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New Methods in Local Government Finance: Case of MCGM

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Abstract: *Rapid growth of economy led to rapid urbanisation, such a high paced sustained movement from rural areas has increased the pressure of providing suitable services on the part of ULBs which further demands greater expenditure outlays but on the contrary the revenue sources has remained almost stagnant. Also the low level of expenditures due to unavailability of resources is hampering the quality of service provision. This paper concerns with finding of new sources of revenues and necessary reforms which needs to be instigated to maintain the revenue-expenditure gap, as the fine balance between both is necessary requirement of smooth functioning of an ULB. This paper also provides a brief overview of revenue and expenditure patterns observed in Greater Mumbai Municipal Corporation (MCGM). In addition, this paper also considers the aspect of the quality of service delivery by the corporations*

Keywords: Urban Local Body, Revenue, Expenditure, ULB Services

I. INTRODUCTION

The efficient maintenance of revenues and expenditures for any organization is critically important for sustainable functioning; same applies for the governments also, no matter what is level of government. While the Twelfth Schedule of the 74th Amendment Act, 1992 demarcates the functional domain of municipal authorities, the Amendment Act has not provided for a corresponding 'municipal finance list' in the Constitution of India (Municipal Finance in India: An Assessment P.K.Mohanty et.al.) With rapid urbanization and the pressure on urban areas for service delivery, the role of urban local government is undoubtedly becoming important and here, their financial capacity can hold the key

Increasing level and pace of urbanization calls for the gearing up of municipal service delivery on one hand, and the emergence of growth opportunities would require efficient supply of civic infrastructure- water supply, drainage, solid waste management, roads and street lights - on the other. As pointed out in Government of India (1996) (Rakesh Mohan Committee), Infrastructural investment requirements are very large in rapidly growing country like India. Besides the delivery efficiency, the civic infrastructure is dependent, to a good extent, on the amount of financial resources available for undertaking various development projects of civic infrastructure services. Here, municipal finances hold an important key to the production and delivery of these civic infrastructure services. But for provision of such complex urban services, requires monetary stability which stems out from the sound revenue generation capacity of the ulb. Conversely various studies and observation reveals that revenue generation capacity of the local bodies is worrisome factor, hampering the provision of basic urban services which further dampens the economic growth.

The 74th CAA envisaged decentralized government structure but never transferred the necessary taxing powers to the local government. Property tax and Octroi tax are the most dominant form of taxes amongst the total tax revenues but are severed by inefficient and fractured tax systems. Such uneconomical taxing and sharing system of the local bodies provides impetus for finding out new avenues of financing sources which includes accession to the capital markets also. Such a poor financing structure leads to the high dependency of ULB on the State finances. High dependency is also acknowledged as the key deterrent in smooth functioning of the ULB. Currently many local governments in India has understood the magnitude of problem and started accessing the financial markets and banks for the required finances. Jawaharlal National Urban Renewal Mission (JNNURM) by the Government of India on 3rd December 2005 reflects the recognition, at the Government of India level, of the need to support ULBs to improve infrastructure facilities and basic services to the poor in cities and towns (P.K.Mohantyet. al 2007). Innovations are also required for augmenting the non-tax revenues of the local bodies cause such sources provides better stability to the local bodies.

The Vicious cycle of poverty

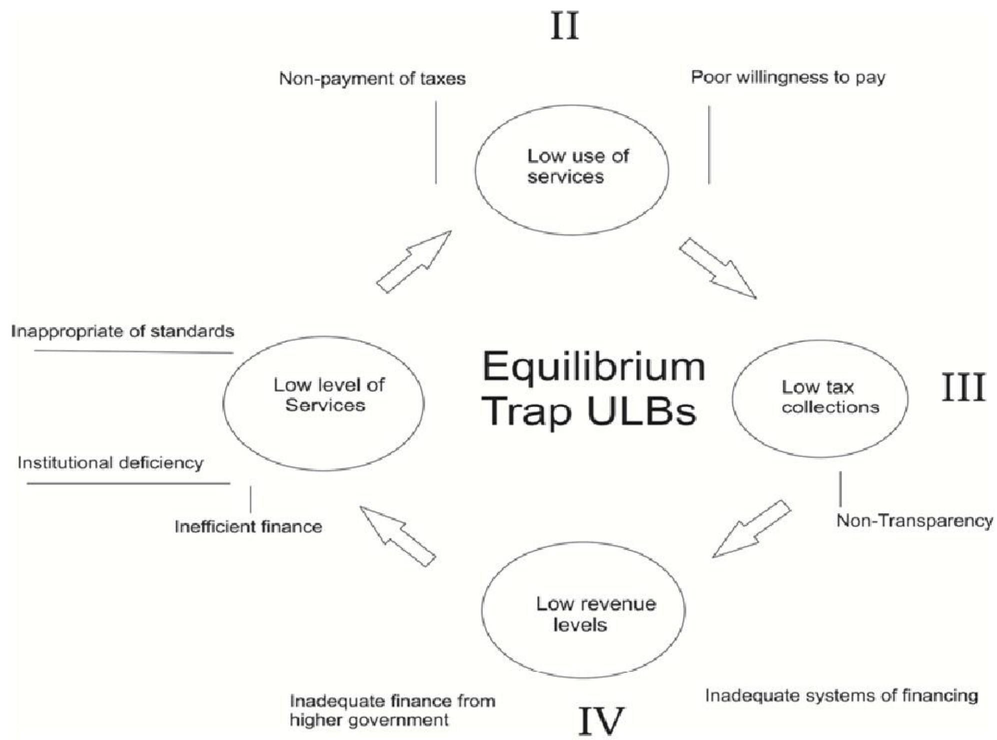

Fig 1

The above figure throws considerable light on the underlying importance of proper ULB finances. Argument of the vicious cycle can very well be extended to ULBs also. To break such poverty traps innovations followed by necessary reforms is very much needed.

II. TRENDS IN REVENUES AND EXPENDITURES OF MCGM

In terms of both governance, finance and service delivery, Indian cities have considerable catching up to do as detailed in the Report of the High Powered Expert Committee (HPEC) on Urban Infrastructure and Services (HPEC, 2011). The Greater Mumbai Municipal Corporation is one of the largest ULBs in India. Also Mumbai being the city of economic importance to the whole Indian nation, provision of quality urban services acts like a catalyst, driving the economic growth. So this paper majorly concerns with the various financial aspects of the MCGM. The implications of centralised planning, administrative and financial regime in the MCGM has manifested in poor quality of civic services, and lopsided and inadequate infrastructure development (Price Water House Coopers' Report of Mumbai Municipal Finance and Investment 2010).

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2.1 Sources of Revenues

Revenue Head/Category	Sources of revenue
Tax revenue	Property Tax, Octroi, Advertisement Tax, Tax on Animals, Vacant Land Tax, Taxes on Carriages and Carts.
Non-Tax revenue Other receipts	User Charges, Municipal Fees, Sale & Hire Charges, Lease amounts Sundry receipts, Law charges costs recovered, Lapsed deposits, Fees, Fines & Forfeitures, Rent on Tools & Plants, Miscellaneous Sales *etc.*
Assigned (Shared) revenue Grants-in-aid	Entertainment Tax, Surcharge on Stamp duty, Profession Tax, Motor Vehicles Tax (i) Plan Grants made available through planned transfers from upper tier of Government under various projects, programmes and schemes (ii) Non-Plan Grants made available to compensate against the loss of income and some specific transfers
Loan	Loans borrowed by the local authorities for capital works *etc.* - HUDCO, LIC, State and Central Governments, Banks and Municipal Bonds

2.2 Budgets of MCGM

The Budget of MCGM is bifurcated as follows:

Budget “A”: General budget consisting of incomes and expenses pertaining to general tax, octroi, wheel tax, fire tax, license tax, market fee, secondary education, Deonar abattoir and entertainment tax

Budget “B”: Incomes and expenses pertaining to improvement schemes of trust properties taken over by the Corporation in 1933

Budget “C”: Incomes and expenses pertaining to BEST undertaking

Budget “E”: Incomes and expenses pertaining to primary education such as education cess and receipt on account of government grants

Budget “G”: Incomes and expenses relating to water and sewerage projects being undertaken by MCGM

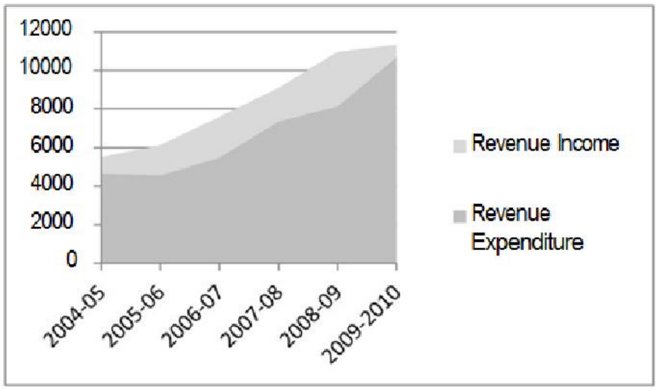
2.3 Budget Accounting Practice undertaken by Price Water Cooper

For accounting purposes, Budgets A, B, E and Tree Authority are grouped together, with consolidated budgeting and financials available.

Budget “G” is ring-fenced without transfers of finances to and from other budgets. Budgeting and financials for this budget are available independently

Budget “C” is wholly separated from other budgets of MCGM. The BEST undertaking functions in a fairly autonomous manner, with separate financial management.

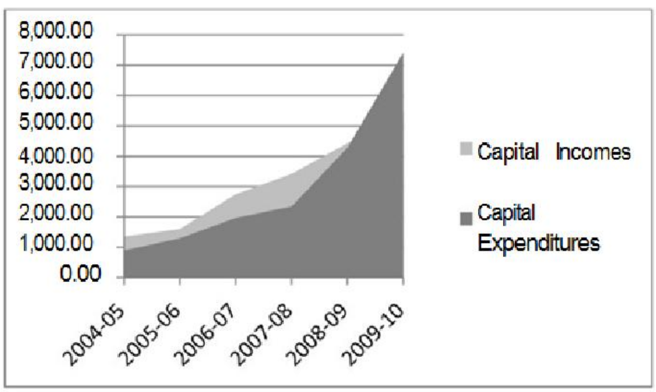
2.4 Revenue Incomes and Revenue Expenditures



(For detailed table see appendix.)Fig2

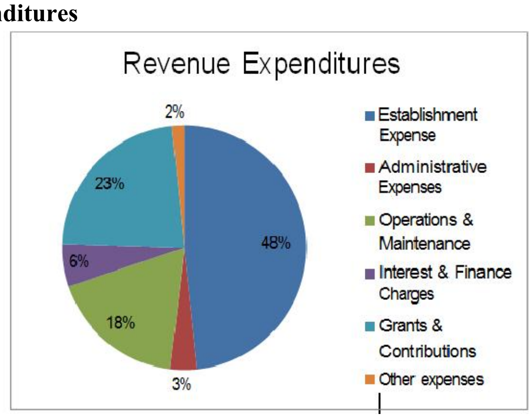
The analysis has been carried out on the Budget ABE and Budget G, as well as a consolidated analysis of all four budgets Revenue Income of the Corporation has grown to Rs. 10,963 Crore in 2008-09 from Rs. Rs. 5,511 Crore in 2004-05, at an annual growth rate of 18.7 percent. Revenue expenditure increased at an average annual rate of 15 % from Rs. 4,651 Crore to Rs. 8,124 Crore during the assessment period. The revenue account maintains surplus during the entire assessment period and maintained a maximum surplus of Rs. 2,840 Crore in 2008-09 (Price Water House Coopers' Report of Mumbai Municipal Finance and Investment).

2.5 Capital Incomes and Expenditures



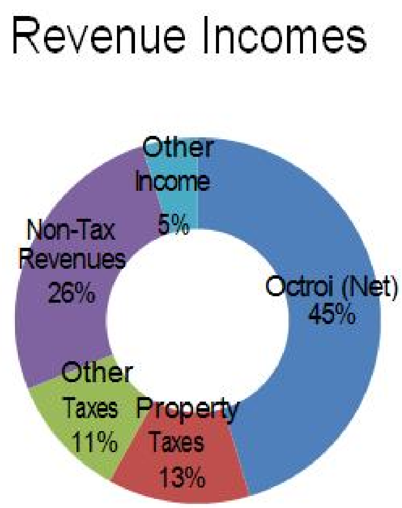
Corporations Capital income comprises of loans, grants and own contributions (withdrawal from funds, other receipts). Capital expenditure stood at Rs. 900.56 Crore in the year 2004-05 and grew at approx. 70% Compounded Average Growth Rate (CAGR). Whereas Capital income grew at approx. 42% CAGR and hence such divergence in growth rates resulted in deficit in the year 2009-10. The adjacent chart displays the sudden rise in capital expenditures from the year 2008-09. In the year 2009-10 capital expenditure stood at Rs. 7,410.35 Crore and capital income stood at 5,446.72 Crore posting overall deficit of Rs. 1,963.63 in the capital accounts.

2.6 Overview of Revenue Expenditures



Revenue expenditure of Corporation has been analyzed based on expenditure heads broadly classified as - Establishment expenses, Administrative expenses, Operation and Maintenance, Debt Service (Interest and Finance charges), Grants and Contribution, etc. These expenditure heads would primarily involve the following departments - General administration, Town Planning, Public works, Sanitation and Solid Waste Management, Health, Civic amenities and miscellaneous expenses. Water Supply and Sewerage revenue expenditure is maintained separately. Average of 4 years i.e. from 2004-05 to 2007-08 is considered for the calculations As can be observed the average share of establishment expenses from 2004-05 to 2007-08 is over 45% of total revenue expenditure. This high level of salary and pensions costs to the MCGM impacts the availability of revenue income year-on-year for transfer to the capital account. This in turn limits the value of capital works that may be carried out without receipt of grants/loans from external sources. Operation and Maintenance expenses account for about 18 %. Debt services of the Corporation accounts for only around 6 % of the revenue expenditure, given the relatively low debt levels.

2.7 Composition of Revenue Sources in total revenues average of 4 years from 2004-05 to 2007-08



comprise around 70% of total revenues. Tax income is derived majorly from octroi followed property taxes. Property taxes include General tax, Fire tax, Street tax and Education Cess. During the period of 2004-05 to 2007-08 collection of property tax grew at 8% CAGR1 Octroi (Net) and collection of octroi tax grew at around 12% 45% CAGR.

Data for the analysis is taken from Price Water House Coopers' Report of Mumbai Municipal Finance and Investment 2010

2.8 Composition of Capital Expenditures

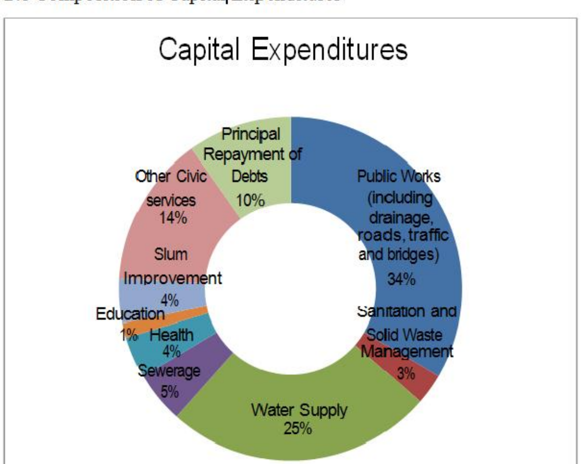
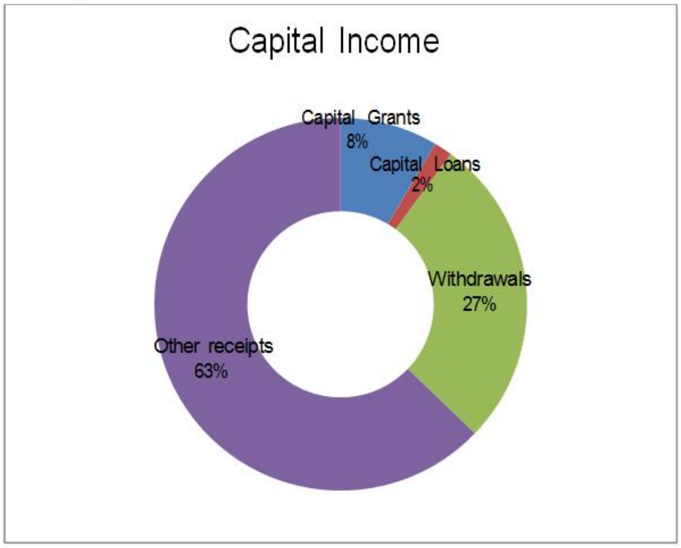


Fig 6

Sizeable share of capital expenditure is taken up by Public works and water supply. As by the definition of capital expenditures which means the maximum share is spent on new constructions and installments. Capital outlay on social sector is minimal, which is matter of concern. In the initial years of assessment period capital utilization was around 70% (refer fig2) but in later years it improved. For any ULB proper capital utilization is a key.

2.9 Composition of Capital Incomes



Majority of the share accounted here comes as transfer from Revenue account, which is about 63%. Own contributions (through withdrawals from various funds - Land Acquisition fund, Asset Replacement fund, Development fund, Sinking fund, etc) have constituted the maximum share, after transfers, under this account. It account for 27% on an average. Asset Replacement Fund and Sinking Fund have been the major sources for withdrawals About 8% of capital income comes from Grants and Borrowing (generally project specific).

III. AUGMENTING URBAN FINANCE

The above ratio analysis brings out three main areas of concern, high share of establishment expenses into total revenue income, capital utilization ratio and lastly the increasing dependency ratio. These three financial assessment ratios imply the urgent restructuring of the ULB finance. It can be done in following ways.

I. Increasing Tax revenue income.

II. Increasing Non-tax revenue income.

III. Capital Market accession.

3.1 Increasing Tax Revenue Income

As we know from the above analysis tax revenue is dominant among the total revenue income. Tax provides the stable source of income to the local body. But the problem lies with limited taxation powers to the local body. It is very much desirable for the ULB to be equipped with proper taxing handles. It is advisable to state governments to handover the taxing instruments to the local government which logically and economically belongs to ULBs. I will address the above argument of increasing tax revenues with respect to following taxes.

a. Property Tax
b. Professional Tax
c. Entertainment Tax

3.1a. Property Tax Reforms

As stated by the HPEC (2011; p. XXVII), "Urban local governments in India are among the weakest in the world both in terms of capacity to raise resources…..the tax bases of ULBs are narrow and inflexible and lack buoyancy…." Unfortunately, reliable information on the collection of revenue from property tax in the country is not available. The available anecdotal information shows that as compared to the developing country average of about 0.7 per cent of GDP, the revenue realized through property taxation is estimated at about 0.2 per cent of GDP. (Property Tax System in India: Problems and Prospects of Reform, M. Govinda Rao). Especially in Mumbai the Property Tax reforms are must as the principle of stock and flow is violated. The per capita tax collection in 36 large municipal corporations in 2006 was just about Rs. 486 and the annual growth rate observed during the three year period (2003-2006) was 7.9 per cent which is marginally higher than the inflation rate which implies that revenues in real terms were virtually stagnant. With the nominal GDP increasing at over 14 per cent during this period, the revenue from the tax as a ratio of GDP has actually shown a decline (M.Govinda, 2013). Such problems relating to tax system provides impetus for rolling out necessary reforms regards to property tax. Currently property tax is collected on the basis of annual ratable value. In the ratable value system, the property tax is charged on the basis of the rent which the rental property is likely to fetch. The rental value of any property is the rent that it earns to the owner. However, if the same property is self-occupied, its rental value is a notional value which is very much different than its actual rental value, if it is given on rent to others. To replace such inefficient tax system with more economical one is need of the hour. So the capital value based property tax system is proposed. In capital value based tax system the present market value of the property is determined as if it is in the possession of the owner without any encumbrances. To determine the market value corporation has adopted the rates of stamp duty ready reckoner with slight variations. As compared to ratable value capital value of the property makes more sense for taxation of property is concerned. Such system can really help in regards to revenue generation in the form of property tax.

3.1b Professional Tax

The present taxing structure in which professional tax is collected by state government and predetermined share of the same is transferred to the local body such share doesn't reflect the true amount which an ULB is entitled to get. Professional activities are majorly carried out in the city premises. Also the professional activities can get affected by the urban services. Many businesses, offices and corporates always have their head offices and branches situated in urban areas. Also skills of the employees which are hired by the companies get affected by the provision of urban services by the ULBs. So it is very much rational to handover the professional taxing instruments to the local government. The activity which is thoroughly local must be taxed by local body which can in turn help the provision of such basic services. Such transfers of powers relating to professional taxing can augment the tax revenues of the ULB which in effect can engage itself into the development activities.

3.1c Entertainment Tax

On the similar lines with the professional tax case can be made in regards to the entertainment tax. As entertainment by its nature is very local phenomenon and so such activity which is widely recognized as local should be taxed by local body only. In the case pertaining to the Mumbai, Entertainment industry is hugely affected by the local services and hence the local body has every right to tax such activities. City is only place where all sorts of entertainment is available and ULB has the responsibility of delivering the necessary services which can flourish such entertainment activities. State government is not directly involved with the local entertainment mechanisms so levying tax on entertainment should be subject of the local body. Thus it is utmost important to transfer rights of taxation to the local government as such move will surely bring welfare in the entertainment industry as they will get enhanced urban services in return of taxes.

3.2 Increasing Non-tax Revenues

The other component of own revenues is non-tax revenues. Over the past years not much has been done in this department. Above financial assessment shows the share of non-tax revenue in total revenue has grown marginally over the period of 2004-05 to 2010-11. The argument of increasing non-tax revenues can be made with respect to the following dimensions of the non-tax revenue sources.

a. User pricing and charges
b. Carbon credits

3.2a User pricing and charges

The proper pricing of various services of the ULBs is crucial when recovery of cost is concerned. Not just recovery cost but proper user charges can earn handsome revenues for the ULB. Provision of services is a complex and cost incurring process and for the efficient maintenance of it pricing plays important role. In most of the cases, user charges were fixed by the ULBs long ago, which have not been revised since and do not match with the current market prices. Rational user charges will recover cost and financially strengthen the ULBs to provide quality services on sustainable basis. The other positive implication of full cost recovery is that it will discourage the ULBs to divert or consume resources meant for other services or sectors. Also as far the user is concerned appropriate tariffs will empower service users to demand quality service thus ensuring accountability on the part of the ULBs.

3.2b Carbon credits as a source of Income

Solid waste management is a serious concern for every ULB. Also the improper waste management can cause environmental hazards. So to minimize such environmental hazards World Bank has instigated Community Development Carbon Fund (CDCF). CDCF buys the Carbon Emission Reduction units thus aiding the ULB to recover cost relating to the solid waste management. Such measures of cost recovery can free up the resources which can be made available for other social sectors. Recently MCGM had got Rs. 24.5 crore from the Asian Development Bank (ADB) in exchange for the estimated generation of 4.3 lakh emission reduction units over five years, starting 2009. One emission reduction unit, or a carbon credit, equals one tonne of carbon dioxide reduced (TOI article dated Sep 22, 2012). According to Indian Express article dated May 06 2009, 75 ULBs of Gujarat are setting up Compost Plants as the part of solid waste management program. Such compost plants are expected to treat solid waste of around 2200 tonnes per day which in turn is expected to fetch 16.5 million dollars in carbon credits for the first ten years. Such kind of resource mobilization will augment the revenue generation capacity and hence lowering the dependency ratio. Such moves will have large welfare effects in regards to the environment as well.

3.3 Capital Market Accession

Traditionally ULBs had to depend upon the upper governments for the grants and loans. Such dependency hampers the timely delivery of services. The ULBs often require large amount of capital for setting new plants and projects, for such requirements loans are provided to the local body. But if there is complete capital market available for the ULBs then it will convenient for them to raise money for such projects and hence increasing the service quality. The declining viability of subsidized funds from state governments and semi-public financial institutions has limited the flow of funds to ULBs for infrastructure projects and compelled them to explore alternate sources and methods of finance (Mathur, 2005). The most notable initiative in the municipal sphere has been the emergence of a municipal bond market Ahmedabad Municipal Corporation became the first municipality in the country to issue bonds of Rs 100 crore at 14 per cent interest payable semi-annually Following this example, a number of municipal entities and parastatals have since accessed capital market funds, with the back-up of CRISIL and two credit rating agencies, namely ICRA Ltd. and CARE, who have developed systems for evaluating the creditworthiness of municipalities. The nine municipalities, which have accessed the capital market have thus far been able to raise Rs 618.5 crore, by issuing bonds. An important feature of municipal bonds is that with the exception of bonds issued by the Bangalore Municipal Corporation and Indore Municipal Corporation, other bonds have been issued without a state government or a bank guarantee (Mathur, 2005). Municipalities will have to perform well in order to receive the higher ratings from credit rating agencies, such need of ratings will incentivize ULBs to perform well. Due to some parameters of performance some ULBs fail to qualify for accessing the capital market particularly debt market. Such problem can be rectified by creating virtual entities -self help groups amongst ULBs - that could expand the domain of eligible ULBs (Pethe and Lalvani). Capital market accession without backing of state government will give rise to self-sufficient local government and such self-sufficiency will enhance the performance of the local government improvising the welfare in the region.

IV. CONCLUSION

As discussed above the 74th CAA has increased the role and importance of the local government but financial ability of ULBs is undermining the enforcement of such laws. After the thorough financial analysis of MCGM we found out three major problematic areas which can have deleterious implications on the service provisions of the ULB. Firstly high share of establishment expenses into total revenue income, secondly more than 100% capital utilization ratio and lastly the increasing dependency ratio. Such underlying problems provide necessary impetus for augmenting urban finance. The major areas of improvements which can increase the revenue generation capacities via taxation are property tax, professional tax and entertainment tax. The basic argument relating to the property tax is that it should be converted to capital value based taxation. And in order to increase the basic provision of services the local taxation powers (Professional and Entertainment Tax) which belongs to the local body by their definition should be transferred to the local government. Other forms of revenue generation like non-tax revenue can be enhanced through implementing proper pricing mechanisms and other innovative revenue sources. Also to decrease the dependency level of the ULBs we discussed the importance of the capital market accession of the ULBs. In altogether the performance of the ULBs is very crucial for the growth of economy and addressing above issues will always have long term welfare effects at the aggregate level.

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