

**MOBILISING
URBAN INFRASTRUCTURE FINANCE
IN INDIA
IN A RESPONSIBLE FISCAL FRAMEWORK**

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*India has large and growing
urban population*

- Population 1027 million as on 1st March, 2001
- 285 million live in urban areas (27.8% of population)
- Net addition of population in urban areas was 70 million in 1991-2001 decade with decadal growth of 31.2 percent
- Share of urban population went up by 2.1%
- Twenty seven million plus cities (35 urban agglomerations)
- 5000 census urban areas
- Urban corporatised entities are over 3700 (109 municipal corporations, 1432 municipal councils and over 2100 city-rural bodies).

*Constitution allocated primary responsibility
for urban infrastructure in India to States*

- Local government in India is assigned to the states under entry 5 of the State List
- Most types of urban infrastructure (public health and sanitation; hospital and dispensaries, roads, bridges, ferries and other means of communication including municipal tramways, ropeways, and traffic, water supplies, drainage, land, industries, gas and gas works, markets and fairs, theatres, cinemas, entertainment and amusements) are state list subjects
- Twelfth Schedule of Constitution lists subjects which can be entrusted to urban local bodies after 74th Constitutional amendment
- States have to still pass law to confer this jurisdiction
- All taxation powers on usual urban tax bases are also state subjects

*Municipal political framework is in place, but
their empowerment is not*

- Mandatory constitution, timely elections, clear identified list of subjects, representation of all sections of urban population, Finance Commission for fiscal resources are all in place
- But, municipalities empowerment has not taken place
- Still entrusted with very basic and traditional functions in most of the states
- Separate institutional arrangements for area development
- Very little fiscal empowerment

*Indian economy is growing at a healthy rate
with good savings rates*

- Indian economy has grown at a healthy average rate of over 6% for more than two decades now, with service sector recording highest growth rates
- India's gross domestic savings- reasonably healthy at 24%
- Public sector continues to be a net dis-saver, which peaked at -2.7% of GDP in 2001-02
- Household savings at over 22.5% are robust; households however increasing their savings in physical assets
- Gross domestic investment rate of public sector has come down notably from 7.7% of GDP in 1995-96 to 5.7% in 2002-03
- India had a positive savings- investment gap of .3% and .9% of GDP in year 2001-02 and 2002-03. The same trend is likely to continue in the financial year 2003-04 and 2004-05.

*Demand for urban infrastructure growing
fueled by increasing urban incomes*

- Most of the service sector GDP originates in urban area and goes to the factors of production residing in urban areas
- Massive spurt in demand for urban infrastructure
- Urban infrastructure services in the public sector like water, electricity, sewerage, roads have not responded to meet the growing demand for quantity and quality of service
- Communication infrastructure has been expanded substantially as private sector players have come in

*General government finance presents
a grim fiscal situation*

- General government tax receipts has been 15% of GDP for centre (9%) and states (6%)
- After tax transfers, states share in total tax revenues go up to little over 8%
- General government revenues at 19% of GDP grossly inadequate to support present expenditure of 30% of GDP
- General government fiscal deficit is around 10% of GDP for several years
- Revenue deficit more than 2/3rd of fiscal deficit
- Capital expenditure by both levels of government is only around 3.5% of GDP (88,000 crore or \$20 billion in 2002-03)
- Large accumulated debts and liabilities further constrain governments' abilities to scale up infrastructure financing

*Low private sector investment demand has enabled
governments to run large fiscal deficit without any
pressure on interest rates and any crowding out effect*

- 10% average fiscal deficit financed for more than 5 years now without any crowding out effect
- In fact, interest rates had come down by 4-5% during last three years to hit the low rate of less than 6% on 10 year GOI paper
- There are good signs of investment pick up now
- States' papers are facing flagging demand, with higher spread being demanded
- Capital expenditure, already low, will face further cut back if revenues do not go up to make up for lesser borrowings

Municipal Financing framework and resources are quite weak

- Municipalities financial position is not available in a consolidated manner nationally
- Taxation resources of the municipalities are very meager: most of the local taxes are also levied by the states
- Octroi has been generally abolished barring few states like Maharashtra, Orissa, Manipur; Profession tax, entertainment and advertisement taxes are also mostly levied and collected by the state governments; some share is passed on to the municipalities
- **Property tax is the only major source of tax revenues**

Municipal Financing framework and resources are quite weak-II

- State Finance Commissions have adopted different approaches to devolution of taxes to urban bodies
- Government of India provides general purpose grants to local bodies via state governments on recommendations of the central finance commission
- State governments also provide grants to municipalities, but these are quite nominal except for compensating grants for abolished octroi
- Central finance commission required to recommend measures for augmentation of the resources of the state government

Government of India has initiated measures for bringing about fiscal reforms and consolidation at state and municipal level

- Fiscal Reforms Facility: Rs. 10,600 crore incentive fund for promoting balanced budgets on revenue account
- GOI has put in place a borrowing capping arrangement for controlling states' growing indebtedness
- Model fiscal responsibility legislation for adoption by the states.
- Debt swap and other measures
- Government of India launched Urban Reforms Incentive Fund (URIF) for promoting urban and municipal reforms

CURRENT ARRANGEMENTS FOR FINANCING URBAN INFRASTRUCTURE

- Responsibility for specific urban infrastructure services differs widely across the states and municipalities
- Central Government provides specific grants for select infrastructure investments- Mega City scheme, Integrated Development of Small and Medium Towns (IDSMT) scheme, Urban Water Supply scheme and a few other minor schemes
- State Governments departments make investments in specific sectors where they are charged with the responsibility to provide service
- Specialised agencies like water and sewerage boards, BEST undertake projects financed on their strength

*CURRENT ARRANGEMENTS FOR FINANCING
URBAN INFRASTRUCTURE-II*

- HUDCO is primary national financing agency in urban infrastructure
- IDFC and ILFS have also identified urban infrastructure sector as their principal infrastructure financing area
- There are state level municipal finance agencies like TNUIFSL in Tamilnadu and KUIDFC in Karnataka
- World Bank and some other external assistance agencies have financed urban infrastructure projects
- Metro development agencies like MMRDA, cities development agencies and urban improvement trust and municipalities themselves undertake directly financed infrastructure works also

*Municipal bonds issues and pool finance
structures have also made their debut in India
at municipal level*

- Bangalore Municipal Corporation issued government guaranteed bonds in 1997 followed by Ahmedabad Municipal Corporation bond issue of Rs. 100 crore in 1998 without government guarantee support; Couple of bond issues thereafter
- Tamilnadu Urban Development Fund (TNUDF) pioneered pooled finance structures, encouraged by USAID as part of its FIRE-D project and World Bank
- Issues rated by the rating agencies
- Government of India is also coming up with a scheme to help municipal bonds and pool finance from capital markets

New initiatives in financing urban infrastructure

- Community based urban infrastructure financing
- Government of India also contemplated to create a City Challenge Fund
- integrate URIF and concept of City Challenge Fund into an Urban Infrastructure Development Fund (UIDF)
- City based initiatives- Bangalore Action Task Force
- Differentiated sales tax, cess on petrol and diesel
- Urban Reforms projects from multilaterals
- Fire-D project of USAID
- Municipal bodies developing bankable projects

Major Issues in Urban Infrastructure Financing in a fiscally responsible way

- Do state governments have fiscal capacity to meet the growing and large need of urban infrastructure without further worsening their revenue imbalance and indebtedness?
- Cities do not have debt overhang. What does it take to make cities in India become major drivers of infrastructure investment?
- Would states be able to resolve the conflict of legislators and civil servants preference for state dominance and constitutional mandate of local provision?

*Major Issues in Urban Infrastructure
Financing in a fiscally responsible way-II*

- Is there an inherent conflict between strong 'district administration and city governance models?
- Can cities empowerment take place without central government assuming a very proactive role in nudging the states to delegate the constitutional mandate to the municipalities and structuring them financially strong?
- What is the better course of action for central government- another constitutional amendment to create autonomous third level of governance or a major conditional grants scheme?

What is the way ahead?

- India needs to think through the third level governance structure for both urban and rural bodies and their co-existence with district administrative arrangements
- It would make make sense to begin with transforming metropolitan areas and 109 municipal councils
- A major conditional grants programme by Centre in these cities can bring about necessary reforms

What is the way ahead-II?

- Institutional constraining factors- rent control acts, land ceilings, FSIs etc. would need to be reformed
- Public sector would not be able to meet the cities infrastructure investment requirement and it need not be the best way always
- Strong system of concessions to private sector and public-private sector partnerships would need to be created

What is the way ahead-III?

- India is urbanizing and needs to urbanize faster;
- Strong cities government would be primary vehicles for meeting growing aspirations of urban population
- Citizens participation would need to be scaled up, including handing over several types of responsibilities to their associations