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RBI releases DRG Study on "Municipal Finance in India – An Assessment"

[Note: DRG is constituted in the Reserve Bank's Department of Economic Analysis and Policy for undertaking effective policy-oriented research backed by strong analytical and empirical basis on subjects of current interests. The views expressed in these studies are those of the authors and do not reflect the views of the Reserve Bank]

The Reserve Bank of India (RBI) today published a Study entitled "Municipal Finance in India – An Assessment". The Study is co-authored by Dr. P.K.Mohanty, Mission Director, Jawaharlal Nehru National Urban Renewal Mission, Government of India, along with three research staff members (B.M.Misra, Rajan Goyal and P.D.Jeromi) from the Reserve Bank. The Study was undertaken under aegis of the Development Research Group (DRG).

Using the data from 35 metropolitan Municipal Corporations (MCs), the Study attempts to analyse the reasons for differential performance of Urban Local Bodies (ULBs) with respect to fiscal parameters and provision of civil amenities. The Study was undertaken in the background of assignment of important responsibilities to the ULBs under the Constitution (74th Amendment) Act, 1992.

The major findings of the Study are summarised as follows:

- There is a mismatch between functions and finances of ULBs, which primarily explains the vertical imbalance.
- Out of 18 functions to be performed by the municipal bodies in India, less than half have a corresponding financing source.
- Own taxes and user charges of the ULBs in India are grossly inadequate to meet the expenditure needs of ULBs.
- Elaborate State Government controls on municipal authorities to levy taxes and user charges, to set rates, to grant exemptions, to borrow funds, *etc*, and on the design, quantum and timing of inter-governmental transfers constrain the ability of the ULBs in mobilising resources.
- The Study states that the conventional method for assessing municipal finances in terms of analysis of revenue and expenditures of municipalities may not be appropriate as the ULBs are required to generate a revenue surplus due to statutory requirements.
- Overall resource gaps of ULBs, as seen from municipal budgets, are not very large. However, the spending by all the MCs are lower than that required for providing a minimum level of civil amenities.
- Based on per capita spending on core services by metropolitan MCs, the Study indicates that the level of underspending on an average works out to about 76 per cent. The Study suggests that ULBs have considerable scope for debt financing as they have low debt and interest coverage ratios.

- The backlog, current and growth needs of infrastructure in cities and towns far exceed the resources at the disposal of the ULBs.
- Based on certain assumptions, the study estimates the projected investment requirement of funds for urban infrastructure in the country at about Rs.63,000 crore per annum for the ten year period (2004-05 to 2013-14). This does not include the needs for redistributive functions like urban poverty alleviation. Assuming a status quo in the federal fiscal relationships in the country, the municipal bodies in India can at best raise up to about Rs.27,285 crore per annum. Within this, the resources available for asset creation after meeting current expenditure would at best be of the order of Rs.17,736 crore, implying an annual shortfall of at least Rs.10,000 crore (2004-05 prices), even for providing core urban services.
- The Study suggests that the problems of municipal finance in India need to be addressed in a holistic manner through comprehensive reforms. It suggests that the issues of lack of clarity, consistency and predictability in expenditure assignment and revenue assignment need to be addressed. In particular, the system of taxes, user charges, inter-governmental transfers and borrowings in respect of ULBs need to be reviewed for their adequacy and suitability to match the expenditure needs.
- The Study highlights that a national consensus needs to evolve on a 'municipal finance schedule' for assignment to the ULBs to match the list of functions included in the 12th Schedule of the Constitution.
- The Study also emphasises the function-finance mapping to ensure that each function to be performed by the ULBs is backed by a corresponding financing source.
- According to the Study, revenues and expenditure have to be carefully matched by reforming property tax, using land by adopting 'user pay', 'beneficiaries pay' and 'polluters pay' principles, linking individual services with user charges and collective services with benefit taxes.
- The Study further suggests for restructuring inter-governmental transfers with a simple distributive formula that gives due weights to needs, rights to minimum basic services, incentives to performance and inter-jurisdictional equity.
- Furthermore, it suggests easing of borrowing restrictions on ULBs and for financing urban infrastructure through exploring the options of:
 - (i) municipal bond markets, (ii) specialised municipal funds and (iii) public-private partnerships.
- The Study suggests improvement in expenditure management, professionalisation of staff and efficiency in service delivery of the ULBs.
- The Study also suggests for improvement in the budgeting and accounting systems of ULBs and disclosure of adequate information by ULBs to the public at regular intervals.
- The Study emphasises the need for developing new benchmarks for estimating the costs of municipal services in India by constituting new groups and by undertaking primary studies.

The full Study is available on the Reserve Bank's website (www.rbi.org.in) under Publications.

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