CHAPTER - 7

Augmenting the Resources of Urban Local Bodies in Punjab

Introduction

The resources of ULBs in Punjab are inadequate to meet the increasing demand for urban civic services. The ULBs cannot depend upon government grants as these are highly erratic and unpredictable and constitute a very low percentage of total revenue of the ULBs. Therefore, ways have to be found to augment the limited resources of the ULBs. Moreover, under the Seventy-fourth Constitutional Amendment, the resource mobilization has become the primary responsibility of the ULBs to achieve the constitutional objective of financial autonomy and for improving the financial health of the ULBs.

For augmenting the resources of the ULBs in Punjab, our focus in this chapter would be on the following measures:

- User charges for urban services
- Commercial exploitation of municipal properties
- Privatization of urban services
- Accessing the Capital Market: Municipal Bonds

User Charges for Urban Services

User charges are the charges levied for the use or for having access to a given service. The fees and user charges occupy an important place in the municipal finance. The First Punjab Finance Commission (1995) in its
report observed that the principle of user charges is not being properly enforced by the ULBs for providing civic services. Consequently, most of the civic services, which should be covered by the principle of user charges, are heavily subsidized or given free. The commission also observed that in Punjab the ULBs do not cover even one-third of the cost of maintenance (O &M charges) of water supply and sewerage not to mention the recovery of capital cost. Generally a service should be paid in full by the users.

The levy of user charges is important for many reasons. The user charges are an essential source of revenue to augment the resources of the ULBs. The ULBs are recovering either nothing or much less than the actual cost of operation and maintenance of services. It will also lead to better planning and utilization of various civic services, as provision or expansion services should be undertaken in proportion to the demand for these services and not under any populist considerations. Once the user knows that he/she has to pay for the services which he/she is availing, it will automatically act as curb on excess demand. Moreover, the services will also not be used excessively or wastefully. It will also reduce wastage which is the bane of municipal administration at present. The user charges have also merit on grounds of equity which requires that an individual should pay for what he gets. At present what is happening is the reverse as most subsidized services such as water supply, sewerage, sanitation, lighting etc. are being availed of by the influential urban section of population.
In order to generate more revenue resources and to reduce subsidies for various services, the ULBs should extend the domain of user charges so as to recover the cost of services from the beneficiaries. In this regards, the following measures would be extremely useful:

- The domain of user charges should extend to water supply, sewerage, parking lots and may later on be extended to solid waste management by the levy of a solid waste collection fee. The principle of user charges is that it should apply to services which are for benefit of identifiable beneficiaries rather than the community at large.

- On the whole, the principle of full cost recovery should be used for services which are covered by the user charges. The total cost will include operation and maintenance, billing and collection cost, capital costs and depreciation charges.

- To insure that the poorer sections of the urban populations can afford the civic services, a system of charges based on the level of consumption may be introduced to provided necessary cross subsidies. This would imply low rates for the low consumption blocks and progressively higher charges for higher consumption blocks.

- They should be a periodic revision of charges at least every three years to bring them at par with the current rates.
• Proper accounts in respect of all services should be introduced so that the charges for a service are fixed in a scientific manner by taking various elements of cost into account.

The principle of user charges should in no case be used as a cover up for inefficiencies in provisions such as high administrative cost, wastage, system leakages and the cost of collection of charges as such inefficiency would push up charges to unnecessarily high level. Therefore, the ULBs must ensure an efficient and desirable level of services to justify recovery of user charges. It would be necessary to introduce greater transparency in system of fixing user charges and collection procedures as well as effect necessary management improvements. Such a transparency would act as an incentive to reduce inefficiencies and also make user charges more acceptable to the general public.

It has been found that the ULBs are most reluctant to adopt the principle of user charges for reasons of populism. To ensure that the ULBs are weaned away from the habit of dependence on State funds, they must be encouraged to take measures for their resource augmentation by recourse to greater and more effective use of user charges in respect of various urban civic services. Therefore, encouragement for utilizing user charges should be given to the ULBs by linking their own efforts in this regards with transfers of incentive grants. Suitable parameters need to be devised relating
to the performance of levying user charges and a well designed system evolved for this purpose.

**Commercial Exploitation of Municipal Properties**

Municipal properties in various cities and towns of the State constitute valuable capital assets of the ULBs. The revenue received by the ULBs from these properties is extremely low. A large number of municipal lands are also under unauthorized occupation. The lands in urban areas have a tremendous potential for commercial exploitation. These can generate considerable resources for the cash-starved ULBs if properly planned and developed. Kumar and Aggarwal (1997) in their study of ten ULBs of Punjab suggested measures to increase rent of municipal property. The study found that majority of the tenant were paying a monthly rent of less than Rs. 500/-. Some of them were paying a monthly rent as low as Rs. 10/-. Whereas due to litigation, heavy arrears of rent had accumulated, this had gone as high as Rs. 1 crore for Amritsar Municipal Corporation. The study suggested that all low rent-yielding property should be sold immediately to tenants to get more revenue for the ULBs. As regards rationalization of increase of rent of the municipal property, the study suggested a 20 per cent increase after every three years in case of properties located in commercial areas, 15 per cent for properties in semi-commercial areas and 10 per cent for properties in peripheral areas of the State.
The tenanted properties which are yielding very low returns, may be sold to tenants. Instructions have been issued by the Department of Local Government, Punjab for transferring these properties to sitting tenants on a prescribed percentage of market value. Where the sitting tenants are not willing to buy these properties at concessional rates, the same may be sold in open auction. Such a measure will be financially beneficial to the ULB as long as the sale price yields higher income by way of interest at the current interest rate than the rent received by it.

Another problem faced by ULBs is the unauthorized occupancy of municipal lands. All-out efforts should be made for removal of unauthorized occupants from municipal lands. Simultaneously, plans should be chalked out for the utilization of the vacated lands either for provision of civic services or for commercial exploitation as such lands are at risk of being encroached upon again. The Punjab government, vide its memo dated 08th May, 2001 issued instructions to regularize such encroachments on the municipal land on which the encroachers had constructed houses/dwelling units more than five years back by charging 20 per cent of the market value in case of houses built on land upto five marlas, 30 per cent of the market value for land upto 10 marlas, 40 per cent upto one kanal and 50 per cent of market value beyond one kanal. However the implementation of these orders has been stayed by the Punjab and Haryana High Court in a writ petition.
Sometimes it may make commercial sense to transfer property to an unauthorized occupant where the chances of eviction through legal measures is uncertain and the proceedings would involve disproportionate expenditure of time and money. However, this should be left to judgment of the ULB concerned with requirement for prior approval from the State Government to prevent to transfers on extraneous considerations. The State Government should not normally order such transfers on its own. In exceptional cases where the transfer of such property to the unauthorized occupants is to be ordered on general policy considerations, the ULB should be compensated for difference between the market value of the property and the price at which its required to be transferred.\footnote{3}

**Privatization of Urban Services**

It is estimated that the proportion of urban population to total population in India is likely to increase to nearly 40 per cent by the year 2025. This will happen in Punjab too as it is the third most urbanized State of the country. The gradual migration of rural population to urban areas due to rapid industrialization is inevitable. Despite the major contribution of urban centres to economic growth, the cities in Punjab do not give a clean look. The cities in Punjab face a serious crisis with respect to the availability of infrastructure and other basic and essential civic services such as drinking water, sanitation etc. Roughly one-fourth of urban population has no access to safe drinking water and more than half of the population has no access to
safe sanitation. The quantum of water for domestic use is not sufficient even for those who have access to it. Moreover, the problems of transportation and power, rising air and water pollution and acute shortage of housing had made urban living difficult. The Report of First Punjab Finance Commission\(^4\) (1995) suggested that the ULBs have an annual per capita revenue income in the range of Rs. 200/- to Rs. 350/-. This low level of income is insufficient for the maintenance and also to substantially improve existing civic services. This grim situation in almost all cities of the State is largely linked to the poor financial health of the ULBs, who are in a financial crisis and cannot even perform their obligatory functions satisfactorily. An estimate by NIUA\(^5\) suggest that ULBs all over the country would require nearly Rs. 39000 crore (at 1991 prices) in the next decade to augment municipal services. It is amply clear that the Central and State Governments do not have sufficient budgetary resources for such investments.

Given this situation, the alternative left with the ULBs is to privatize the urban services. In this context, the ULBs can consider the involvement of private sector by entering into partnership with the ULBs in the provision of urban services because most of the municipal services are amenable to privatization. There is a compulsive need to privatize in view of the growing demand for urban services. The growth in demand is both due to increasing urban population as well as the increasing income of households in urban
areas. Given the inability of the ULBs to raise the necessary resources, there is a case to promote private capital to maintain and to augment the civic service in the urban areas of the State. The advantages of privatization are:

Cost Savings – The use of private sector for municipal services leads to significant savings in cost for ULBs. Experience from different cities shows savings of up to 50 percent in some of the municipal services.

- **Increase in Service Coverage** – The ULBs are often unable to provide services to the entire area within their jurisdictions. Private sector, on the other hand, is able to service a larger population because of its ability to raise resources and mobilize manpower.

- **Increased Revenues** – The cost recoveries of various services provided by the ULBs are low. When private parties provide services, cost recoveries are astonishingly high enough.

- **Capital Infusion** – The private sector with access to capital market will find it easier to infuse much need capital investments for urban services.

- **User Responses** – Generally, most users of municipal services are dissatisfied with the level of services and the uncaring attitude of the municipal officials. The private sector responds to consumer complaints and grievances in a responsive manner.
• **Improvements in Efficiency** – The Private sector, with its flexibility in adapting to changing needs and working for profits, will provide much more efficient service than the public agencies. The cost reduction and increased revenues are due to the efficiency in the use of capital. The operation and maintenance of services improves with private participations. Also, the private sector may bring in modern technology which may further enhance its efficiency in providing the service.

Arrangements with the private sector can be made in two ways: First, by fully divesting the public authority of the functions; and Second, by public-private partnerships (PPP) where to parties come together to provide a service or facility. Although fully divesting is not advisable, unbundling of services into a number of activities will enable a ULB to contract out if few activities in each service while retaining overall control of the service. The municipal services where private sector may be allowed entry in providing services are sanitation and public health, solid waste management, roads and streets, water supply, tax collection, gardens and parks, market development and land development etc.

A ULB can use many partnership arrangements in provision of urban services. The mean types of partnership arrangements often prevalent in the area of urban infrastructure and services are as follows:
• **Build-Own-Operate (BOO)** – An arrangement whereby a private entity is responsible for the financing, construction and operation of an infrastructure facility and where the private entity retains the ownership of the facility.

• **Build-Operate-Transfer (BOT)** – This is an arrangement where a private entity is responsible for the financing, construction and operation of an infrastructure facility and the private entity transfers the facility to government agency at the end of the specified period.

• **Build-Own-Operate-Transfer (BOOT)** – Here the private entity provides finance for construction, owns, operates, and maintains the facility for a specified period and then transfers ownership to local government. The condition of the asset on transfer must be specified by the public agency.

• **Competitive-Tendering (CT)** – The process of seeking a number competitive tenders for a defined service to be performed under contract.

• **Compulsory –Competitive-Tendering (CCT)** - Same as CT, but is carried out through force of legislation or regulation.

• **Contracting Out** - In this arrangement, the local government contracts with private firms or other agencies to perform particular operation or maintenance functions for a fixed period and for a specified compensation.
• **Co-operatives** – Self governing voluntary organizations designed to serve the interests of their members.

• **Franchising** – In this arrangement, a private partner takes over the responsibility for operating a service and collecting charges and possible for funding new investment in fixed assets, mostly within a defined geographical area.

• **Concession** – An arrangement whereby a private entity leases assets for service provision from a public authority for an extended period and is also responsible for financing specified new fixed investments during the period. These new assets then revert to the public sector at the expiry of the contract.

• **Afformage** – In this arrangement, the public authority controls the construction, owns the fixed assets, but contracts out operations, maintenance and billing.

• **Leasing** – An arrangement whereby a private party (lesser) contracts with a public authority for the right to operate a facility (and the right to flow of revenues from providing a specific service) for a specified period of time. The facility continues to be owned by the public authority. Unlike in a concession, the lesser does not have the responsibility for investment in fixed assets.
- **Management Buy Out (MBO)** – The management of a well run internal function negotiate the purchase of that function and becomes a private venture.

- **Privatization** – The entire public service is sold to a private company.

- **Vouchers** – Vouchers enable consumers to obtain goods and services free or at reduced cost while retaining the power to choose between competing suppliers.

- **Management Contract** – An arrangement whereby a private agency assumes the responsibility for a full range of operation and maintenance functions, with the authority to make day-to-day management decisions. Competition may be based partially on the services rendered (as for service contracts) and partially on the performance achieved (as in profit sharing).

  Contracting out is the most common means of involving the private sector for providing urban services. The terms of contract determine the level of involvement of the private partner. The States like Maharashtra, Gujarat, Tamil Nadu, Assam, Rajasthan, Karnataka, Kerela, Bihar, Haryana and Punjab have involved private sector for services such as maintenance of street lighting, gardens, garbage removal etc. In Punjab, the municipal corporations of Amritsar, Jalandhar and Ludhiana have used private sector for such activities as sanitation and public health (conservancy/ drain...
cleaning/sanitation/maintenance of STP), solid waste management (garbage collection/disposal/street cleaning) and development and maintenance of gardens and parks (parks/play grounds/sports complex/swimming pool, planetariums/traffic islands). The experience has been good in providing services and in reducing cost. These arrangements have improved the cleanliness of the cities and the system is being extended progressively.

The privatization of tax collection is not favoured among the people. This is a public function and should be performed by the public agencies only. Levying of taxes and their collection is a sign of power and authority which the ULBs enjoy. This function should not be abdicated in favour of a private agency. Greater use of the private sector should be made in the provision of services particularly those which are discrete and whose consumption is possible and is attributed to individuals/households.

In the light of the above, it is suggested that a number of civic service should be transferred progressively to the private sector so that the people have access to the desired level of service on payment basis. This will reduce burden on budgets of ULBs and still ensure a higher level of satisfaction to the users of civic services in urban areas of the State. In the context of the Seventy-fourth constitutional amendment, it is important to include an enabling clause in the State municipal legislation for privatization of municipal services. A ULB may, through a resolution, provide the specified services through contractors or other agencies to extent it deems
fit. In matters of fixing the tariff for such services, the role of ULBs is crucial and needs to be defined specifically for each contract so that the interests of the users are safeguarded.

**Accessing the Capital Market: Municipal Bonds**

Of late, municipal bonds have emerged as an important instrument for financing urban infrastructure projects. Municipal bonds are issued by the ULBs who finance, construct and deliver a variety of urban infrastructure projects and services such as water supply, sewerage, solid waste disposal etc. Municipal bonds can either be general obligations bonds, where all legally permitted taxes and general revenue of local authorities can be used for debt servicing or revenue bonds, which rely upon specified sources of revenue from facilities or services financed from bond proceeds.

Municipal borrowing through bond issues has many advantages. It enables municipal authorities to raise revenue resources from the capital market. It also motivates municipal agencies to increase their overall efficiency as the credit rating of bonds is largely dependent upon the ability of the ULBs to manage their resources. Revenue bonds are serviced through the stream of returns from a particular project. This will require development of commercially viable infrastructure projects and rationalizing the pricing of urban services.

The municipal bond market is especially well-developed in the US and has been in existence for over a century. The US bond market is by far
the most active in the world and is often cited as a role model for the development of similar markets in developing economies. It finances over 70 per cent of its urban infrastructure development. The total outstanding volume of municipal bonds in the US is $988 billion and each year bonds worth $200 billion are issued. The main reasons for the success of the US municipal bond market are absence of government controls, active and large secondary market largely due to securitization of municipal bonds and tax exemption from interest income which attracts a large range of investors. However, municipal bonds are not an entirely accepted phenomenon in European markets although the ULBs in some countries of Europe and South-East-Asia have also began to raise resources through bond issues.

In India, the municipal bond market as an instrument to finance urban infrastructure is still in its nascent stages. Some developments in the economy, particularly the new economic policy, have put in place initiatives towards accessing the capital market on the strength of commercially viable and bankable projects in 1994. The advent of the Indo-USAID Collaborative – financial institution’s reforms and expansion-debt (FIRE-D) Project in 1994 was directed towards this end. However, the experience has not been very satisfactory even after more than a decade and a half of FIRE-D operations in India. The urban sector in general and the municipal sector in particular continue to constitute an insignificant share of the total amount mobilized through the domestic capital market. Bagchi (2001) has analyzed
the constraints in accessing capital market by the ULBs in India. These constraints may be summarized as follows:

1. Economic Constraints
   - Absence of buoyant tax sources for the ULBs
   - Low implementation of user charges
   - High establishment expenses

2. Institutional Constraints
   - The municipal governance system
   - Lack of financial discipline on the part of ULBs
   - Lack of a developed capital market

3. Structural Constraints
   - Lengthy procedures and formalities
   - Preconditions imposed by SEBI for rating of debt instruments issued by ULBs by a credit rating agency.

The municipal bond market has enormous potential in India with the size of the market estimated at Rs. 80 billion. The development of bond market would open up not only a vast new source of funds for municipal corporations but also a lot of business for merchant bankers and other intermediaries. The Local Authorities Loans Act, 1914 would need to be amended to foster growth of municipal bond market. The development of a full-fledged municipal bond market in the country requires a regime of fiscal concessions to induce individual/institutional investors to invest in bonds, a
package of regulatory measures for bond guarantee, insurance etc. and a specific role for the Securities and Exchange Board of India (SEBI) or a similar regulatory authority. Some of the States including Maharashtra and Gujarat have explicit legislative procedures for ULBs to undertake open market borrowings. Since the FIRE-D initiative, eight municipal corporations have issued municipal bonds to finance investments in various projects in the urban infrastructure sector. These are Ahmedabad, Bangalore, Hyderabad, Nasik, Nagpur, Ludhiana, Madurai and Indore. Ahmedabad Municipal Corporation has benefited from this initiative twice. Table-7.1 gives details of structure of bonds issued by municipal corporations in India.

<table>
<thead>
<tr>
<th>Cities</th>
<th>Amount (Rs. Million)</th>
<th>Placement</th>
<th>Government guarantee</th>
<th>Assigned Rating</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ahmedabad-I</td>
<td>1000</td>
<td>Pr/pub</td>
<td>No</td>
<td>AA-(SO)</td>
<td>WS and S project</td>
</tr>
<tr>
<td>Ludhiana</td>
<td>100</td>
<td>Private</td>
<td>No</td>
<td>LAA-(SO)</td>
<td>WS and S project</td>
</tr>
<tr>
<td>Bangalore</td>
<td>1250</td>
<td>Private</td>
<td>Yes</td>
<td>A-(SO)</td>
<td>City roads/street drains</td>
</tr>
<tr>
<td>Nasik</td>
<td>1000</td>
<td>Private</td>
<td>No</td>
<td>AA-(SO)</td>
<td>WS and S project</td>
</tr>
<tr>
<td>Nagpur</td>
<td>500</td>
<td>Private</td>
<td>No</td>
<td>LAA-(SO)</td>
<td>WS project</td>
</tr>
<tr>
<td>Madurai</td>
<td>300</td>
<td>Private</td>
<td>No</td>
<td>LA+(SO)</td>
<td>Madurai inner ring road project</td>
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<tr>
<td>Ahmedabad-II</td>
<td>1000</td>
<td>Private</td>
<td>No</td>
<td>AA (SO)</td>
<td>WS and S project</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>825</td>
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<td>No</td>
<td>LAA+ (SO)</td>
<td>Road construction and widening</td>
</tr>
<tr>
<td>Indore</td>
<td>500</td>
<td>Private</td>
<td>Yes</td>
<td>A (SO)</td>
<td>Improvement of city roads</td>
</tr>
</tbody>
</table>

Source: Soumen Bagchi and Anirban Kundu (2003)

In Punjab, a sum of Rs. 17.84 crore was raised by Ludhiana Municipal Corporation in 1999 by issuing secured non-convertible, non-
cumulative redeemable bonds through private placement. The corporation has reported that the transaction cost for the bond offerings which is quite reasonable as compared to the cost involved in getting the loan from financial institutions such as HUDCO and the rate of interest was also 1 per cent lower than that would be payable on loan from HUDCO.

All these bonds have been made free from income tax by the amendment of Income Tax Act by Finance Act of 2000. As a sequel to this amendment, guidelines for issue of tax free municipal bonds have been issued by the Department of Economic Affairs, Ministry of Finance, Government of India. Under these guidelines, these bonds can be issued for setting up of new projects and expansion, augmentation or improvement of the existing system in the sphere of water supply, sewerage, sanitation, drainage, solid waste management, roads, bridges and flyovers. Upto one-third of the project cost or Rs. 50 crore, whichever is lower, can be raised through the bonds. Specified bonds that are notified in the official gazette by Department of Economic Affairs, Ministry of Finance, Government of India, on the recommendation of the Ministry of Urban Development will be eligible for tax exemption under Section 10(15) (vii) of the Income Tax Act.

Till now, the municipal corporations of Ahmedabad, Greater Mumbai and Pune have already been credit rated. The municipal corporation of Vijayawada and Kerala Water Authority as well have been credit rated by CRISIL. The Investment Information and Credit Rating Agency (ICRA) has
developed rating methodology at the instance of National Institute of Urban Affairs (NIUA) under the FIRE-D programme for Punjab Water Supply and Sewerage Board. The ICRA has also completed credit option studies for Ludhiana Municipal Corporation.

The Report of Second Punjab Finance Commission\(^9\) (2002) has also recommended the issuance of municipal bonds by the ULBs of Punjab. The report observes that it would be possible only for larger ULBs with sound financial position as these would need favourable rating by the credit rating agencies. Moreover, while in case of loans from financial institutions, the amounts may be drawn as the expenditure progresses, in case of bonds, interest on the entire amount will be payable from the date the bond is subscribed. Therefore, it will be necessary to have the project report with requisite technical and administrative clearances ready before the bond is issued so that the local body does not have to pay unnecessary interest on the amount that remains with it unutilized. In a market where interest rate may fall in future, it is also necessary to limit the amount of bond issue to the amount required in the near future. Subject to these limitations, the ULBs with sound financial position should be encouraged to go in for tax free municipal bonds instead of taking loans from financial institutions for their major infrastructure projects to reduce the expenditure on interest payment.
Notes and References


