Chapter III

FACTORS AFFECTING TO FINANCES OF MUNICIPAL COUNCIL
Chapter No. 03

Factors Affecting To Finances of Municipal Council

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3.01 Introduction:

In India out of the total population of 1027 million as on 1st March, 2001, about 742 million live in rural areas and 285 million in urban areas. The net addition of population in rural areas during 1991-2001 has been to the tune of 113 million while in urban areas it is 6 million. The percentage decadal growth of population in rural and urban areas during the decade is 17.9 and 31.2 percent respectively. The percentage of urban population to the total population of the country stands at 27.8. The percentage of urban population to total population in the 1991 Census (including interpolated population of Jammu & Kashmir where Census could not be conducted in 1991) was 25.7 percent. Thus, there has been an increase of 2.1 percentage points in the proportion of urban population in the country during 1991 - 2001.1

The urban and sub-urban areas in India are mainly taken care of by the municipalities and municipal corporations. The size of the municipality can vary from one place to another. It can be as large as a district and as small as a tehsil. Work pressure on the municipalities has increased immensely from independence. Various types of technologies are being implemented to reduce the pressure. The governance of the municipalities has also become easier with the introduction of technology. The implementation of technology has also helped in tax recoveries. Previously the municipalities were dependent on the State Governments for aids and finances. After 2000, they started becoming financially independent and self-sufficient.2

The Municipal Corporation plays an important role in city administration. The Municipal Commissioner is the head of the Executive branch of the Municipal Corporation. The Municipal Commissioner has all the executive powers. The mayor is also an integral part of the Municipal Corporation, though he lacks any...
form of executive authority. There are also councilors, who work at the acute local level. The Municipal Corporation is responsible for the maintenance of roads, supply of clean and potable water to the general masses, street lighting, removal of garbage, sanitary and healthcare facilities, registration of births and deaths in the area, maintenance of bridges and heritage buildings, operating schools on primary level, opening of dispensaries and health clinics, naming of streets and houses and many more.

There are also some discretionary functions that are carried out by the Municipal Council. These include conducting surveys, public entertainment, organizing public receptions, public exhibitions, to construct and maintain museums, libraries, public parks and gardens, planning and laying of areas, construction of orphanages, leper homes, rescue home for women and street children, rest houses and many more. The welfare and well being of the municipal employees is also taken care of by the Municipal Councils. The Municipal Councils has to work hand in hand with the State Government for effective implementation of the various plans and programs that are set up for the welfare of the common people. However, at times it has been seen that there are disputes between the State Government and the Municipal Councils on the ways of working and management of funds. There are also many non-government organizations and agencies that work with the State Government as well as with the Municipal Councils to ensure better services to the people.

3.02 Role and Function of Municipal Councils:

The role and functions of the Municipal Councils are similar to Municipal Corporations. The only difference is the area that is covered by each of them. While a Municipal Corporation takes care of a large area, municipal councils work for a comparatively smaller area. The Municipal Councils are governed directly by State
statutes. The municipal councils vary from one state to other depending on the size and population of the state. The members, who are an integral part of the Municipal Council, are its President, the Committee and the Chief or the Executive Officer. The President is elected from among the councilors and can be approached for any required help.

The term of the President also varies from one to three years and is not the same as that of the council. Both deliberative and executive powers are vested in the President of the municipal council. The tenure of the councilors in the municipal councils varies from three to five years, in accordance to the municipal acts that are passed for the individual state. The municipal councils also have discretionary and obligatory functions that have to be carried out and are almost similar to the functions of Municipal Corporations and Municipalities. With passage of time, new steps have been taken up to update and upgrade the municipal system in the country. Many modern mechanisms have been applied to these local bodies to that their efficient functioning is ensured. Quality of work has also been emphasized in the various agendas and acts that have been brought forward by the local administrative bodies.
Table No. 3.01
Assignment of Functions of Municipal Council

<table>
<thead>
<tr>
<th>Essentially Municipal Functions</th>
<th>Municipal Corporation</th>
<th>Municipal Council</th>
<th>Nagar Panchayat</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban planning including town planning (subject to broad 'outline' or 'structural' plan prepared by the District and Metropolitan Planning Committee/State Government)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Regulation of land-use and construction of buildings (subject to broad 'outline' or structural' plan prepared by the District and Metropolitan Planning Committees/State Government)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Planning for economic and social development (Preparation and implementation of socio-economic development plan)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Roads and bridges</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Water supply domestic, Industrial and commercial purposes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Public health, sanitation, conservancy and solid waste management</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Fire services</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Urban forestry</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Preventive Health Care</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Provision of urban amenities and facilities such as parks, gardens, playgrounds</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Burials and burial grounds, cremations, cremation ghats/grounds and electric crematoria</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Cattle pounds, prevention of cruelty to animals</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Vital statistics including registration of births and deaths</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Street lighting</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Parking lots, bus stops and public conveniences</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>
Regulation of slaughter houses and tanneries | Yes | Yes | Yes
---|---|---|---
Slum improvement and upgradation | Yes | Yes | Yes
Protection of the environment and promotion of ecological aspects | Yes | Yes | Yes
Safeguarding the interests of weaker sections of society, including the handicapped and the mentally retarded | Yes | Yes | Yes
Urban poverty alleviation | Yes | Yes | Yes
Promotion of cultural, education and aesthetic aspects | Yes | Yes | Yes
Primary Education | Yes | Yes | No
Primary Health Care | Yes | Yes | No


3.03 Powers, Authority and Responsibilities of Municipal Councils:

The State legislatures may by law endow the municipalities with such powers and authority as may be necessary to enable them to function as institution of self-government and such law may contain provision for the devolution of powers and responsibilities upon municipalities in respect of preparation of plans for economic development and social justice and for implementation of schemes as may be entrusted to them including those in relation to the matters listed in the Twelfth Schedule of the Constitution viz-

1) Urban Planning including town planning;
2) Regulation of land use and construction of buildings;
3) Planning for economic and social development;
4) Roads and Bridges;
5) Water supply for domestic, industrial and commercial purposes;
6) Public Health, Sanitation conservancy and solid waste management;
7) Fire services;
8) Urban Forestry, protection of the environmental and promotion of ecological aspects;
9) Safeguarding the interests of weaker sections of society, including the handicapped and mentally retarded;
10) Slum improvement and up-gradation;
11) Urban poverty alleviation;
12) Provision of urban amenities and facilities such as parks, gardens, playgrounds;
13) Promotion of cultural, educational and aesthetic aspects;
14) Burials and burial grounds, cremations, cremation grounds and electric crematoriums;
15) Cattle ponds, prevention of cruelty to animals;
16) Vital statistics including registration of births and deaths:
17) Public amenities including street lighting, parking, bus stops and public conveniences;
18) regulation of slaughter houses and tanneries.  

A perusal of these functions assigned to the municipalities shows that the municipalities shall not confine themselves to mere provision of civic amenities but also play a crucial role in the preparation of plans for local development and in the implementation of development projects and programmes including those specially designed for urban poverty alleviation. The geographical area of the municipal council and population residing in the area are the two crucial points, which may primarily influence the size of municipal income to be derived from both the tax and non-tax sources. If the hinterland and core municipal area is richly flourishing with industries and economic activities amidst the sufficiently available natural resources, it without doubt makes municipal council stronger in procuring the funds for the benefits
of its residents. Although, the Municipal councils from the Osmanabad district are having comfortable industrial and agro based economic surroundings instantaneous to growth and the development, there has been lack of the proper imbued leadership cult amongst the municipal councilors for eking the benefits of these favourable economic and industrial surroundings necessarily created by the Government under special development plans.

3.04 Municipal Administration in Maharashtra:

Municipal Administration of Maharashtra looks after the developmental and administrative activities of the different cities and districts of the State. The Municipal Administration of Maharashtra has been delivering its duties diligently. It supervises and administers the urban areas of the state. The various responsibilities of the Municipal Administration are as follows:

- To supply clean and safe drinking water to the people.
- To provide and maintain proper drainage and sewage systems.
- To provide public street lighting.
- To maintain the sanitation and hygiene of public toilets.
- To construct and maintain bus terminals, roads, culverts and bridges.
- To look after the maintenance of public parks and gardens.
- To make sure that there is a systematic and planned growth of cities.
- To regulation of building construction.
- To issue licenses for various Trades.
- To issue Birth and Death certificates.

Apart from these, Municipal Administration deals with some other responsibilities like education, health, community and
recreational services. The main sources of income of the Municipal Administration of Maharashtra are:

- To collect taxes on building and lands.
- To levy taxes on the usage of water.
- To collect fee for issuing trade licenses.
- To collect license fee from builders and promoters.

### 3.05 Trends of Urbanization:

The urban population in India has increased in recent years at rapid rates. In 1961 about 79 million persons lived in urban areas of the country; by 2001, their number had increased to over 297 million, registering an increase of over 376 per cent in the last four decades. Almost all population projections indicate that India will enter the 21st century with an urban population of about 300 million, which will further increase to over 400 million in the year 2011 and 553 million in the year 2021.5

Table 3.02 Trends of Urbanization in India, 1951-2021

<table>
<thead>
<tr>
<th>Census Year</th>
<th>Total population (in million)</th>
<th>Urban Population (million)</th>
<th>Percentage of Urban Population to total population</th>
<th>Decadal Urban Growth Rate (%)</th>
<th>Annual Compound Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1951</td>
<td>361.08</td>
<td>62.44</td>
<td>17.29</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1961</td>
<td>439.23</td>
<td>78.93</td>
<td>17.97</td>
<td>26.41</td>
<td>1.98 2.37</td>
</tr>
<tr>
<td>1971</td>
<td>548.15</td>
<td>109.11</td>
<td>19.91</td>
<td>38.24</td>
<td>2.24 3.29</td>
</tr>
<tr>
<td>1981</td>
<td>683.32</td>
<td>159.46</td>
<td>23.34</td>
<td>46.15</td>
<td>2.23 3.87</td>
</tr>
<tr>
<td>1991</td>
<td>846.30</td>
<td>217.61</td>
<td>25.71</td>
<td>36.47</td>
<td>2.16 3.16</td>
</tr>
<tr>
<td>2001</td>
<td>1048.15</td>
<td>296.97</td>
<td>28.33</td>
<td>36.47</td>
<td>2.16 3.16</td>
</tr>
<tr>
<td>2011*</td>
<td>1298.15</td>
<td>405.26</td>
<td>31.22</td>
<td>36.47</td>
<td>2.16 3.16</td>
</tr>
<tr>
<td>2021*</td>
<td>1607.77</td>
<td>553.04</td>
<td>34.40</td>
<td>36.47</td>
<td>2.16 3.16</td>
</tr>
</tbody>
</table>

*Projected figures*
Present thrust on economic reforms in the country has wider implications for urban management and financing. The pace of urbanization and urban growth is expected to be much more rapid and has wide ranging implications for augmentation of services and urban infrastructure. As the new investments in the form of trade and industrial activities are generally set up either in the urban centers or on the urban fringe, it will put direct demand for urban infrastructure and services as support systems for economic activities. The process, thus, has wider implications for augmentation of urban infrastructure and services.

The municipal bodies which are statutorily responsible for the provision and maintenance of basic infrastructure and services in cities and towns are experiencing tremendous fiscal stress even to operate and maintain the existing services at satisfactory levels, let alone augment them. While their responsibility to meet the growing demand to maintain existing services at satisfactory level is increasing rapidly, there is no commensurate increase in their revenue base, which has in fact been depleting constantly. Faced with such a situation the urban local bodies are becoming increasingly dependent on higher levels of government for their operation and maintenance requirements. What is worse, many urban local bodies have accumulated huge debts and are facing serious problems in even servicing their debt. This has serious repercussions on the availability and quality of urban basic services in urban areas of the country.

Municipal Councils of the country are facing a peculiar situation where the demand for services has been rising due to urbanization and urban growth, but on the supply side, the local resource base has been constantly declining. In effective local governance, inefficient management practices, poor planning...
process, lack of periodical revision of municipal tax rates/user charges, poor information system and record management are some of the basic weaknesses in the present municipal administration system. Many municipalities in India, particularly those belong to small and medium size cities are poorly staffed, that the staff responsibilities are unclear and often fragmented, and that their capabilities and motivation to deal with the increasing complex urban needs are extremely low. The result is that the resources at their command which are scarce to begin with, are not put to efficient use and are, in a sense wasted.

As per the conservative estimates, the municipal bodies of India would require an additional investment in basic infrastructure and services if the deficiencies in the existing level of services are to be eliminated and all sections of urban population are to be provided with an access to a modicum of basic urban services by 2020. In addition, approximately Rs. 18 thousand crores annually would be needed to operate and maintain these services at the barest minimum levels. At the present rate of municipal taxation, user charges and efficiency, it is expected that roughly two-third of the total operation and maintenance requirements will be generated by the municipalities themselves, levying a recurrent gap of nearly Rs. 5 crores per annum.

Thus the financial requirements for bridging the existing gaps and meeting the increasing demand for basic services are quite large. But there is hardly any awareness and sensitivity towards the financial dimensions involved in providing and managing even the minimum basic level of services. The net result is deprivation of substantial proportion of urban population from core urban services such as water supply, sanitation, primary health, street lighting, primary education, etc. This has led to
marked deterioration in the standard and quality of life of urban residents.

3.07: Municipal Finances:

While cities have larger populations and expanding boundaries to shoulder, their financial base remains as fragile as ever. The abolition of octroi and imposition of the Rent Control Act have not helped matters. Cities themselves have not been very prudent in their spending practices and wasteful expenditures and financial irregularities in urban local bodies are not hard to find. Cities have been shy to tax and their capacities at innovation generally appear to be low. It is quite evident that cities need to put their house in order through prudent financial practices and come up with innovative ways of generating resource. Government of India has taken certain welcome steps to help urban infrastructure. Tax exemption for municipal bonds and guidelines for their issuance, fiscal incentives for private sector participation in urban infrastructure, permitting FDI inflows into city hardware have heralded the possibilities of great change. The pouring of institutional finance further into urban infrastructure, for instance, is an area that deserves further attention. There is also, at the same time a case for allowing cities greater borrowing flexibility.

The performance of any local government whether central or Municipal largely depends upon the availability of finances. In performing functions by Municipal government economy is secured because Municipal authorities out of the funds raised municipally by levying taxes perform Municipal functions. When the Municipal people are entrusted with the management of Municipal affairs, they will manage them at the lowest cost because they know that it is their money, which is spent on Municipal services. Therefore, they remain conscious to make services more economical and avoid wastage.
3.08 Significance of Municipal Finances:

The significance of municipal finance is too obvious to need any elaboration, as no organization can exist, much less achieve its objectives without at least a minimum of finances. That is why Kautilya, the great Indian philosopher, remarked, "all undertakings depend upon finance, and hence foremost attention should be paid to the treasury." Every administrative act has its financial implications, either creating a charge or contributing to treasury. In fact, finance constitutes the backbone, the life and blood of government. It provides fuel to the administrative machinery. Sound fiscal policy is therefore, of crucial importance to the government whether central, state or local. Imprudent financial management not only brings discredit to the government but also alienates it from the people, and may endanger its very existence.

The responsibilities of municipal bodies have tremendously increased as a result of the rapid increase in urbanization and adoption of welfare state as the ultimate goal of our polity. In any multilevel pattern of government the effectiveness with which the lower units would operate, is determined to a large extended on how their finances are organized in relation to their functional responsibilities. Local government finance, thus assumes great importance. Municipal bodies in order to be able to discharge their obligations in respect of development and improvement of their respective areas, provision of civic amenities and welfare services require adequate financial resources commensurate with the tasks assigned to them. But unfortunately municipal authorities in our country are proverbially deficient in financial resources. As far back as in 1925, the Indian Taxation Enquiry Committee had noted that the finances of local bodies were inadequate for the services they were required to perform.
The Municipal Acts set out an impressive list of obligatory and discretionary functions entrusted to the local authorities. And, besides these legally allocated functions, their responsibilities have been growing in the wake of rapid urbanization exercising continuing and mounting pressure on the civic facilities and amenities. But it is regrettable that the importance of these obligations with adequate resources has never been sufficiently recognized. Since independence, this aspect has been enquired into by numerous central and state commissions and committees but their recommendations have not been matched with adequate follow-up action towards implementation. The decentralization movement of the post-independence period has not radically adhered to financial conditions of local government and they continue to suffer from paucity of resources, and the gap between their finances and desired level of services is continuously widening.

Local government finance has in the past, received little attention from the union or the state governments. Even the social scientists and the students of public finance had paid lesser attention and importance to the problems of finances of municipal governments or the Panchayati Raj. Local finance is comparatively neglected part of public finance. Just as local administration is a comparatively neglected part of politics and public administration. The finance of urban local bodies must match with the functions that are required by the Acts or Statutes to be performed by them. The central problem in local finance is to ensure the purposeful matching of obligations with the resources facilitating the fulfillment of national priorities on the one hand and for a measure of local initiative on the other.
The finances given to urban local bodies pertaining to the performance of essential local activities and services which are considered "to remote to be performed by state governments and which require in their performance immediate local attention, direction, control and supervision". The activities and services of local importance include health, education, water supply, sanitation and other amenities provided to the citizens of urban areas in order to improve their standard of living. The theory of local finance informs us that the matching of urban local finances should be done with functions. In United Kingdom, the local bodies enjoy power to tax and perform functions assigned to them in the charters as well as the statutes. In U.S.A. the functions to be performed by the urban local bodies and the power of taxation is given in the charter of the individual cities.11

In India the functions and finances of municipal committees are provided in the Acts passed by the state legislatures. Any mismatch or discrepancy between the two is likely to create conditions of chaos. Ursula K. Hicks says in this regard: that "If local bodies are to play any significant part in economic or social development, they must clearly have access to adequate finances Local government system both in India and Britain were subordinated to national priorities, functions and services. In U.S.A., "the superiority of the financial resources of the federal government tends to cause programs to gravitate to the national level. The federal government has appropriated some of the best revenue sources. Particularly income taxation and this has made it difficult for the state and local government to find adequate resources.12 We may summarize the theory of municipal finance in one word: "establishing a stable equilibrium between functions and finances." Thus the basic problem of municipal finance remains as to how to maintain a standard of local governmental services for the welfare of the people with the scarce national resources." Some of the most
difficult problems of public finance today can be found in metropolitan areas. Because legal jurisdictions of governments do not coincide with economic boundaries, the proper provision of government services requires some cooperation, coordination, and some centralized planning.

The basic problem with the Indian municipal system of government and administration today is "economic chaos" and "financial bankruptcy". All the economic difficulties of municipal councils in India may be attributed to the following:

(a) Physical and economic deterioration of the cities due to excessive slums which have been sprung up since mid-seventies
(b) Suburbs with rapidly rising population have run into financial problems. Their tax resources are small in relation to needs and demands of the urban communities.

3.09 Theory of Municipal Finance:-

Tiebout says that "local government represents a sector where the allocation of public goods (as a rejection of the references of the population) need not take a back seat to the private sector".13

Muttalib & Mohd. Akbar Ali Khan stated that "A number of factors contribute to the structural construction of local finance, like pattern of local polity, size and level of local units, local functions and government control" and "the local revenue is primarily based on distribution of functions between state government and local government; and for the performance of obligatory functions local resources are identified. In order to ensure that priority is given to such functions and obligatory budgetary provision is made for them"14
The above experts insist for obligatory provisions for obligatory functions as expected from the municipal councils. V. K. Venkataraman suggested that local functions and local finances be put in order. The government should itself evince interest in this matter. It should part with a portion of resources so that they can be exclusively earmarked for the orderly functioning of local bodies based on properly settled scheme of planned needs and resources.

M. P. Sharma was of the opinion that "ability to pay, rather than the amount of benefit received, is the true criterion of allocating tax burdens according to present day notions of social policy. Secondly unearned income or wealth which comes into existence as a result of the operation of social forces should increasingly be diverted to the coffers of the community to be used for the benefit of all. Finally, the local bodies should so regulate their affairs that in course of time, they should be able to depend largely, if not wholly, on their own income from properly and undertakings instead of taxation."

Felix A. Nigro has rightly observed - "Financial administration is of great importance today because of the tremendous increase in the amounts of money expended for government services. Every government does require money. It is utterly essential that sound principles and techniques of financial administration be employed."

3.10 Financial Management of Municipal Councils of Maharashtra:

3.10.01 Municipal Fund: The Model Municipal Law (MML) provides for a number of account heads under which municipal moneys may be kept. The concern is to see that taxes levied for a particular service are spent for the
provision of that service and are not diverted for other purposes. This objective is helpful. The MML also tightens the legal provision in regard to expenditures out of municipal funds outside the municipal area, restricting these to creation of physical assets relating to core functions and with governmental approval. The Maharashtra Acts have similar provision but the MML takes it logically further.

3.10.02 Submission of Budget Estimates: The MML specifies in Clause 86 different authorities to which the Budget estimate would be submitted. The Maharashtra system probably is more liberal and allows more leeway to municipal bodies and fewer levels of approval. The Chapter needs to be reviewed from the point of view of local empowerment. In any case no retrograde step should be taken that moves the State laws backwards.

3.10:03: Accounts and Audit: There has been a lot of criticism in regard to the quality of accounting and auditing in urban local bodies. The Model Municipal Law suggests major changes in regard to these matters, and one of the most constructive are the external auditing of municipal expenditure. Maharashtra has already taken up the introduction of accrual based double entry accounting system that make urban local bodies more market friendly and transparent. A Municipal Accounting Manual has also been envisaged and Government of Maharashtra is also seized of this. Moreover the Municipal Account Committee is provided with outside members making its composition more broad based. These need to be pursued, as the experience with internal mechanisms of auditing has not been entirely satisfactory. The Municipal Chief Auditors that work in municipal corporations under the control of the Standing Committee have not been completely unfettered in their job.
3.10.04 **Municipal Property:** In regard to municipal properties, the MML stipulates that the Municipality shall prepare an inventory of properties of Municipality and, in each year, present a Report on the changes made in the holdings of its immovable properties along with the Budget Estimate. Greater transparency in what is happening in regard to municipal properties is absolutely critical to the long term financial health of cities and this piece of information must be in the public domain. The Maharashtra Act must incorporate this provision. Public urban properties acquire enormous value as cities expand in size and are prone to be poached by powerful elements in the cities.

3.10.05 **Borrowings:** The MML has very comprehensive provisions in regard to borrowings by ULBs. It provides for framing by the State Government of A Comprehensive Debt Limitation Policy for raising loans, limit to loans, rate of interest and terms and conditions for repayment. It includes provisions for credit rating and issue of municipal bonds. The objective is to lay down overall borrowing policy rather than detailed regulation of individual loans by municipal bodies. These are important provisions and bring the ULBs in line with modern municipal practices observed in developed countries. They also seek to empower municipal bodies in line with their financial, technical and managerial capabilities. These provisions are recommended.
3.11: Reasons for Critical Financial Condition Of Urban Local Bodies:

Local taxes have reached saturation points and any amount of local efforts may not fill up the existing gap between the local revenue and the local expenditure. The most fatal blow to municipal taxation is exemption. The contributing factor to local financial inadequacies is welfare measures of government in which case, weaker sections of society are exempted from payment of taxes. Some of the local taxes are abolished by state governments and some are taken over. The government of Karnataka and Maharashtra State has taken over profession tax, which is, and essentially a local tax. The Urban Local Bodies as discussed above suffer from acute scarcity of finances. The reasons for their critical financial condition are as ahead:

3.1101 Inadequate Distribution of Revenue Sources: The sources of income assigned to municipal bodies are inadequate as compared to their functions. These bodies are allocated taxes like octroi, terminal tax, house tax, etc. The proceeds collected from these taxes are not sufficient for the municipal bodies to perform their functions effectively. The taxes which are highly payable like customs, excise duties, sale tax, income tax, land revenue, etc. have been included either in the Union List or are levied by the State Governments. Therefore injustice has been done with the Urban Local Governments as far as sources of income are concerned. The functions of these bodies are always on the increase but the higher governments have never paid any attention about their sources to make them proportionate with their functions.
3.1.02 Defective Budgeting: The system for preparing municipal budget is defective. Balance is not kept between income and expenditure. Sometimes expenditure exceeds the proposed income and the municipal bodies have to face a crisis which ultimately results in breakdown of services. Some municipal bodies start certain projects even before the budget is prepared. When the budget is prepared and placed before the competent authority for approval, those projects even do not figure in the budget and therefore the municipal bodies have to suffer financial losses.

3.11.03 Hesitation to Impose new Taxes: The Local Authorities have been empowered to impose certain taxes. The elected members, who constitute the local council, are always afraid of imposing new taxes on the people because they feel that this will result in their unpopularity and resentment among the people and they will not vote for them in the next elections.

3.11.04: Defective System of Grants: The grants provided by the state government are an important part of municipal finance. But it is unfortunate that these grants are inadequate, unmatched to their needs, irregular, unsystematic and uncertain. There are no uniform criteria to provide grants to the municipal bodies and generally, these are adhoc and discretionary depending upon the availability of funds with the state governments.

3.11.05 Government's Attitude: The attitude of the state governments towards municipal bodies is quite rigid. In some states, like Punjab and Haryana, the State government has taken over some of the municipal functions and has set up specific purpose agencies to perform those functions. But the expenditure in regard to these functions is borne by the municipal bodies. This kind of attitude is very unfair.
3.11.06: **Defective Accounting System:** Accounting and auditing have an important place in municipal administration. Both are instruments for keeping a check on utilization of public money. In various municipalities, audit objections remain pending for many years and in some municipalities audit is not conducted regularly. The accounts rules and regulations framed by the respective state governments are not followed, resulting in financial losses and embezzlements.

3.11.07: **Limited borrowing powers:** The municipal bodies have with very limited borrowing powers. Those borrowing powers are under the central legislation known as Local Authorities Loans Act, 1914. The State Government has the power to sanction up to Rs. 5 lakhs of borrowing in the open market with a condition of repayment in 30 years. The approval of the central government is required if the amount exceeds Rs. 5 lakhs. The rate of interest charged is also generally higher than the market rate. Largely, the attitude of the state / central government is not in favour of municipal borrowing.

3.11.08: **Faulty Tax Administration:** The system of municipal tax administration suffers from various defects. The administrative machinery for collection of taxes is inefficient and ineffective. The concerned personnel are not equipped with adequate training and requisite skills for the purpose. The staff is not paid adequately for the reason that the financially, starved local bodies cannot pay their employees attractive salaries. The employees in order to meet their needs and requirements indulge in corrupt practices, which results in leakage of revenues, mounting size of uncollected dues, evasion in taxes
and further widening the gap between resources and expenditure.

3.11:09: **Urban Poverty:** Urban Poverty in India is one of the most crucial factors responsible for critical financial condition of urban local bodies. The per capita income of an individual is much low as compared to other prosperous countries of the world. The Union and state governments exploit this limited taxable capacity of the people fully leaving a very little scope for the local government. The rapid growth of urbanization has further aggravated the situation and has made the services more costly provided by the municipal bodies.

3.12 **The Weakness In Finance Collection And Proper Utilization**

The main weakness of the Municipal Government in Maharashtra has been the absence of a well-organized and effective system of personnel administration. The local services have failed even to perform normal functions to be facilitated by utilizing the financial resources. The paucity of resources and the poor performance of most of the Municipal committees are due to the inefficiency and inadequacy of the administrative and technical personnel. The same causes the smooth finance procurement and their utilization. What kinds of men do we want to man the civic services in relation to our goals and tasks? How do we go about getting and developing such men? What do we do to motivate them for better performance? Requirements of a good personnel policy have been identified for efficient administration as:

- The best man for the job.
- Increasing professionalism.
- Competitiveness in selections for higher administrative positions.
- Placement to be job-oriented and not status-oriented.
- Motivation for better performance.
• Equal pay for equal work.
• Objective evaluation of performance.
• Selecting out or the weeding out of dead wood.
• Rational promotion and personnel development system.
• Appropriate policies for optimum personnel performance.

Administrative capability at all levels of administration is one of the scarcest of all resources. Since Independence, we have not made any substantial changes in the local administration so as to make it responsive and reorient to the goals of development and welfare. The policy, institutional and operational framework of the personnel system has to be so redesigned as to meet the current needs of local administration. So far every reform has been peripheral and conceived within the traditional framework and standards which have insufficient orientation towards achievement of development, goals and objectives. The existing staff-patterns in the local government may need some significant modifications to induct specialists and professionals in large numbers and to make it more performance-conscious. The generalists will need to develop, through appropriate career development plans, specialized abilities and insights in various segments of local administration. A forward-looking local personnel policy will have, therefore, to be evolved in the contemporary situation to stop further deterioration.

3.13 Municipal Finance for Urban Infrastructure:

Traditionally, municipal councils have relied on subsidized funds for providing urban services which constraints the introduction of user charges and efficient project operation and maintenance. Direct access to capital market would now be an accepted viable option. However, access to capital market requires financial discipline and enhanced credit rating. It has been the experience that only bigger municipal councils are in
a position to take the advantage of the resources available in capital market. Medium and smaller municipalities are unable to do so due to weak financial position and lack of capacity to prepare viable project proposals. A State level pooled financing mechanism is being proposed for smaller and medium municipalities. The objective of a State level pooled finance mechanism is to provide a cost effective and efficient approach for smaller and medium sized ULBs to access the domestic capital markets for Urban infrastructure and to introduce new institutional arrangements for mobilizing Urban Infrastructure Finance.18

3.14 New Ways in Municipal Finance:

An exciting paradigm shift is emerging in developing and transitional economies. With increased decentralization and urbanization, local governments have taken on greater responsibility in the provision of basic municipal services. To help fund education, solid waste management, water and sanitation, and other economic development projects, municipalities have turned to innovative financing mechanisms to meet local demand. Since central government support cannot finance the service needs of most municipalities, local governments are increasingly turning to: (1) own-source revenues such as taxes, licenses and permits, user fees for services, and municipal assets; and (2) borrowing from private capital markets.

Many developing countries are in the midst of a paradigm shift on how to generate resources to increase the delivery of municipal services such as drinking water, sanitation, roads, and schools. Conventional thinking and practice has been that the central government is the primary funder of municipal projects. This attitude was further supported by an international development community focused on grant funding and concessionary loans. Fiscal deficits and other investment priorities
have significantly reduced central government transfers to local municipalities, limiting the provision of basic municipal services. This situation is compounded by rapid urbanization. Demand for municipal services, which already exceeds supply, is increasing exponentially as more people live in urban environments. The inability of municipalities to meet demand has resulted in the spread of diseases, the failure of cities to realize economic development potential and generate own-source revenues, and the increased cost of building infrastructure within existing settlements.

A new paradigm is emerging given that cash transfers from central governments and grants and concessionary loans from bilateral and multilateral donors can only meet a small portion of total local government infrastructure and services needs. Local governments have become more innovative in obtaining sources of funds to finance economic development, with many municipalities turning to the local capital markets to fund municipal projects.

### Sources of Funding for Municipal Facilities.

<table>
<thead>
<tr>
<th>Old Paradigm</th>
<th>New Paradigm</th>
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<tbody>
<tr>
<td>Cash transfers from higher levels of government, and/or grants and below-market-rate loans from bilateral and multilateral donors.</td>
<td>Leveraging market-based local currency loans through strategic use of cash transfers, grants, and concessionary loans.</td>
</tr>
</tbody>
</table>

The prospects of utilizing local capital markets are tremendous. In most developing economies, the supply of capital available from the domestic private economy greatly exceeds the opportunity for investment. Investors in many countries are seeking alternative investment vehicles. Tapping into private
capital markets is not only good for municipalities, but also for economic development. A significant portion of local funds is invested in low-paying central government bonds, unproductive real estate assets, or sent abroad.

Many municipalities have reduced their reliance on government cash transfers and donor loans and grants through own-source revenues. Increasing own-source revenues provides new funds to pay for building critical infrastructure. To increase own-source revenues, local governments have adopted programs to: improve billing and collections; reduce operating costs by implementing energy efficiencies; and, in the case of water supply, minimize lost water due to leaks. These actions are all within the manageable interest of municipal elected officials and managers and do not require difficult political decisions such as raising rates. In some instances, where there have been improvements in service delivery, governments have been able to raise service rates and tariffs to increase local revenues.

With more developed capital markets, municipalities are able to rely more on new paradigm approaches — raising funds directly from market-based sources such as banks and investors (generally with the support of grants and concessionary loans). As an example, the total development cost of a municipal facility is determined. A feasibility analysis is used to determine the sources of funds available for market-based borrowing. The gap between market-based sources and total development costs is filled with grants and below-market-rate loans. The grants provide an incentive for municipalities by decreasing borrowing costs, while achieving a larger policy objective of reduced pollution for all residents living in the watershed. Grants and below-market-rate loans may be structured on a competitive basis to achieve policy objectives. The bond banks use the funds to reduce the cost of
borrowing for municipalities through pooled finance and revolving funds.

3.15 Bank Loans as Municipal Finance:

Banks represent the simplest strategy for providing loans to municipalities; the repayment period, however, is likely to be three to five years, much shorter than needed for large capital projects. This is because banks rely primarily on deposits to make loans. Proper portfolio risk management requires that deposit terms be matched with loan terms. Like a home mortgage loan, to be affordable capital projects such as water, sanitation, and roads often require longer repayment periods; this is difficult for banks given portfolio management risk restrictions. Banks rely on standard loan agreements. These agreements often have terms and conditions that are not in the best interests of a municipality as a borrower. For instance, banks may restrict the use of loan funds or require a pledge of assets in excess of the amount borrowed, which will limit further borrowing by the municipality.

3.16 Municipal Bonds:

Municipal bonds are a bit more complex. Municipal bonds are an improvement over bank borrowing, as the municipality creates a debt instrument with term and conditions that meet its needs and the needs of the investor. The interest rate and repayment period are negotiated. The use of funds and collateral requirements can meet the needs of both the municipality and the investors. The purpose of the prospectus is to inform investors of the risks they undertake by purchasing shares in the bond transaction. Thereafter the debt instrument is sold to investors. To improve the water supply, a municipal bond will be sold to institutional and individual investors located in the city. In addition to a market rate of return, investors also gained because
their businesses derive economic benefits from the water improvements. In addition to the financial incentives, individual investors were attracted because they personally benefit from increased water supply. Credit enhancements are essential for municipal bonds. The need to finance municipal facilities combined with the inability of central governments to transfer sufficient funds needed by local governments will drive the policy reforms needed to unlock these funds.

3.17 Revenue Generation for Municipal Developmental Activities:

Matching responsibility for provision of municipal services with the authority to raise revenues is critical. Technical assistance for designing regulations to increase local government revenue generating powers may be needed. Technical assistance may include something as simple as business licenses, or as complicated as the ability to issue debt instruments. Cash transfers from the government based on incentives for municipalities to undertake reforms are needed, because local government officials and staff are often reluctant to change. In many cases central governments use ad hoc approaches to allocate revenue sharing funds. The aim is to carefully target these cash transfers to achieve needed reforms. For instance, funds may be allocated on a competitive basis to municipalities that pledge to institute double entry accounting systems, or develop pro-poor policies to ensure that people living in slum settlements have access to clean water and sanitation. A portion of the cash transfer can be used to pay for local accounting firms to provide assistance to the municipality. Other examples of criteria for competitive allocation of transfer funds include decreasing operating costs, increasing customer services, and instituting energy savings improvements.19

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