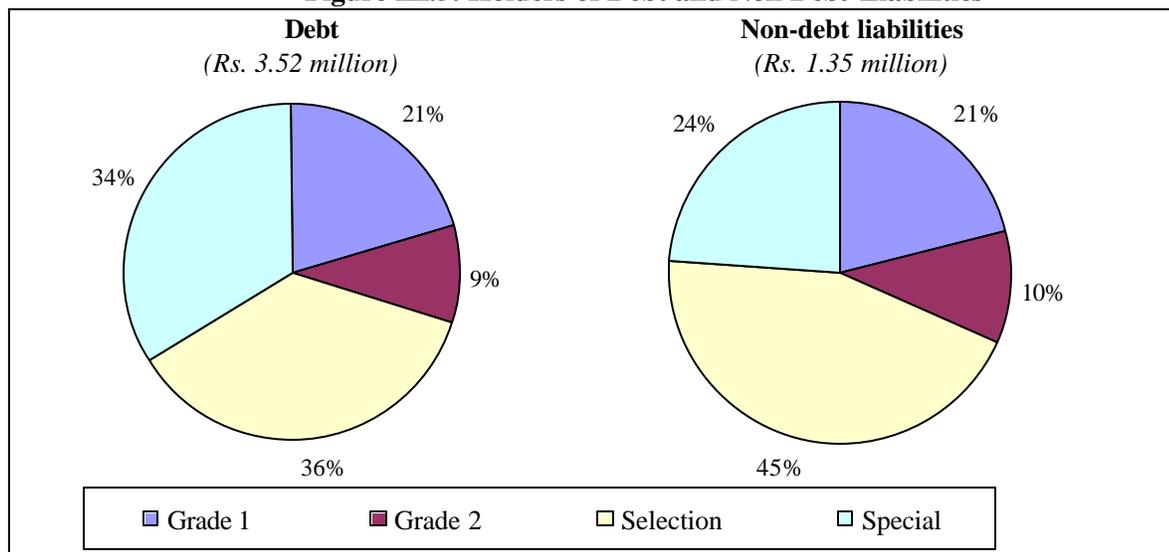
	Share of ULBs with debt service expenses	Share of ULBs that borrowed during the year	Share of ULBs with outstanding debt	Loans (share of rev.)
	1999/00	1999/00	1999/00	1999/00
<b>Municipalities</b>	93%	36%	92%	4.4%
Grade II	84%	44%	84%	7.8%
Grade I	97%	31%	92%	2.0%
Selection	96%	39%	96%	6.7%
Special	92%	31%	100%	3.2%
<b>Corporations</b>	100%	100%	100%	16.1%

Source: SSFC data

The composition of debt and the distribution among municipalities are presented in Figure III.5 and the Annex tables. Figure III.5 shows that Selection Grade Municipalities have accumulated the largest amount of non-debt liabilities (Rs. 602,000).

Table III.13 shows the total outstanding debt held by corporations.

**Figure III.5: Holders of Debt and Non-Debt-Liabilities**



### Box 5. Tamil Nadu Urban Development Fund

The Tamil Nadu Urban Development Fund was established in 1996 to develop urban infrastructure within the State. Since 1988, the GoTN has been implementing the Tamil Nadu Urban Development Project (TNUDP) financed by the World Bank, and which established a Municipal Urban Development Fund (MUDF). The MUDF was converted to the TNUDF in 1996. TNUDF's objectives are:

- To fund urban infrastructure projects that improve the living standards of the urban population
- Facilitate private sector participation in infrastructure through joint venture and public-private partnership
- Operate a complementary window, the Grant Fund, to assist in addressing the problems of the urban poor
- Improve the financial management of ULBs enabling them to access debt finance from markets

According to the Annual Report of the TNUDF (2001-2002), 179 urban projects have been approved at a project cost of Rs. 675.02 crores. Typical projects include storm water drains, solid waste management schemes, roads, and revenue-generating commercial complexes, wholesale markets and bus stands.

TNUDF has a strong repayment rate (“zero non-performing loans”) in large part due to mandatory establishment of escrow accounts in advance, and payment of arrears out of monthly Grant Fund distributions.

The Grant Fund provides financing for many ULB technical assistance activities, including accounting and financial management, computerization, development of performance indicators.

TNUDF is looking for opportunities to out-source the design, supervision and maintenance of local projects.

Source: TNUDF Annual Report, 2001-2002; interviews with TNUDF officials.

**Table III.13: Outstanding Loans of Corporations as of 31 March 2000 (Rupees in thousands)**

	GoTN	MUDF	TNUDF	LIC	Others	Total
<b>Corporations</b>	<b>2,534,700</b>	<b>757,600</b>	<b>454,900</b>	<b>79,600</b>	<b>1,957,400</b>	<b>5,784,200</b>
Chennai	1,066,300	528,200	82,800	0	943,000	2,620,300
Coimbatore	725,200	93,900	24,500	0	2,100	845,700
Madurai	169,300	86,600	279,800	26,800	801,500	1,364,000
Salem	223,900	32,900	40,900	52,800	210,800	561,300
Tiruchirappalli	0	0	0	0	0	0
Tirunelveli	350,000	16,000	26,900	0	0	392,900

Source: SSFC report, Table 1 on page 92.

As reported earlier, one way municipalities have financed their deficits is by deferring payment of interest and Government of Tamil Nadu (GoTN) and LIC loans (“water sector loans”). As a result, in 1998, the GoTN rescheduled outstanding loans drawn by various local bodies since 1945. The ULBs were offered a uniform interest rate (13.5 percent), and given 20 years to repay the loan in half-yearly installments. If the LB failed to repay, the GoTN would recover the money by deducting the amount from the SFC devolutions. According to the SSFC report, this move has resulted in a sharp increase in debt service payments. This can also be seen in the Annex Tables that show annual “debt service payments” which have more than doubled in most cases since 1997/98.

## Borrowing Capacity Analysis

This section assesses the total borrowing capacity of ULBs in Tamil Nadu. First, only those ULBs that have a revenue surplus after meeting current revenue expenditures (including debt servicing) are considered to have borrowing capacity, due to their ability to service debt out of such surplus. To arrive at a suggestive amount available to borrow, the current surpluses are assumed to continue over 15 years, and that only half of these surpluses would be available for servicing new debt obligations. These “surplus cashflows” have then been discounted at an assumed rate of 12 percent per annum to arrive at a Net Present Value (NPV); the total amount a ULB would be able to borrow today and be able to comfortably service over the next 15 years.

As earlier tables showed, only 59 percent of municipalities have current account surpluses in 1999/00 and are, according to our analysis, capable of borrowing additional funds. Table III.14 shows that these 60 Municipalities are capable of borrowing almost an additional Rs. 2 billion (\$41 million) and 5 Corporations could borrow an additional Rs. 5.6 billion (\$118 million).

**Table III.14: Borrowing Capacity Assessment, Based on 1999/00 data**

	Excluding loans taken during the year			After including loans taken during the year		
	Number of ULBs with borrowing capacity	As a % of number of ULBs	Aggregate Borrowing Capacity (thousands Rupees)	Number of ULBs with borrowing capacity	As a % of number of ULBs	Aggregate Borrowing Capacity (thousands Rupees)
Municipalities	60	59%	1,931,500	60	59%	1,825,950
Grade II	11	85%	110,751	11	85%	106,292
Grade I	21	58%	445,737	21	58%	441,900
Selection	17	61%	495,834	17	61%	444,908
Special	11	85%	879,177	11	85%	832,849
Corporation	5	83%	5,567,872	5	83%	4,703,595

Moreover, Table III.15 shows how many ULBs have borrowing capacities above certain thresholds: \$10,000, \$100,000 and \$1 million. The analysis shows that 50 municipalities and 6 corporations are capable of borrowing \$100,000 or more, whereas only 10 municipalities and 3 corporations meet the higher threshold of \$1 million in borrowing capacity.

**Table III.15: Number of ULBs with Borrowing Capacity above Thresholds**

	Number of ULBs	(>\$10,000) >Rs. 472 thousand)	(>\$100,000) > Rs. 4,716 thousand)	(\$1 million) > Rs. 47,158 thousand)
<b>Municipalities</b>	<b>102</b>	<b>59</b>	<b>50</b>	<b>10</b>
Grade II	25	11	7	0
Grade I	36	21	17	1
Selection	28	16	15	3
Special	13	11	11	6
<b>Corporation</b>	<b>6</b>	<b>4</b>	<b>4</b>	<b>3</b>

Note: Water account has been included, and loans taken during 1999/00 have been subtracted from borrowing capacity.

## GOVERNANCE ASPECTS

### Budgeting and Financial Management

Sections 70 and 71 of the TNULB Act provide detailed guidelines regarding the preparation and presentation of ULB budgets. The SSFC has recommended that ULBs introduce zero-based budgeting. ULB budgets (except for Chennai Corporation) are submitted to the Department of Municipal Administration and Water Supply (DMA) for approval. Each budget must show a consolidated budget surplus, with at least 1 lakh surplus in the Revenue Budget. DMA periodically monitors ULB budgets, and it requests revised budgets from each of the ULBs in November of each year.

About 40 cities are in the process of preparing City Corporate Plans, which formalize a medium-term capital plan for the city.

Annually, the DMA issues a performance budget for ULBs, which includes basic information, major finance items, details of works undertaken and various performance measures. These performance measures reflect outputs: kilometers of roads, numbers of street lights, vehicles used, quantity of garbage collected per day, number of water supply and sewerage facilities, number of compost yards, etc. The budget does not really report performance information, such as the quality, duration nor satisfaction of services delivered, although as noted below, the DMA has proposed a series of performance indicators that it would like to develop.

Tamil Nadu is relatively unique among Indian states in having introduced double entry, accrual accounting in all Municipalities and Municipal Corporations in 2000-01. Accrual accounting was piloted in 10 Municipalities and 2 Municipal Corporations beginning in 1997-98, prior to being introduced across all municipalities and municipal corporations. Before accrual accounting was introduced, ULBs had reasonable control procedures in place; they had fund-based accounting systems (e.g., General Fund, Water Fund, Education Fund, and Lighting Fund), with requirements for regular reporting of fund balances and statements of liability. Once computerized accounts are fully implemented (expected in 2004), the DMA and Department of Town and Country Planning expect to be able to monitor ULB fiscal performance in “real time.” ULBs typically update their trial balance each month or quarter. With full computerization, the DMA target is for all ULBs to calculate their trial balances within 3 days of the close of each month. About 60 percent of ULBs are reported to meet that target presently.

The Director of Local Fund Audit has audited ULBs accounts since 1921. The audit covers all accounts. These audits traditionally focused on verifying ULB transactions. The TNULB Act specifies that Municipal Corporations must compile and submit their accounts for audit before 1 July; other ULBs

submit their accounts for audit by 15 May of every year. In theory, local accounts are to be audited within one year from the date of completion of accounts. However, in practice, audits have been delayed. As of the date of the SSFC report, audits of ULB accounts had been completed up to 1997/98, except for those ULBs with records are in the Vigilance Department. Audits for 1998-99 have been partially completed, and for 1999-2000, ULB accounts have been compiled and submitted for audit, which is in process.

### **Monitoring and Supervision of ULBs**

The DMA exercises administrative control and is responsible for overseeing ULBs. The Commissioner of Chennai Corporation reports to the Secretary, Municipal Administration. Other corporations and municipalities report to the Commissionerate, Municipal Administration. Regional Directors support 12 to 17 municipalities. These Directors are typically former Chief Local Officers who have been promoted to facilitate municipal functions; they report to the Commissionerate, Municipal Administration, and serve more in an advisory than regulatory mode. District Collectors play less of an oversight role in Tamil Nadu than in other states. While District Collectors are technically responsible for inspecting ULBs, in practice, they have little day-to-day responsibility.

Improving the quality of ULB fiscal and performance data is a high priority of the DMA. It spent roughly five years designing and implementing a data collection system, and has developed a series of performance indicators (see Table III.16). DMA envisions developing score cards that would monitor ULB performance according to the indicators, benchmarked to some norms. It is hoped that by providing more information to citizens through these score cards, a “revolution” would ensue with citizens demanding improvements in ULB performance, and ULBs competing among each other.

The DMA is also assisting ULBs in developing City Corporate Plans (CCP), which provide a snapshot of ULB financing, systems and capacity to citizens and businesses. The TNUDP is piloting the development of City Corporate Plans in 50 ULBs, and the GoTN is committed to expanding CCPs to all ULBs.

**Table III.16. DMA Proposed ULB Performance Indicators**

<b>Sector</b>	<b>Indicators Proposed to be Developed</b>
Property Tax (8)	<ul style="list-style-type: none"> <li>▪ Current Collection Performance</li> <li>▪ Average Tax Demand per property</li> <li>▪ % arrears pending for 5 Years</li> <li>▪ % Properties Issued Demand Notice within 30 days of due date</li> <li>▪ No. of Assessments per collection Staff</li> <li>▪ % Increase in Assessments</li> <li>▪ Assessment Efficiency</li> <li>▪ Salary Expenditure to collect Rs. 1000 of property Tax</li> </ul>
Resource Mobilization (4)	<ul style="list-style-type: none"> <li>▪ Per Capita Income</li> <li>▪ % Contribution by Own Sources</li> <li>▪ % Contribution from properties</li> <li>▪ Growth in Revenue Income</li> </ul>
Expenditure, Debt and Liability Management (10)	<ol style="list-style-type: none"> <li>1. <i>Expenditure Management</i> <ul style="list-style-type: none"> <li>▪ Per Capita Expenditure</li> <li>▪ Operating Ratio</li> <li>▪ Establishment Expenditure as % of Revenue Income</li> <li>▪ Growth in Revenue Expenditure</li> <li>▪ Capital Utilization Ratio</li> </ul> </li> <li>2. <i>Debt and Liability Management</i> <ul style="list-style-type: none"> <li>▪ Per Capita Outstanding Debt</li> <li>▪ Debt Payment to Actual Commitment</li> <li>▪ Overdue as % of Outstanding Loan</li> <li>▪ Outstanding Debt to Revenue Income</li> <li>▪ Outstanding Non Debt Liability as % of Revenue Income.</li> </ul> </li> </ol>
Water Supply (9)	<ul style="list-style-type: none"> <li>▪ Supply Frequency</li> <li>▪ Gross lpcd (w.r.t current population)</li> <li>▪ % Storage Capacity</li> <li>▪ % Assessment covered with HSC</li> <li>▪ Slum Population per Stand Post</li> <li>▪ Ratio: Distribution Network to Road length (Incl. SH, NH &amp; MDR etc.)</li> <li>▪ Cost per 1000 litres (Only O &amp; M)</li> <li>▪ Revenue per 1000 litres</li> <li>▪ Current Collection Performance of water charges</li> </ul>
Sewerage and Sanitation (4)	<ul style="list-style-type: none"> <li>▪ % HHs with Sewer Connections</li> <li>▪ Ratio: UGD Network length to Road length (Incl. SH, NH &amp; MDR etc.)</li> <li>▪ % Houses with LCS &amp; Septic Tank Facility</li> <li>▪ Slum population per seat of Public convenience</li> </ul>
Solid Waste Management (5)	<ul style="list-style-type: none"> <li>▪ Per capita waste generated (Current Population)</li> <li>▪ % Capacity of the Fleet of Vehicles to waste generated</li> <li>▪ Collection Efficiency</li> <li>▪ Spacing of Dustbins</li> <li>▪ Road length per conservancy staff</li> </ul>
Roads, Storm Water Drains and Street Lighting (5)	<ul style="list-style-type: none"> <li>▪ % Roads Surfaced</li> <li>▪ Percentage Road Covered with pucca Drains</li> <li>▪ Drain Length per drain cleaner</li> <li>▪ Spacing between lights</li> <li>▪ % Sodium &amp; Mercury Lamps</li> <li>▪ O &amp; M Cost Per light</li> </ul>
Demography, Slum and Social Indicators	<ul style="list-style-type: none"> <li>▪ % Slum Population</li> <li>▪ % Population Below Poverty Line</li> <li>▪ Persons per Park and Playground</li> <li>▪ % Women Beneficiaries under SJSRY scheme</li> </ul>
Urban Governance (8)	<ol style="list-style-type: none"> <li>1. <i>Fiscal Discipline</i> <ul style="list-style-type: none"> <li>▪ Revenue Realization: Budget vs. Actual</li> <li>▪ Rev. Expen. Control :Budget Vs Actual</li> <li>▪ Capital Works :Budget vs. Actual</li> <li>▪ No. of audit objections</li> <li>▪ Receipt of any Incentive Grant</li> </ul> </li> <li>2. <i>Performance and Public Responsiveness</i> <ul style="list-style-type: none"> <li>▪ % Water connection given within the stipulated time</li> <li>▪ % Building permissions issued within the stipulated time</li> <li>▪ % Litigation in favour of municipality during the year</li> </ul> </li> </ol>

Source: SSFC Report, Annexure V-18

## **Improving Service Delivery**

The DMA has been working with ULBs to establish local service centers to facilitate electronic interactions with citizens. For example, Ambattur Municipality has established four service centers where citizens can pay their taxes, apply for licenses and permits, and record and check basic information (addresses, etc.) These service centers offer the possibility of vertically integrating government services – operating as a “one-stop” shop for paying and registering for local and state government services. These centers are linked by computer networks to state and DMA offices, and information is shared daily. It is hoped that they could some day be used to manage daily cash flows. Rather than collecting assigned revenues through the Collection Department and then transferring the shared portion back to ULBs, those revenues could be remitted on a daily basis through the service center to the ULB where they were paid.

The GoTN has already launched a series of reforms that will strengthen the state and local capacity and promote improved ULB performance. These reforms include:

- Establishing the TNUDF and providing grant funding for local capacity building
- Establishing Regional Directors (operating between ULBs and the DMA) to support and advise ULBs in improving performance
- Introducing double-entry, accrual accounting systems and computerizing financial management systems in ULBs

These are encouraging reforms that will provide a strong framework for improving the performance of ULBs.

## Annex Tables

**Annex Table III.A.1 Revenue Regression Equation**

REVENUE Regression

Dependent Variable: LOG(OSR\_PC)

Method: Least Squares

Sample(adjusted): 1 102

Included observations: 101

Excluded observations: 1 after adjusting endpoints

White Heteroskedasticity-Consistent Standard Errors &amp; Covariance

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(POPULATION)	0.159801	0.06901	2.315607	0.0227
LOG(ECONPROP_PC)	0.243064	0.041364	5.876185	0
LOG(SLUMPC)	0.055532	0.098661	0.562855	0.5748
LOG(GRANTSPC)	0.158261	0.066212	2.390201	0.0188
C	4.10394	0.889616	4.613157	0
R-squared	0.257794	Mean dependent var		5.60938
Adjusted R-squared	0.226869	S.D. dependent var		0.468592
S.E. of regression	0.412023	Akaike info criterion		1.112763
Sum squared resid	16.29725	Schwarz criterion		1.242224
Log likelihood	-51.19453	F-statistic		8.336056
Durbin-Watson stat	1.714927	Prob(F-statistic)		0.000008

ECONPROP\_PC is the number of assessed industrial and commercial properties per capita (a measure of the economic base)

SLUMPC is slum population per capita. One would expect a negative coefficient on both slum population and share of poor people but in both cases is the coefficient positive and insignificant.

POPULATION is the population in 2000, as estimated by the Municipalities.

**Annex Table III.A.2 Expenditure Regression**

Dependent Variable: LOG(EXPEND\_PC)

Method: Least Squares

Sample(adjusted): 1 102

Included observations: 101

Excluded observations: 1 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(POPULATION)	0.02404	0.055233	0.435255	0.6644
LOG(ECONPROP_PC)	0.181392	0.041634	4.356809	0
LOG(SLUMPC)	0.050032	0.06222	0.804112	0.4233
LOG(GRANTSPC)	0.212653	0.062635	3.395104	0.001
C	5.632875	0.739168	7.620557	0
R-squared	0.260567	Mean dependent var		6.111751
Adjusted R-squared	0.229757	S.D. dependent var		0.38858
S.E. of regression	0.341032	Akaike info criterion		0.734554
Sum squared resid	11.16504	Schwarz criterion		0.864015
Log likelihood	-32.09497	F-statistic		8.457284
Durbin-Watson stat	1.690113	Prob(F-statistic)		0.000007

TRANSFERS\_PC is assigned revenue and grants per capita

**Annex Table III.A.3 Financing Flows of Municipalities, 1995/96-1999/2000**

(Rupees in thousands)

<b>Municipalities</b>	<b>95/96</b>	<b>96/97</b>	<b>97/98</b>	<b>98/99</b>	<b>99/00</b>
<b>Current revenues</b>	<b>2,156,386</b>	<b>2,603,078</b>	<b>3,575,461</b>	<b>3,720,434</b>	<b>4,481,797</b>
Own-source	1,517,031	1,630,363	1,891,978	1,866,839	2,754,901
Tax	892,315	927,483	979,166	848,758	1,709,764
Non-tax	624,716	702,879	912,812	1,018,081	1,045,137
of which: water receipts	182,621	188,716	207,110	223,903	321,033
Transfers	639,355	972,715	1,683,482	1,853,594	1,726,895
Assigned revenue	561,842	746,533	737,200	859,402	851,880
Grants	77,513	226,182	946,282	994,192	875,016
<b>Current expenditures</b>	<b>1,976,307</b>	<b>2,268,761</b>	<b>2,721,820</b>	<b>3,423,801</b>	<b>4,153,444</b>
Establishment	1,024,931	1,139,048	1,329,982	1,712,130	1,861,621
of which: water establ.	85,470	99,477	120,311	146,689	163,861
Operation and maintenance	650,894	777,436	949,312	1,124,324	1,254,326
Water expenditures	189,297	242,860	251,819	295,068	369,060
Debt servicing	111,186	109,417	190,707	292,279	668,436
<b>Balance of current account</b>	<b>180,079</b>	<b>334,317</b>	<b>853,640</b>	<b>296,632</b>	<b>328,353</b>
<b>Capital receipts</b>	<b>85,125</b>	<b>223,472</b>	<b>327,232</b>	<b>518,991</b>	<b>507,245</b>
Grants and sale of assets	85,125	223,472	327,232	518,991	507,245
Capital expenditures	371,577	484,830	877,865	1,173,821	1,478,407
of which: water	64,926	53,477	91,273	101,955	174,295
<b>Balance of capital account</b>	<b>-286,452</b>	<b>-261,358</b>	<b>-550,633</b>	<b>-654,830</b>	<b>-971,162</b>
<b>Overall balance</b>	<b>-106,373</b>	<b>72,959</b>	<b>303,007</b>	<b>-358,198</b>	<b>-642,808</b>
<b>Financing</b>	<b>106,373</b>	<b>-72,959</b>	<b>-303,007</b>	<b>358,198</b>	<b>642,808</b>
Loans	55,550	45,384	126,344	7,940	198,594
Others	50,823	-118,343	-429,352	350,258	444,215
				0.2%	4.4%
<b>Stock of debt</b>					<b>3,522,913</b>
Government of Tamil Nadu					1,666,119
LIC					1,065,029
IDSMT					189,785
IUDP					78,500
MUDF-I					140,675
MUDF-II					122,493
TNUDF					111,652
Others					148,659

**Annex Table III.A.4 Financing Flows of Grade I Municipalities, 1995/96-1999/2000**

(Rupees in thousands)

<b>Grade I Municipalities</b>	<b>95/96</b>	<b>96/97</b>	<b>97/98</b>	<b>98/99</b>	<b>99/00</b>
Current revenues	<b>476,083</b>	<b>596,976</b>	<b>845,059</b>	<b>908,400</b>	<b>1,042,838</b>
Own-source	336,851	370,251	419,281	440,494	599,016
Tax	193,922	202,265	210,797	198,458	328,724
Non-tax	142,929	167,986	208,484	242,037	270,293
of which: water receipts	46,742	44,570	50,043	56,905	65,089
Transfers	139,233	226,724	425,778	467,906	443,822
Assigned revenue	126,775	172,635	168,333	200,540	187,717
Grants	12,458	54,090	257,444	267,366	256,105
Current expenditures	<b>453,491</b>	<b>556,249</b>	<b>661,207</b>	<b>873,489</b>	<b>978,169</b>
Establishment	270,084	302,134	354,790	466,831	496,571
of which: water establ.	23,466	27,977	34,777	45,319	45,945
Operation and maintenance	123,209	175,884	203,259	260,448	274,877
Water expenditures	34,797	47,106	53,326	69,237	74,887
Debt servicing	25,400	31,125	49,831	76,973	131,833
Balance of current account	22,593	40,727	183,852	34,912	64,669
Capital receipts	<b>34,650</b>	<b>75,686</b>	<b>87,834</b>	<b>148,069</b>	<b>147,524</b>
Grants and sale of assets	34,650	75,686	87,834	148,069	147,524
Capital expenditures	50,780	95,753	225,013	264,075	356,307
of which: water	3,553	15,106	34,720	36,440	34,603
Balance of capital account	-16,130	-20,068	-137,179	-116,006	-208,784
Overall balance	<b>6,463</b>	<b>20,659</b>	<b>46,673</b>	<b>-81,095</b>	<b>-144,115</b>
Financing	<b>-6,463</b>	<b>-20,659</b>	<b>-46,673</b>	<b>81,095</b>	<b>144,115</b>
Loans	6,463	13,160	15,553	0	20,958
Others	-12,926	-33,819	-62,226	81,095	123,157
Stock of debt					<b>726,514</b>
Government of Tamil Nadu					353,640
LIC					164,477
IDSMT					82,199
IUDP					18,663
MUDF-I					20,900
MUDF-II					39,236
TNUDF					17,373
Others					30,027

**Annex Table III.A.5 Financing Flows of Grade II Municipalities, 1995/96-1999/2000**

(Rupees in thousands)

<b>Grade II Municipalities</b>	<b>95/96</b>	<b>96/97</b>	<b>97/98</b>	<b>98/99</b>	<b>99/00</b>
<b>Current revenues</b>	<b>145,113</b>	<b>207,800</b>	<b>289,856</b>	<b>320,600</b>	<b>333,380</b>
Own-source	103,976	116,732	133,693	148,166	179,956
Tax	59,495	61,552	65,755	67,047	99,550
Non-tax	44,481	55,180	67,938	81,119	80,406
of which: water receipts	14,856	14,941	15,138	18,052	20,722
Transfers	41,137	91,068	156,163	172,434	153,424
Assigned revenue	36,597	62,137	48,614	67,155	67,445
Grants	4,540	28,931	107,550	105,280	85,979
<b>Current expenditures</b>	<b>148,000</b>	<b>182,739</b>	<b>235,023</b>	<b>290,684</b>	<b>339,151</b>
Establishment	87,271	104,613	122,802	159,096	186,055
of which: water establ.	9,038	11,396	12,637	15,665	18,835
Operation and maintenance	43,757	60,054	84,856	100,666	100,443
Water expenditures	9,027	10,799	15,672	12,330	14,771
Debt servicing	7,945	7,273	11,694	18,593	37,882
Balance of current account	-2,887	25,060	54,833	29,916	-5,771
<b>Capital receipts</b>	<b>9,183</b>	<b>32,140</b>	<b>45,953</b>	<b>79,970</b>	<b>89,146</b>
Grants and sale of assets	9,183	32,140	45,953	79,970	89,146
<b>Capital expenditures</b>	<b>19,410</b>	<b>40,382</b>	<b>84,885</b>	<b>127,487</b>	<b>133,440</b>
of which: water	2,329	7,022	8,971	15,136	10,977
Balance of capital account	-10,228	-8,242	-38,931	-47,517	-44,293
<b>Overall balance</b>	<b>-13,115</b>	<b>16,818</b>	<b>15,901</b>	<b>-17,602</b>	<b>-50,064</b>
<b>Financing</b>	<b>13,115</b>	<b>-16,818</b>	<b>-15,901</b>	<b>17,602</b>	<b>50,064</b>
Loans	1,061	6,219	1,588	711	25,968
Others	12,054	-23,036	-17,489	16,891	24,096
<b>Stock of debt</b>					<b>331,933</b>
Government of Tamil Nadu					101,960
LIC					136,978
IDSMT					28,210
IUDP					31,934
MUDF-I					861
MUDF-II					567
TNUDF					0
Others					31,423

**Annex Table III.A.6 Financing Flows of Special Grade Municipalities, 1995/96-1999/2000**

(Rupees in thousands)

<b>Special Municipalities</b>	<b>Grade</b>	<b>95/96</b>	<b>96/97</b>	<b>97/98</b>	<b>98/99</b>	<b>99/00</b>
Current revenues		<b>812,460</b>	<b>898,149</b>	<b>1,179,413</b>	<b>1,134,505</b>	<b>1,611,584</b>
Own-source		563,587	581,352	691,744	548,032	1,046,224
Tax		326,523	331,077	352,545	249,440	677,246
Non-tax		237,064	250,275	339,200	298,592	368,978
of which: water receipts		59,337	66,485	69,188	67,564	137,951
Transfers		248,872	316,797	487,669	586,473	565,360
Assigned revenue		223,438	260,355	270,423	300,575	301,692
Grants		25,434	56,442	217,246	285,898	263,669
Current expenditures		<b>709,758</b>	<b>750,552</b>	<b>873,856</b>	<b>1,123,108</b>	<b>1,373,503</b>
Establishment		323,519	345,662	414,873	526,864	561,748
of which: water establ.		22,448	23,984	34,714	36,749	48,756
Operation and maintenance		262,830	264,697	321,142	395,203	443,893
Water expenditures		86,543	110,670	88,853	110,341	144,420
Debt servicing		36,866	29,523	48,988	90,701	223,442
Balance of current account		102,702	147,597	305,557	11,397	238,082
Capital receipts		<b>14,121</b>	<b>44,199</b>	<b>66,990</b>	<b>121,198</b>	<b>102,821</b>
Grants and sale of assets		14,121	44,199	66,990	121,198	102,821
Capital expenditures		176,024	222,632	252,887	318,856	547,674
of which: water		37,543	10,475	16,539	17,162	81,721
Balance of capital account		-161,903	-178,434	-185,896	-197,658	-444,853
Overall balance		<b>-59,201</b>	<b>-30,836</b>	<b>119,661</b>	<b>-186,262</b>	<b>-206,771</b>
Financing		<b>59,201</b>	<b>30,836</b>	<b>-119,661</b>	<b>186,262</b>	<b>206,771</b>
Loans		30,398	8,590	47,670	3,402	50,828
Others		28,803	22,246	-167,331	182,860	155,943
Stock of debt						<b>1,190,876</b>
Government of Tamil Nadu						648,139
LIC						282,116
IDSMT						25,360
IUDP						14,009
MUDF-I						102,009
MUDF-II						22,492
TNUDF						61,669
Others						35,082

**Annex Table III.A.7 Financing Flows of Selection Municipalities, 1995/96-1999/2000**

(Rupees in thousands)

<b>Selection Municipalities</b>	<b>95/96</b>	<b>96/97</b>	<b>97/98</b>	<b>98/99</b>	<b>99/00</b>
Current revenues	<b>722,730</b>	<b>900,153</b>	<b>1,261,133</b>	<b>1,356,928</b>	<b>1,493,994</b>
Own-source	512,616	562,027	647,260	730,147	929,705
Tax	312,375	332,590	350,069	333,813	604,244
Non-tax	200,241	229,438	297,191	396,335	325,461
of which: water receipts	61,686	62,720	72,741	81,382	97,271
Transfers	210,113	338,126	613,872	626,781	564,289
Assigned revenue	175,032	251,406	249,830	291,132	295,026
Grants	35,081	86,720	364,043	335,648	269,263
Current expenditures	<b>665,058</b>	<b>779,221</b>	<b>951,734</b>	<b>1,136,520</b>	<b>1,462,621</b>
Establishment	344,057	386,639	437,517	559,340	617,246
of which: water establ.	30,517	36,120	38,182	48,956	50,325
Operation and maintenance	221,098	276,801	340,054	368,007	435,113
Water expenditures	58,929	74,285	93,968	103,160	134,982
Debt servicing	40,974	41,496	80,195	106,013	275,279
Balance of current account	57,671	120,933	309,399	220,408	31,373
Capital receipts	<b>27,171</b>	<b>71,447</b>	<b>126,454</b>	<b>169,754</b>	<b>167,754</b>
Grants and sale of assets	27,171	71,447	126,454	169,754	167,754
Capital expenditures	125,363	126,062	315,080	463,402	440,986
of which: water	21,500	20,874	31,044	33,217	46,994
Balance of capital account	-98,192	-54,615	-188,626	-293,648	-273,232
Overall balance	<b>-40,520</b>	<b>66,318</b>	<b>120,773</b>	<b>-73,240</b>	<b>-241,858</b>
Financing	<b>40,520</b>	<b>-66,318</b>	<b>-120,773</b>	<b>73,240</b>	<b>241,858</b>
Loans	17,628	17,416	61,533	3,827	100,840
Others	22,892	-83,734	-182,306	69,413	141,018
Stock of debt					<b>1,273,590</b>
Government of Tamil Nadu					562,380
LIC					481,458
IDSMT					54,016
IUDP					13,895
MUDF-I					16,905
MUDF-II					60,198
TNUDF					32,610
Others					52,127