

## SUMMARY OF FINANCES OF URBAN LOCAL BODIES IN THE STATE AND THEIR RESTRUCTURING

### 15.1.0 Introduction :

15.1.1 This Part (*Part II Urban Local Bodies*) of the State Finance Commission report contains *7 Chapters (Chapter 9 to Chapter 15)*. The Summary that we present in this report covers the Chapters, which exclusively deal with *ULBs*.

### 15.2.0 Urbanization and Local Self-Government In the State :

15.2.1 *Chapter 9 of this report* presents a brief review of the *Process of Urbanization* in the State in its different manifestations. The State is reckoned among the less Urbanized States of India, with only **20.09%** of *its Total Population being Urban*, according to 2001 Census. The process of Urbanization has been slow, unplanned and dysfunctional. Chhattisgarh is a State of Small Towns, and the Urban Hierarchy is top-heavy, with concentration of 63% of its Urban Population in 7 cities, each with a population of one lakh or more. The Small Towns, each with a population of less than **20000** accounts for 14.86% of Total Urban Population. With the attainment of the status of statehood, on 1<sup>st</sup> November, 2000, the process of Urbanization in Chhattisgarh State is likely to be accelerated. But currently, the process of shift of working population from Rural to Urban Economy has been very slow, in view of the slow growth of Urban Economy, as evidenced by sluggish growth of Secondary and Tertiary Sectors. There are big shortfalls in basic Municipal Services and Infrastructure in terms of roads, drinking water supply, drainage, sanitation, solid waste disposal and public health and convenience.

[Para 9.2.1, 9.2.8, 9.2.9, 9.2.10, 9.2.14, Table No.9.3]

15.2.2 In 2001, The State had 10 *Municipal Corporations*, 28 *Municipal Councils*, and 72 *Nagar Panchayats*, having 62.13%, 21.58% and 16.29% of Total Urban Population respectively. The State does not have a single Metropolitan City. The urban problems in the state can be easily tackled when the size of urban settlements and the magnitude of the problem is not very large.

(Para 9.3.13, Table No. 9.5)

15.2.3 Consequent upon the creation of the New State, laws governing the constitution and functioning of Local Bodies in the erstwhile State of Madhya Pradesh, were made applicable to Chhattisgarh State, along with Rules and Regulations. Today, ***the ULBs in the state are being governed by the Chhattisgarh Municipal Corporation Act and Chhattisgarh Municipalities Act*** which is, by and large, replica of the laws of the erstwhile state of Madhya Pradesh, with necessary amendments made after the creation of New State, from time to time. ***As in Madhya Pradesh, the Functional Decentralisation in terms of Schedule XII<sup>th</sup> of the Constitutional Amendment Act, 1992, has taken place in Chhattisgarh also.*** In addition to Traditional Functions, ***ULBs*** on the State have been assigned some New Functions like planning for Social and Economic Change, Urban Planning, Poverty Alleviation, Urban Forestry and Environmental Protection. But Functional Decentralization has not been accompanied by decentralization of adequate funds and functionaries, with the result that the capacity of ULBS to perform their functions adequately and efficiently has been restricted.

[Para 9.4.1& 9.4.2]

***15.2.4 Section 132 of the Municipal Corporation Act and Section 127 of the Municipal Act, confer powers respectively to Municipal Corporations and Municipalities to impose certain taxes which have been broadly classified into Compulsory and Optional, subject to the regulation of the State Government.***

[Para 9.5.2]

15.2.5 Though Chhattisgarh State has been affected to a very small extent by the introduction of the process of Economic Reforms in the Country since 1991 but the process is likely to gather momentum in the near future. The ULBs in the State have to prepare themselves well in advance in terms of building up their infrastructure and basic Urban Services, with a view to attracting Domestic and Foreign Investment. They have also to gear up their Functioning and Financial Resources to take advantage of Centrally Sponsored Schemes and Programmes of Urban Development and Renewal, Floated very recently.

[Para 9.6.1& 9.6.7]

### 15.3.0 A Macro Review of Urban Local Bodies:

15.3.1 *The Next Chapter* is devoted to the **Macro Review of ULBs Finances** in the State, on the basis of data published in the *XII<sup>th</sup>FC* Report, covering the period of 1998-99 to 2002-03, supplemented by data contained in the Memorandum of the State Government submitted to the *XII<sup>th</sup>FC*. **This review is made with the intention of finding out the extent to which ULBs in the State are moving in the direction of Fiscal Decentralization and Fiscal Autonomy.** We have viewed **Fiscal Decentralization** and **Fiscal Autonomy** from a number of angles, the growth of **ULBs Revenue** and **Expenditure** as percent of Central and State Government Revenue and Expenditure, **ULBs Revenue** and **Expenditure** as Percent of **GSDP from Non-Agriculture** in the State. We have examined the totality of the situation by including both **PRIs** and **ULBs** in the exercise and also separately for **ULBs**. **To measure the extent of Fiscal Decentralization, we have calculated Three Ratios** (i) **The Expenditure Decentralization Ratio**, which measures the Percentage of Total Local Spending to Total State Government Spending, **which has shown a deceleration during 1998-99 and 2002-03.** (ii) **Revenue Decentralization Ratio**, which measures the Percent of Total Tax Revenue of Local Bodies to the Total Tax Revenue of the State Government. **This ratio has also shown a down-trend.** (iii) **Fiscal Autonomy Ratio** which measures the Percentage of Locally Raised Revenue Resources, both Tax and Non-Tax Revenue, to Total Revenue Expenditure of Local Bodies. **This Ratio has also shown a decline during the period under study.**

[Para 10.3.1, 10.4.1, 10.5.2, Table No. 10.5]

15.3.2 Considering the fact that Urban Economy in the State generates more than 60% of the GSDP, **Total Receipts** of **ULBs** accounted for only 1.05% **GSDP from Non-Agriculture** in 1998-99, increasing to 1.34% in 2002-03. The Percent of their **Total Expenditure** to the **GSDP from Non-Agriculture** has been lower than that of **Total Revenue**, indicating the fact they could not spend whatever they raised from own sources and also from external sources of Revenue. **Surplus Budgets may not be justified in the face of inadequacy of Municipal Infrastructure and Services.**

[Para 10.8.5, Table No 10.3]

15.3.3 *Our review of ULBs Finances* has revealed the fact the share of *Own Tax Revenue in the Total Revenue* of all the three types of *ULBs, has been declining* over time. *The most worrisome is the fact that ULBs in the State are financing a declining proportion of their Revenue Expenditure, through their Own Resources.* This fact has led to *increasing dependence of ULBs in the State on Transfers* from the State Government, undermining their Fiscal Autonomy, which runs counter to the requirement of the Constitutional Amendment. Another matter of considerable concern is that in respect of all the three types of ULBs, Total Receipts which include besides Own Revenue Receipts, Transfers from External Sources and Capital Receipts, have been exceeding their Total Expenditure. This cannot be justified against the background of unsatisfactory conditions of Municipal Services.

[Para 9.13.2 (i) (iii) (iv) (viii)]

15.3.4 The Poor Financial Position of the Municipal Government in terms of their *Own Resources, both Tax and Non-Tax* may be attributed to factors like Narrow tax base and less elastic and less productive nature of their taxes, limited Revenue through user charges for their services, higher incidence of administrative and establishment charges, inadequate efforts made by ULBs in the direction of Mobilization of their Own Resources, large scale evasion, laxity in revenue collection and the nearness of tax levying government to the tax payers, present as well potential.

[Para 10.15.1]

#### **15.4.0 Grants-in-Aid To Urban Local Bodies :**

15.4.1 *Next chapter* deals with *Grants-in-Aid and Transfers to ULBs*. We have discussed and reviewed briefly the principles, which should govern the dispensation of Grants-in-Aid, the objectives of Grants, *the Role of Grants in Municipal Finances, the Types of Grants and the System of Grants-in-Aid in Chhattisgarh. The Total Transfers from the State Government to ULBs* accounted for 33.4% of their *Total Revenue* in 1998-99 which increased to 57.23% in 2002-03, the percent being the highest in respect of *Municipal Councils* (57.58%), followed by *Municipal Corporations*, (57.52%) and *Nagar Panchayats*, (53.81%) in 2002-03. Of the *Total*

*Transfers* from the State Government, 87.91% were in the form of Compensation for the abolition of Certain Taxes and Assigned Revenue, in respect of *Municipal Corporation*, in 2001-02, increasing to 92.45% in 2003-04, in respect of *Municipal Councils*, increasing from 84.64% to 86.95%, and in respect of *Nagar Panchayats* declining from 74.16% to 73.63% during the same period. The Grants-in-Aid and other transfers from the State Government have failed to stimulate ULBs in the direction of mobilizing their Own Resources. On the other hand, they have increased their dependence on outside sources thereby eroding their autonomy.

[Para 11. 6.1, 11.9.2, Table No. 11.1]

### **15.5.0 A Micro Level Study of Urban Local Body Finances :**

**15.5.1** *In the Next Chapter*, the Commission has made an appraisal of the finances of *ULBs* in the state by adopting Micro-level Approach, with the main objective of capturing their Financial Strengths and Weaknesses and also for estimating their Future Requirements. *The study is based on the data collected by the SFC through Structured Questionnaires from Sampled ULBs in the State, Covering the Period of 1999-2000 to 2003-04.* The study covers all the *10 Municipal Corporations*, *20* out of *28 Municipal Councils* and *20* out of *72 Nagar Panchayats*, covering 45.45% of *all the ULBs* and 82.56% of their *Total Populations*, which is adequate enough to represent the universe. The number of *Nagar Panchayats* included in the study is small because a number of questionnaires filled up by them were rejected on account of their being incorrect or incomplete. *We have made an appraisal of Own Tax and Non-Tax Revenue and Total Revenue Receipts of all the three categories of ULBs separately, the extent of their Self-Reliance, their Tax Structure, Transfer of Funds from the State and Central Government, Per Capita Tax and Non-Tax Revenue and Per Capita Expenditure on different Municipal Services, allocation of Revenue Expenditure on different Municipal Functions and also Over-All Financial Position of each category of ULBs in the State.*

[Para 12.1.2, Table No. 12.1]

15.5.2 Some of the important conclusions emerging from the Study are the following:

- (i) ***Total Own Resources of all the category of ULBs have been declining***, mainly due to sharp decline in the share of ***Own Tax Revenue*** in Total Revenue Receipts:
- (ii) ***Non-Tax Revenue as percent of Total Revenue*** has recorded a decline in respect of ***Municipal Corporations and Nagar Panchayat*** but increased in respect of ***Municipal Councils***.
- (iii) ***Increasing dependence of ULBs on External Sources of Finance***, more particularly ***Transfers from the State Government***.
- (iv) In the year 1999-2000 of the ***Total Transfers from the State Government***, Grant-in-Aid constitute a very small proportion, the bulk of Transfers partake the nature of Compensation to ***ULBs*** in lieu of Abolition of Certain Taxes and partly or account of Assigned Revenue. but opposite in the year 2002-03 (excluding ***Municipal Corporation***)
- (v) No indication of diversification of ***Taxes Structure*** of ***ULBs***, which is dominated by a few ***Compulsory Taxes***.
- (vi) The Growth Rate of ***Tax Revenue*** has been poor mainly due to low tax base, no increase in rates of certain taxes since long, laxity in tax collection, large-scale evasion, lack of efforts to diversify tax structure and mobilize more resources.
- (vii) ***Non-tax Sources*** of Revenue have not been exploited to the optimum extent by majority of ***ULBs***.
- (viii) ***Revenue Expenditure as percent of Total Expenditure*** has been increasing in respect of ***Municipal Corporations*** (except 2003-04) but declining in respect of ***Municipal Councils*** and ***Nagar Panchayats***.
- (ix) There has been increase ***in the percent of Capital Expenditure in Total Expenditure*** in respect of ***Municipal Councils*** and ***Nagar Panchayats*** but not in respect of corporations. (except 2003-04)

- (x) The fluctuating nature of *Revenue Expenditure* characterized by sudden increase/decrease and sometimes negative growth, due to poor planning and management of Expenditure, lack of stability in Revenue Receipts and local pressures, determining allocations on different heads of Expenditure.

[Para 12.19.1 (ii) to (viii), 12.20.7&12.22.2]

15.5.3 *Another Worrisome Finding is that whereas Municipal Corporations have shown Revenue Surplus in 3 out of 5 years of the Study but Deficit in Over-All Financial Position in 3 out of 5 years, the other two category of ULBs have shown Surpluses on Revenue Account as well as Over-All Surpluses, which may imply that they could not utilize their available funds even in the midst of deplorable position of Municipal Infrastructure and Basic Services.*

[Para 12.24.2, 12.24.3, Table No. 12.28]

15.6.0 **Estimation of Revenue Gap And Determination of Fiscal Package For Urban Local Bodies :**

15.6.1 *In the Next Chapter (13), an attempt has been made in the direction of estimation of Revenue Gap and construction of Fiscal Package. In the first instance, we have estimated Actual Revenue Gap in terms of average of 3 years, 2001-02 to 03-04. Revenue Gap may be defined as excess of Revenue Expenditure over Own Revenue Receipts (both Tax and Non-Tax Revenue) The Actual Revenue Gap is estimated at Rs. 142.90 crores in respect of Sampled ULBs, blown up for the whole State to Rs. 163.40 crores, as the average of 3 years period. Own Resources of ULBs taken together accounted for 29.70% of their Revenue Expenditure. We have suggested an alternative approach of estimating Revenue Gap under which the gap is considerably reduced.*

[Para 13.2.1, 13.3.2, 13.3.2, 13.8.1& 13.8.2]

15.6.2 Because of the limitations of Actual Revenue Gap as a tool of estimating future needs and resources, *we have estimated Potential Revenue Gap on a Normative Basis for the period, 2005-06 to 2009-10.* We have followed, by and large the simple

methodology, recommended by the *XII<sup>th</sup>FC*. *We have taken the norm of Per Capita Revenue as well as Revenue Expenditure of the 3 best ULBs in each category of ULBs as the benchmark, the level to which all other ULBs in each category would be required to raise their Per Capita Revenue and Expenditure. The underlying idea is that when some ULBs in a category could achieve higher level of Per Capita Revenue and Expenditure, why cannot the same levels be achieved by others in the same category?* The average Rate of Growth of Revenue and Expenditure in the last three years is used as a reasonable rate of growth of Revenue and Expenditure as the basis of these rates of growth. We have estimated the Potential Gap separately *for each category of Sampled ULBs* for the period, 2005-06 to 2009-10. *The Aggregate of Potential Revenue Gap of the three categories of ULBs comes to Rs. 174.84 crores in 2005-06, rising to Rs. 378.48 crores in 2009-10. The figure of Sample ULBs has been blown up to Rs. 210.78 crores in 2005-06. Rising to Rs.451.02 crores in 2009-10. Higher as well as rising Potential Revenue Gap, may be mainly attributed to the fact that increasing level of Revenue Expenditure has been financed by increasing level of Transfers from the State Government, particularly in terms of Compensation and Assigned Revenue.*

[Para 12.4.0, 12.5.0, 13.6.3 & 13.7.1]

15.6.3 The Fiscal Package that we have recommended cannot fill up the entire Revenue Gap because of its increasing size and importance. Moreover, it has the intention of the SFC for *ULBs* to achieve the incremental development goals. SFC recommended more than Revenue Gap. This is essential for tier development. goal of filling up the Revenue Gap. The Fiscal Package that *we have recommended includes a number of components: Devolution of share of the Tax Revenue of the State Government to Local Bodies, Grants-in-Aid and other Transfers, assuming the form of Compensation and Assigned Revenue*. In this context, our *First Task has been to estimate the Size of Divisible Pool in terms of share of Local Bodies in the Own Tax Revenue of the State Government*. Taking into account a number of factors like the Size of Revenue Gap, the Capacity of Local Bodies to raise their Own Resources, their Over-All Financial Position, the Fiscal Health of the State Government,



*we have recommended that 8.287% of the Net Own Tax Revenue of the State Government be devolved to Local Bodies, for being allocated among PRIs and ULBs on the basis of their population in the Total Population of the state, as per 2001 Census. this comes to 6.628% as the share of PRIs and 1.659% of ULBs during the award period.* For the purpose of inter-se distribution among different *ULBs*, we have recommended the following criteria: (i) *Population* with a weight of 80%, (ii) *Area of ULBs*, 10%, (iii) *Slum Population in ULBs*, 10% weight. In Addition to Tax Sharing, *we have recommended General-Purpose Grant-in-Aid of Rs. 16 crores Per Annum, to be increased by Rs. 1 crore every year during the award period. The criterion for allocation among different ULBs being, Population, 10% weight, Revenue Effort, 40% weight, distance from the highest Per Capita Expenditure on Public Health and Convenience, 50% weight.* The Tax Effort is to be estimated on the basis of *Ratio of Own Revenue to Revenue Expenditure*, the Per Capita Grant increasing with this ratio. While recommending inter-se distribution among different *ULBs*, the Commission has taken into account three factors, *the Needs, the Revenue Effort and the Equity Factor.*

[Para 13.12.6,13.11.8, 13. 11.10, 13.11.12, 13.12.1&13.12.2]

**15.6.4** *The Commission recommends 15% annual increase in the transfers from the State Government in respect of Compensation for Certain Taxes and Assigned Revenue and every year the amount has to be increased in Octroi Compensation should increase accordingly with Entry Tax.*

[Para 13.12.5]

**15.6.5** *The Fiscal Package that we have recommended may meet nearly 80% of the Potential Revenue Gap of ULBs of the State and helpful their development. This is an approximation, hedged by a number of assumptions. The Impact of the Package on the State Budget may not be high, 4.55% of the projected Own Revenue in 2005-06, 3.64% in 2009-10.*

[Para 13.12.10, Table No.12.9]

### **15.7.0 Beyond The Fiscal Package :**

15.7.1 The solution to the financial problems facing *ULBs* cannot be found only in

Fiscal Measures and the Fiscal Package, but also in certain reforms and measures which are generally clubbed together to constitute “*Beyond The Fiscal Package*”. *These measures may be Administrative, Institutional, Managerial, Technical and Political, intended to enhance the inner strength, resilience and capabilities of ULBs essential for making them viable units of Self-Governance.* In fact, measures beyond the Fiscal Package would increase the effectiveness of the Fiscal Package and also improve the *Functional* and Fiscal Performance of Local Bodies.

[Para 14.1.2,14.1.3]

15.7.2 *Beyond the Fiscal Package may include a number of Reforms listed below :*

- (i) The improvement of Administrative Structure and Management of Municipal Services.
- (ii) The Restructuring of the Institutional Frame-Work, more particularly, the State-Local Relations.
- (iii) Reforms in the System of Budgeting, Accounting and Audit
- (iv) Building up of Data Base of ULBs
- (v) Urban Planning and Management.
- (vi) The Computerization of Municipal Operations as well as Documents
- (vii) Reforms in Tax Structure and Non-Tax Structure
- (viii) To explore the scope for Public-Private Partnership
- (ix) Privatization of certain Municipal Services
- (x) Reforms in the Political Set-Up

[Para 14.2.1]

15.7.3 Though some initiatives in the direction of “*Beyond the Fiscal Package*” have been made by the Central Government and also recommended by the Central Finance Commission, the significance of such reforms has yet to be recognized at the State Level. This Commission recommends that along with the implementation of the

Fiscal Package, the State Government may initiate the process of Urban Reforms in the above directions, with a view to enhancing the efficacy of the Fiscal Package and also their Functional Performances. At present the progress in this direction seems to be slow and tardy.

[Para 14.2.2]

15.7.4 To begin with, the Commission recommends that *Municipal Corporations* and bigger *ULBs*, each with a population of 50000 and above may prepare road-maps and action plans for introducing these reforms in different directions. *The State Government can play an important role in facilitating ULBs to introducing such reforms, through guidance, Financial and Administrative assistance and monitoring these programmes.* Another added advantage of these reforms may be in terms of making *ULBs* eligible for taking advantage of the Financial Assistance from the Central Government under the recently floated programme, known as *Jawaherlal Nehru National Urban Renewal Programme.*

[Para 14.15.2, 14.15.3]