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Municipal Finance for Inclusive Development

Innovative models for funding infrastructure and services for state and local self-governments

Paper prepared for CLGF by: GHK Consulting Limited

Supported by the Commonwealth Secretariat

The Commonwealth Local Government Forum

The Commonwealth Local Government Forum (CLGF) is the official Commonwealth organisation representing local government. Set up in 1994 at a time when many countries in the Commonwealth started to decentralise powers and functions from the centre to local government, CLGF brings together ministries with responsibility for local government, local government associations, and individual councils from across the 54 countries of the Commonwealth. CLGF's associate membership structure also includes academic, professional, research and training organisations with an interest in local government.

At a time of increased recognition of the limitations of top down, sector specific policies, national governments are moving towards a more localised approach to development to ensure that goods and services are provided where and when they are needed. This shift brings a new emphasis on the role of local government and a corresponding change in the role and responsibility of central government. With rapid urbanisation, global financial crisis and with the growing impact of migration and climate change, local government's role as the part of government closest to the people, with responsibility for delivery of essential services, promotion of economic development and maintenance of safe and inclusive communities has never been more important.

CLGF and its members promote local democracy and good governance in line with the principles and democratic values set out in the *Aberdeen Agenda*. The *Aberdeen Agenda* has been adopted by members, and affirmed by Commonwealth Heads of Government as part of its commitment to fundamental political values.

CLGF works with its members to promote and strengthen effective democratic local government, and to facilitate the exchange of learning and good practice across the Commonwealth. It supports the development of essential capacity for local government to play a full role in effectively addressing the global and local challenges that they face.

There is huge value in learning from practitioners active in the sector and the CLGF provides a valuable and supportive network keen to collaborate and work together and keen to learn from Indian and South Asian experience and to share their experiences, knowledge and expertise more widely.

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Municipal finance for inclusive development. This report was commissioned by CLGF and prepared by Richard Slater and Prabkhar Yadav, GHK Consulting Ltd, with support from the Commonwealth Secretariat.

Foreward

Traditionally, sub-national government funding has come from intergovernmental fiscal transfers and internally generated revenues. Increasing pressures on services and infrastructure, particularly in urban areas, demand more innovative financial instruments and methodologies to address key and immediate infrastructure and service needs that respond to the needs of all citizens and stakeholders and help to alleviate poverty.

It is against this background that the Commonwealth Local Government Forum (CLGF) decided to commission a study of South Asia on *Municipal Finance for Pro-Poor and Inclusive Development* to look at revenue-raising mechanisms that can support pro-poor and inclusive development. This paper sets out some of the issues and highlights some examples of approaches in India and other countries in South Asia. CLGF is grateful to the authors Richard Slater and Prabhaker Yadav for their work in compiling this comprehensive study.

The pamphlet showcases some successful, practical and re-employable examples of funding mechanisms from around the Commonwealth that can deliver funding to support pro-poor and inclusive development. I hope that our members in South Asia and elsewhere, including policy makers from federal, state and local self-government, will find the analysis and case studies a useful reference when making their own decisions on funding infrastructure to improve services and development in their own areas.

We are very grateful to the Commonwealth Secretariat for supporting the commissioning of this paper.

Carl Wright, Secretary-General, CLGF

Executive summary

It is estimated that by the middle of the 21st century, at least 50 per cent of all South Asians will reside in urban areas, resulting in an urban population of more than 1.2 billion. Whilst the continuing growth of large cities continues to be an important feature of urbanisation, growth is also significant in the small and medium cities of the region. The extent of urbanisation is by no means uniform in the region. Net rural to urban migration has contributed between 25-40 per cent of urban growth in the region, except in the case of Bangladesh and Nepal. Larger cities such as Delhi, Dhaka, Karachi and Lahore may receive more migrants in comparison to other cities, but there is little evidence to support the frequently heard complaint that migrants swamp most South Asian countries.

Almost all urban local bodies (ULBs) in the region which are statutorily responsible for the provision and maintenance of basic infrastructure and services in cities and towns have been experiencing tremendous fiscal stress over the years and hence have not been able to operate and maintain existing levels of service which are well below commonly acceptable benchmarks, let alone expand service coverage and quality on any significant scale. Whilst pressure to meet the present demand for satisfactory levels of service is increasing, cities face an even more difficult task in gearing up to meet future demand for basic infrastructure and services. One of the main underlying problems is that there has been little or no commensurate increase in the revenues available and many ULBs have been forced to depend on higher levels of government for funding, increasing a pattern of dependency that runs counter to the respective devolution frameworks in the region.

The finances of municipal bodies continue to be in a state of disarray with many cities unable to raise adequate resources from their own sources to meet increasing expenditure on services. Moreover, the lack of periodic revision of tax rates/user charges, outdated accounting and financial management and inefficient and ineffective planning and management systems all continue to plague city administrations across the region.

Although many former and current urban development programmes in the region funded by donors such as the World Bank, ADB, UNDP and DFID have included municipal reform components, mostly aimed at strengthening own revenue mobilisation, these initiatives have resulted in some marginal improvement but insufficient to meet the extent of demand for improved service provision.

A new reform driven urban development programme in India (JNNURM), funded by the Government of India with state and city contributions, is an important new approach in addressing some key underlying problems at city level. This programme draws from the 74th Constitutional Amendments in strengthening urban local bodies with incentives designed to encourage State governments to constitute State Finance Commissions (SFCs) to rationalise state-local fiscal relations. This programme provides a substantial amount of grant funding for service improvements whilst requiring cities to implement an ambitious reform agenda.

Whilst the overall performance of the programme has been patchy across the 31 participating states, many cities have made concerted efforts to adopt difficult reforms. At the same time, the programme shows an attempt by central government to reverse a past legacy of funding priority to rural areas at the expense of the urban sector.

In spite of attempts by governments across the region to increase the size and scale of grants to the urban sector, coupled with reform initiatives designed to strengthen municipal finance, planning and management, there remains an enormous funding requirement to address the past infrastructure deficit and meet current and future service demands of the region's cities and towns. This funding gap will need to be met by a mix of interventions that combine higher levels of grant funding direct to cities along with the design and implementation of a series of innovative financing mechanisms that can help to offset the problem of inadequate fiscal resources.

Given the high capital costs involved in developing infrastructure, the traditional sources of finance are not sufficient to turnaround the cities and make them effective growth engines. Hence the need to consider more innovative and flexible financing arrangements. As many urban infrastructure projects are medium to long term without assured income streams, long term debt financing is often seen as a useful strategy. The main source of long-term domestic debt would essentially be from insurance and pension funds and, in some cases, direct subscription by more affluent sections of the population while the depth of supply of long-term debt would broadly depend on macro determinants such as the savings rate and dependency ratios as well as appropriate policy incentives.

In cases where infrastructure investments can generate assured third party sales, equity investment may be a preferred strategy. However, equity investment may require the formulation of a complex procedure for cross subsidisation if the investments are to be truly inclusive. At the same time, for municipalities to engage effectively in equity investment arrangements they require strong institutional support and guidance on formulating the right arrangement and selecting the right party. Other factors, such as the predictability and stability of revenue streams and availability of sufficient domestic savings, which may be crowded out by levels of national or provincial government borrowing.

There has been some innovation in the region in accessing capital markets through bond issues accompanied by specified interest rates and tax exemptions. Municipal bonds can be an effective mechanism since the long term tenure of the bond can match the payback on municipal projects with a wide investor base. The nature of these instruments encourages much-needed institutional strengthening. Ahmedabad Municipal Corporation in India, for example, has raised over Rs 100 *crores* through issuance of bonds and has set an important example in exploring the bond markets for raising capital.

Whilst there has been an increase in bond activity in the region the overall market remains small and fragile. This approach needs to be accompanied by prior credit rating which has been actively assisted in certain countries by programmes such as the USAID FIRE-D and more recently encouraged as part of the JNNURM urban reform. Smaller cities have devised pooling financing structures to

Executive summary

access capital markets although this has been most successful in those cases where demand-side reforms have been effective, based on rational and predictable fiscal transfers such as the case in Karnataka and Tamil Nadu in India.

Public Private Partnerships (PPPs) are a useful mechanism to attract private investment in public infrastructure and services along with private expertise in construction, operations and management. Recent reform programs such as JNNURM in India, specifically encourage PPPs by empowering city governments with the authority to enter into partnerships with the private sector for equity investments and the raising of private debt.

Many South Asian counties have experimented with establishing Municipal Development Funds (MDFs) to finance infrastructure, especially for smaller urban local bodies. Currently, MDFs are operational in India, Bangladesh, Pakistan and Sri Lanka. The fund is established as a legal entity and in some cases includes a professional company to manage the fund. Most MDFs have evolved as extensions of central government infrastructure financing policies, albeit funding projects at the local level. Only recently have they been viewed as possible avenues to access local 'private' capital markets or facilitating direct access by ULBs. As local government borrowers become stronger, there is a possibility for municipal funds (and other government owned financial institutions) to access these innovative sources. The LGU Guarantee Corporation (Philippines), a private finance guarantee institution owned by the Banker's Association of the Philippines and the ADB, is a good example of this. In general though, there has been relatively low progress in raising debt from local markets or actively engaging with private-sector financial institutions in co-lending programs to leverage funds.

Many South Asian countries are now contemplating involving commercial banks, mutual funds, insurance and other financial institutions to participate in such funds. Commercial banks, especially government owned banks have excess deposits in countries such as India and Bangladesh and are thus willing to participate. The success of a typical MDF depends to a great extent on the quality of urban governance and financial management. Along with capital for developing infrastructure, Municipal Development Funds can also provide technical assistance and training to municipalities thereby increasing their capacities.

The paper highlights a wide range of issues that confront municipalities in terms of being able to adopt or replicate the various financial innovations more widely. Equity investment depends on the ability of the municipality to demonstrate stability of revenue streams over the life of the loan. This, in turn, crucially depends on the predictability of internal and external sources of revenue and the existence of a rational and rule based system of inter-governmental fiscal transfers linked to buoyant own sources of revenues.

Local authority borrowing must be developed within the context of constraints on existing municipal systems. In the past, local authorities have had very little freedom with regard to borrowing which has meant they have rarely engaged in long term capital investment planning. The lack of long term investment planning has made it difficult to project and assess debt mobilisation needs against debt service capacities. Local capacity is also inadequate for project management and cost and time overruns are common. These are crucial issues as borrowers need to be in a position to use bond proceeds effectively. Recent experiences of bond issuance by municipal authorities have shown that projects have often not been in a position to absorb the funds mobilized.

Existing accounting and auditing practices also place major constraints on municipal systems. The cash-based, single entry accounting systems used by most municipalities makes it difficult to arrive at accurate financial information. Most municipal legislation also does not provide for mandatory external auditing. These anomalies must be addressed, and the design of a regulatory system will require changes in legislation to ensure improved accounting practices and compliance with proper accounting standards.

The development of effective PPPs has been hampered by the lack of ability of municipal staff to prepare sound tender documents and Detailed Project Reports; nor do staff have sufficient knowledge of various PPP options and arrangements open to them. ULBs require substantial assistance and training in the development of projects on a PPP basis and there is a need for an authority to be constituted with the responsibility of undertaking a regulatory function of PPP projects. The dispute resolution mechanism is also found to be weak in many of the ongoing PPP projects. In the absence of such a mechanism, if disputes (between the private developers and the ULBs) remain unresolved, there is a risk that the smooth provisioning of the services would be affected.

Finally, the paper briefly highlights the role of external assistance in South Asia as the second largest region in terms of population in the developing world with over 1.4 billion people. Although it has been among the world's fastest growing regions, it remains a region with the second highest share of population living below the poverty line. External aid has played an important role in helping to address poverty across the region as well as supporting strategies for growth. Donor agencies have played a significant role in supporting urban infrastructure in order to improve basic urban services for the poor and provide a platform for economic growth.

A variety of donor agencies have supported urban development through both loan and grant support for urban infrastructure as well as municipal reforms. Agencies such as the World Bank, Asian Development Bank (ADB), UNDP and DFID (UK) and GTZ have been amongst the most active supporters of urban development in the region. These agencies have not only assisted in addressing city wide infrastructure gaps in water supply, roads, drains and sanitation but have also invested considerable resources in supporting inclusive development through slum improvement projects and pro-poor reforms. In almost all cases, donor agencies have included municipal management and finance reforms as conditional or complimentary aspects of urban sector support.

The following critical issues are highlighted:

- New mechanisms versus the capacities of the local bodies
- The impact of devolution frameworks on municipal finances
- The importance of reform driven infrastructure funding
- Future approaches to raising capital
- External funding options and priority sectors for funding.

1. Introduction

This background paper provides a summary perspective on the provision of municipal finance for pro-poor and inclusive urban development in South Asia. Whilst the adequacy of funding for basic urban infrastructure and services has been a much debated issue in the past, this has become more critical in recent years as traditionally under-funded and under-resourced urban local governments continue to struggle to provide rudimentary levels of basic service to existing populations whilst at the same time facing new challenges posed by rapid urbanisation.

This problem is compounded by a serious deficit in municipal infrastructure that has accumulated over the years and is exacerbated by the changing structure of most economies in the region with a shift away from primary production. Whilst growth in urbanisation and the attendant problems of underserviced areas and communities have been somewhat kept in check in the past by a host of national policies and programmes which have provided subsidies and support to rural communities, the force of economic drivers of change, rooted in a more urbanised economy will be difficult to resist. In such a situation, the requirement for financing urban infrastructure and services will grow enormously over the next few decades. At the same time, the challenge of how to go about financing pro poor municipal services will also increase, as much of the new funding available will naturally gravitate towards those types of infrastructure and services with more buoyant revenue streams and those communities and consumers with more affordability.

In order to address the issue of municipal finance for pro-poor and inclusive development, the paper firstly examines the trends in urbanisation, urban poverty and municipal governance in South Asia followed by an analysis of municipal finance and different mechanisms for funding pro poor infrastructure and services. The paper will then go on to consider the character of municipal finance, which has traditionally depended on inter governmental fiscal transfers and internally generated revenues prior to an assessment of different financing mechanisms that may offer some potential for meeting the need for increased provision of basic infrastructure and services for underserviced settlements across South Asia. Finally, the paper will consider the issue of municipal capacity development in the context of more innovative financing arrangements and the role of external agencies in supporting this process.

Whilst the paper makes reference to various countries in South Asia the primary focus of attention is India given the size and scale of local government and the wide variety of experience in financing pro poor infrastructure and services. At the same time it should be noted that there are many similarities in the structure and form of local government across the region. In almost all countries of South Asia, municipalities and municipal corporations are the central units of urban local government while panchayats (India) unions (Bangladesh) and pradeshiya sabhas (Sri Lanka) form the basic units of local government in rural areas.

In almost all cases across the region urban local authorities are divided into different categories or classes with varying levels of powers and functions. These typically range from municipal corporations in larger cities to municipal councils or municipalities (*pourashavas* in Bangladesh, *tehsil* municipal authorities in Pakistan) in smaller cities. Urban local authorities may include urban or town councils below municipalities (*nagar panchayts* in India and urban councils in Sri Lanka) in smaller towns. Each type or class of local authority tends to be regulated and operated by a different ordinance along with separate enabling laws providing the legal and policy environment for them to operate and function.

Various laws have been passed over the years to confer powers and functions on urban local bodies ranging from Constitutional Amendments, Decrees and Acts (Local Government/Municipal/ Urban Development Authority Acts) on the one hand, through to more detailed Rules and Ordinances governing the terms and conditions of operation. Whilst Constitutional Amendments and Local Government Laws define the level of devolution and set out the sharing of powers between different units of government, national, state/provincial and local (as in the case of India, Pakistan and Sri Lanka). In all cases, with the exception perhaps of Bangladesh, urban local authorities fall under second tier units of (sub-national) governance varying from State Governments functioning within India's federal system to Provincial Government and Provincial Councils in Pakistan and Sri Lanka respectively.

Municipality/Municipal Corporations Acts define the main powers and functions of specific urban local bodies and typically confer responsibilities such as provision of roads, bridges, drains, culverts, civic buildings, parks, libraries, public housing and the delivery of services including solid waste and public health services. In some cases urban local bodies (ULBs) provide water supply, sewerage and waste water treatment services (certain states in India) whilst in other cases these are provided through specialist water and sanitation agencies (such as Bangladesh, Pakistan and Sri Lanka). In almost all cases, urban local authorities are vested with powers to provide the defined range of services and this will typically include the power to acquire land, enter into contracts, raise funds, purchase goods, materials, equipment and services and to employ staff.

Urban development agencies often function alongside urban local bodies in many of the larger metropolitan cities in South Asia. Such agencies are typically responsible for planning, supervising and promoting the development of the wider metropolitan region and coordinate the development activities of various stakeholders including municipal corporations, water supply and sewerage boards/ agencies, electricity companies and transport authorities.

The Commonwealth Local Government Forum (CLGF) has long been an important champion of decentralisation and local government in Asia and Africa and has helped to promote dialogue and experience sharing within and across governments at national and local level. In highlighting the issue of municipal finance for pro poor and inclusive development, CLGF has focused on a critical issue that will require considerable attention of policy makers, urban managers and communities across South Asia over the coming years as states and cities experiment with different policies, programmes and mechanisms designed to address the funding gap required to meet even the most modest service benchmarks for urban poor communities.

2. Urbanisation in South Asia

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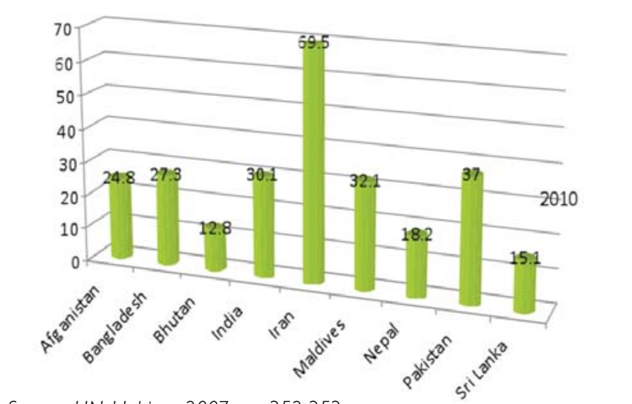
South Asia, like almost all parts of the world, has become increasingly urbanised over the past few decades. This has been fuelled by the twin processes of population growth and economic growth as wealth creation tends to be focused around cities and towns whilst traditional forms of agriculture are increasingly unable to sustain a substantial rise in population.

Historically, South Asia has had a relatively low rate of urbanisation with a predominantly agrarian economy and long periods of political and socio-cultural instability all of which acted as a break on urban growth and expansion across the region. By the time of Independence in 1947 around 16% of the Indian population was residing in urban centres. This had grown to 25% by 1991 and just under 28% by 2001. Whilst the region as a whole has experienced rapid urban growth over recent decades it has nevertheless remained predominantly rural in terms of its economic base and distribution of its workforce.

This is highlighted in the table below which shows the rate of urbanisation in South Asia ranging from 35% in Pakistan to 29% in India and 25% in Bangladesh as compared to a developing country average of 43% and 48% for Indonesia and Nigeria, 63% for the Philippines, 76% for Mexico and 84% for Brazil.

Although the overall rate of urbanisation in South Asia is lower than the developing country average, the rate of growth in urbanisation in the region has been high in recent years varying from 3.0% to 6.5% annually during the 1980s, which was the second fastest urban growth rate in the world at the time it and continues to be around 3% per annum.

The concentration of population growth in the geographical region of South and South East Asia has led to the emergence of many large and densely populated cities across South Asia. By 2001 India alone accounted for 35 of the 300 odd cities in the world with a population exceeding one million. India's urban population at around 340 million is now the second largest in the world after China, and is more than the total urban population of all countries put together barring China, USA and Russia. This is projected to rise to just under 600 million by 2030 and 800 million by 2050. In spite of this projected rise in urban population the rate of growth has been modest from 26% to 30% between 1991 and 2008 but is projected to rise to over 40% by 2030. At present there are 6 States in India with more than 30% of the total population living in urban areas.



Source: UN-Habitat, 2007, pp. 352-353

Figure 1: South Asia urbanisation

These include Haryana, Punjab, Karnataka, Maharashtra, Gujarat and Tamil Nadu with the latter already more than 50% of its population living in urban areas. The overall lower average for India as a whole is, however, affected by States such as Bihar, Himachal Pradesh and Orissa being less than 20% urbanized and many other States between 20% to 30% urbanised.

The number of urban agglomerations and towns in India alone increased from 3,697 in 1991 to 4,378 by 2001 and is expected to rise to over 6,000 by 2051. It is estimated that over the next 2 decades there will be around 70 cities in India alone with a population in excess of 1 million, 10 of which will have in excess of 5 million and 3 cities, namely, Mumbai, Delhi and Kolkata with a population in excess of 20 million or a combined population of just under 80 million.

Country	Area (Km^2)	Population (Millions) 2006	Density (persons/Km^2)	Average AGR (%) Population 2006	GDP per Capita	
					US $	International $ (PPP)
Afghanistan	652,090	26.1	40	4.1	335	1,490
Bangladesh	147,180	156.0	1,083	1.8	451	2,287
Bhutan	47,000	0.6	14	1.8	1,254	4,470
India	3,287,260	1,151.8	350	1.5	797	3,737
Iran	1,648,200	70.3	43	1.2	3,046	8,624
Maldives	300	0.3	1,001	1.7	2,864	8,229
Nepal	147,180	27.6	188	2.0	339	1,873
Pakistan	796,100	160.9	202	1.8	830	2,722
Sri Lanka	65,610	19.2	293	0.5	1,355	5,271
Source: ESCAP. 2008, p. 167 and 183:IMF.2007						

Table 1: Urbanisation in selected developing countries

2. Urbanisation in South Asia

Country	Urban Population						
	Estimates and Projections (000)				Annual Rate of Change (%)		
	2000	2010	2020	2030	2000-2010	2010-2020	2010-2030
Afghanistan	5050	8,838	14,262	22,997	5.60	4.79	4.78
Bangladesh	29,900	42,292	59,525	82,064	3.47	3.42	3.21
Bhutan	186	309	501	774	5.06	4.83	4.35
India	282,480	356,388	457,619	589,957	2.32	2.50	2.54
Iran	42,606	51,625	62,962	71,827	1.92	1.99	1.32
Maldives	80	1199	175	247	3.99	3.87	3.44
Nepal	3,281	5,446	8,537	12,679	5.07	4.49	3.96
Pakistan	47,284	64,812	90,440	122,572	3.15	3.33	3.04
Sri Lanka	3,118	3,262	3,870	5,064	0.45	1.71	2.69
Source: UN-Habitat, 2007, pp. 348-349							

Define as the ratio of urban to total population based on the census definition of urban areas, population >5,000; density>400 persons per square kilometre, 75 percent of male workers in non-agricultural sectors; and statutory urban areas.
Source: India Urbanisation Econometric Model; McKinsey Global Institute analysis

Table 2: South Asia urbanisation

Mega City	Population (million)					
	Estimates and Projections			Annual Rate of Change		
	1995	2005	2015	1990-1995	2000-2005	2010-2015
Dhaka	8.2	12.4	16.8	4.6	4.0	2.8
Mumbai	14.1	18.2	21.9	2.7	2.5	1.8
Kolkata	11.9	14.3	17.0	1.8	1.8	1.8
Delhi	10.1	15.1	18.6	4.1	3.8	1.8
Karachi	8.5	11.6	15.2	3.4	2.9	2.7
Source: UN-Habitat, 2007, pp. 385-389						

Table 3: Population growth in major urban centres

Over the last 50 years, the percentage of the labour force engaged in non-agricultural activities has risen steadily, although governments across the region have implemented a wide array of policies specifically designed to protect and promote agriculture. This has undoubtedly helped to slow the rate of urbanisation in South Asia where a sizeable portion of the population continue to reside in rural areas working in agriculture and related activities. Table 4 shows the composition of the labour force across various sectors over three decades from 1960-1990.

The table highlights an overall decline in the percentage of the labour force engaged in agriculture to around half the labour force in Pakistan and Sri Lanka and just under two thirds of the total labour force in India and Bangladesh. By 1990, the tertiary sector accounted for around 30% of all labour in Pakistan and Sri Lanka and 20% and 18% respectively in India and Bangladesh.

In more recent years, however, there has been an increasing trend towards growth in non agricultural employment with much greater emphasis on knowledge-centric activities and services and attendant growth in financial services and commerce. This has been accompanied by an increased awareness that that the tertiary sector has substantially more revenue generating potential from considerably less capital investment requirement than heavy industry and other high growth industrial segments such as automobiles, pharmaceuticals etc. This new or emerging segment was relatively simple to invest in and was considerably more scalable and diversified than the traditional sectors of industry and agriculture.

A study of the GDP profiles of South Asian countries reveals that the tertiary sector had become the largest contributor to GDP by the mid 1990's. Table 4 shows the past trends in the distribution of GDP over a fourteen year period from 1970 to 1994. This highlights the fact that by 1994 the services sector had overtaken all others as the single largest sector in South Asia accounting for half of all GDP in every country except in India where at 42% it was still the largest single sector.

2. Urbanisation in South Asia

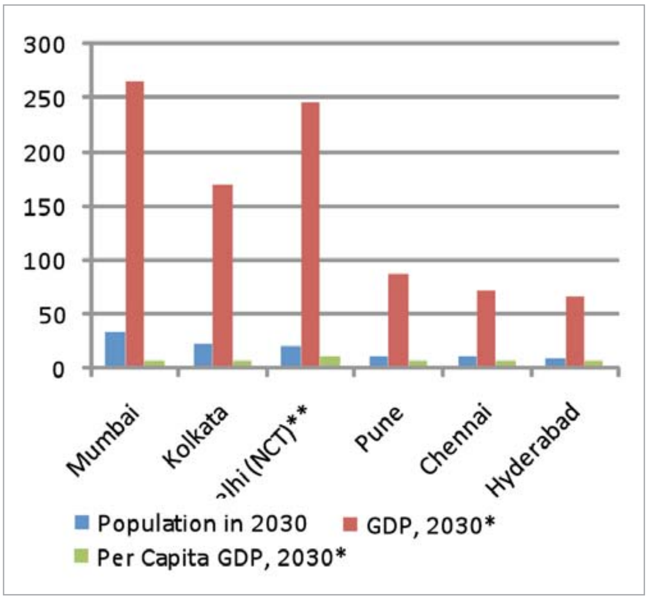


Figure 2: Growth projections for major cities in India

By 2004-2005, the share of the tertiary sector in GDP in India, for example, with the largest labour force in the region, had grown to over 60% of total GDP fuelled to a large extent by the dramatic growth in revenue generated from new knowledge related service activities as one of the fastest growing segments of the overall economy. The growth in the share of non agricultural activities in GDP across the region has translated into a shift in South Asia's demographic profile with the urban sector becoming increasingly important in terms of population as well as economic growth.

It must be noted that geographical area and geophysical profiles have also contributed to the degree of urbanisation. For example, Bhutan and Nepal have a considerable geographical area under hilly terrains, thereby making accessibility difficult and hampering the growth of urbanisation. Whereas Pakistan has more serviceable land and accessible land thereby promoting natural as well as induced urbanisation.

Geographical area and geophysical factors are not the only factors contributing to urbanisation. The economic, political and social landscape also plays a significant determining factor in the urbanisation of a country. Cities are widely acknowledged as engines of economic growth and the process of urbanisation is thus crucial to creating such engines. Whilst many migrate to urban centres to escape poverty or insecurity (push factors) others migrate to access new opportunities (pull factors). There are a number of factors that are important stimulants to urban growth including: (i) shifts in economic activities from agrarian to non agrarian (ii) trends towards the development of economies of scale in production and (iii) an enabling policy environment for urban expansion in terms of land use, planning, housing provision etc.

Classification and pattern of urban settlements

Urban areas in South Asia are typically classified in two ways. Firstly they comprise all statutory places governed by a municipality, municipal corporation, cantonment board or notified town area committee or secondly settlements that comprise other key criteria. In the case of India for example they may include settlements that have the following three criteria namely, a minimum population of 5,000; at least 75 per cent of male working population engaged in non-agricultural pursuits; a density of population of at least 400 per sq km (1,000 per sq mile).

Urban areas classified through the former method in India are often termed as 'statutory towns' while urban areas classified on the criteria method may be declared as census towns. After the enactment of the 74th Constitutional Amendment in India in 1992, the number of categories or tiers of urban local governments was reduced from five to three, with the lowest tier as a nagar panchayat (equivalent to a pradeshiya sabha in Sri Lanka) followed by a municipality (equivalent to a pourashava in Bangladesh) and the upper tier as a municipal corporation. The increase in the number of statutory towns essentially meant that these new statutory towns were largely formed in the nagar panchayat and municipal council categories. During the last Census in India in 2001 it was observed for the first time that the number of statutory towns had actually exceeded the number of census towns, essentially implying that there were now more de-facto urban local Governments by statute, which would also mean that each of these would need a population and an economic mass to sustain its operation.

Countries	Distribution of GDP (%)											
	Agriculture			Industry			Manufacturing			Services		
	1970	1980	1994	1970	1980	1994	1970	1980	1994	1970	1980	1994
Bangladesh	55	50	30	9	16	18	6	11	10	37	34	52
India	45	38	30	22	26	28	15	18	18	33	36	42
Pakistan	37	30	25	22	25	25	16	165	18	41	46	50
Sri Lanka	28	28	24	24	30	25	17	18	16	48	43	51
Source: Based on World Bank (1995,1996) World Development Report 1995 and 1996, New York: Oxford University Press												

Table4: Distribution of GDP by sector in South Asia

2. Urbanisation in South Asia

The case of Gurgaon

Keeping in view the real estate boom of the mid 1990s and early 2000s, the city of Gurgaon was assigned a population of over 16 *lakh* in its draft development plan for 2021 (now upgraded to over 35 *lakh* also accounting for the inclusion of Manesar within the planning area). This was despite estimates of natural progression of population not exceeding 5 *lakhs* by 2021. This discrepancy was accounted for by the hypothesis that the state of development of Gurgaon, being projected as a 'World Class' city would attract potential migrants from far and wide within India and abroad, as compared to the city's original purpose of serving as a 'spillover' from the National Capital Territory of Delhi.

Rapid urban growth across South Asia is in many places changing the pattern of urban settlements and boundaries. Many areas immediately contiguous to cities are in the process of being incorporated into municipal boundaries. These urban extensions tend to focus around economic development activities associated with commercial and industrial growth and consequently displace many of the existing populations and built settlements which are no longer seen as conducive to accommodating the needs of expanding urban enterprise.

Examples of this kind of development are prevalent in many parts of India (particularly the National Capital Region) and Pakistan (eg Gwadar Port and allied developments in Balochistan). Some specific examples of urban extension include the Yamuna Expressway areas in Uttar Pradesh, India (between NOIDA and Greater NOIDA), Manesar in Gurgaon district, Haryana, India. Many State capitals in India have also developed in this manner including Bhubaneshwar in Orissa and most recently Raipur in Chhattisgarh. Similar processes of urban expansion can be seen in Hyderabad and Bangalore. These newly declared 'urbanisable' areas are usually deemed as part of what the Census terms Standard Urban Areas, but may not be accounted for until the census enumeration is actually conducted there.

In recent times, areas such as Special Economic Zones, Information Technology Investment Regions and Special Investment Regions have also exhibited characteristics similar to urban areas, but are not classified as urban until well populated. Many newly urbanised areas fall under 'proxy agencies' such as Development Authorities, which take on the role of service provision backed by revenues accrued through the development and disposal of land and built assets. These agencies rarely depend on user charges or taxes, or other forms of periodic revenue income, although some have constituted service charges for line services that they extend during the formative years of the settlement. However, these lack a democratically elected local interface to control or deliberate matters of urban development and/or administration.

The case of Silvassa

The town of Silvassa, Union Territory of Dadra and Nagar Haveli had seen considerable development between 1991 and 2001 on account of its proximity to National Highway 8, connecting Ahmedabad and Mumbai, especially the Industrial town of Vapi (district Valsad, Gujarat). However, even though the Census classified it as an urban area, the local Government was still a rural one. In 2005, the Union Parliament ratified an Act to apply a new Municipal Act to the Union Territory, as a result of which the Silvassa Municipal Council was created.

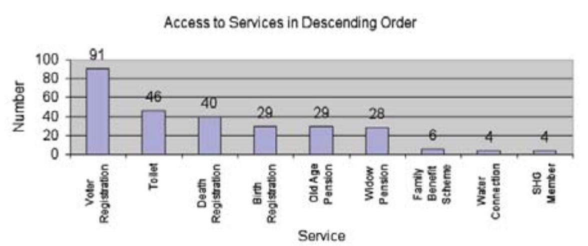
Urban poverty

The prospect of accelerating urbanisation as described above brings with it substantial risks, which have the potential to derail the development trajectory. Official estimates show that 23% of the urban population is living in slums[1]. Poverty reduction is occurring more slowly in urban areas than in rural areas and studies have reported rising inequality and exclusion. Exclusion on the basis of caste, gender and religion is compounded by economic exclusion such as the inability of urban poor to access formal employment.

Traditional methods of determining urban poverty at the national level have tended to address income issues rather than 'access'. As well as basic services, the urban poor also depend on access to other municipal services such as social welfare benefits, ration cards and birth certificates. The delivery of these services is of low priority for most urban local bodies (ULBs) and especially difficult for individuals from socially excluded groups to access.

In many South Asian countries it is the urban local government that has primary responsibility for ensuring equitable growth. However, many counties and states have a legacy of municipal laws that leave urban poverty alleviation to agencies that are not answerable local government, thus making ULBs unresponsive and urban poverty programmes unaccountable.

Urban poverty is typically characterised by lack of income and access to basic urban services Given the general level of development of most rural areas in South Asia, the degree of disparity between the poor and non poor is not as severe in terms



Source: barriers to Access Study for Bhopal Municipal Corporation 2009

Figure 3: Access to services

[1] Town and Country Planning Organisation

2. Urbanisation in South Asia

of access to services as to ownership of productive assets and access to natural resources such as water, on which rural local governments usually exercise little control[2]. However, where urbanisation takes place, the local government is fundamentally obliged to ensure the provision of basic services and other amenities to all citizens; the non-provision of such services constitutes 'access' poverty. Thus, 'access' poverty amplifies income poverty, and in turn, the overall incidence of poverty in urban areas. The cycle is vicious – low incomes lead to low accessibility to services, which further deprives the poor from accessing economic opportunities, hence resulting in lower incomes.

Lack of access to secure tenure as well as basic services such as water supply, sanitation, roads and drains, solid waste and electricity constitutes the main problem for the urban poor. Around one third of the population of cities in South Asia lack access to such basic services and this problem is exacerbated by lack of access to other administrative services which often provide the basis of entitlement to core services including tenure and livelihoods.

A recent study undertaken for Bhopal Municipal Corporation under the DFID funded Madhya Pradesh Urban Services for the Poor Programme on access to services has revealed a surprisingly low level of access with the exception of voter registration where only 10% of eligible household members do not possess a voter id card. The survey was undertaken by 1275 households across a range of services including: birth/death registration, social security pensions, family benefit schemes, vendor/trading licenses, ration cards and water connections.

As can be seen from the graph above, the survey revealed that many services such as widow's pension, old age pension and birth registration were accessed by fewer than 30% of slum households whilst some services such as water connections and family benefit

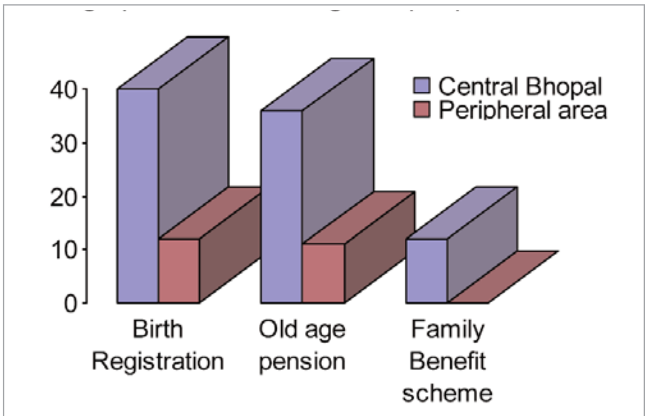


Figure 4: Geographical disadvantages to peripheral slums

schemes were accessed by as few as 4%-6% of households.

The survey also revealed a further disparity based on the geographical location of poor urban settlements. Those residing in peripheral poor settlements experience much lower levels of accessibility than more centrally located (and longer established) settlements. The level of disparity experienced by peripheral slum settlements is highlighted in the diagram below and shows that whilst 60%-70% of households in more centrally located slums had no access to birth registration or old age pension and 90% no access to family benefit, this number rose dramatically for peripheral slum households to 90% with no access to birth registration or old age pension and nearly 100% lacking access to family welfare.

This situation is experienced by most urban poor households across South Asia, with the exception of Sri Lanka where welfare schemes have a tradition of deeper penetration. Lack of access to services and entitlements amongst the urban poor is exacerbated by the low level of capacity and resources of most urban local bodies across the region. Low capacity and inadequate resources result in inadequate coverage of services amongst the catchment population and the poor become further marginalised in this process.

Urban poverty in South Asia is usually accompanied by one or more of the following characteristics occurring within the administrative area of the municipality or corporation:

a. The urban population does not generate a large revenue base through general local taxation (property or trade licenses)

b. A portion of the population has a reasonably high income from sources not indigenous to the local body administration, or sources from which the local body cannot derive revenues in the form of taxes

c. A large portion of the population is dependent upon assets owned or controlled by a few, and where external investment into new economic asset creation is restricted.

d. The elected local self-government cannot facilitate improvements in its revenue base by demanding tax-based revenue from existing economic assets, nor can it easily facilitate the creation of new assets.

In effect, the elected local government neither has the avenues nor incentive to invest in the urban poor. If they are mandated to intervene to reduce urban poverty, most have to do so within whatever minimal fiscal allocation that they can make for such purposes without fundamentally changing the pre-existing urban social or economic order. The poor historic position of urban local governments in terms of fiscal buoyancy and resource autonomy

[2] Typically, rural local Governments have not been entrusted the tasks of 'extending' services through capital and revenue expenditure to the local population, but only oversee the general, social and economic development of villages, often playing the role of adjudicators in resolution of disputes. The 'Pani Panchayats' constituted in some States do carry out the distribution of water, or ensure its provision to all, but primarily regulates sharing and conservation of the resource, and more so when there is an imminent dispute.

2. Urbanisation in South Asia

State Urban Development Agencies

Many States constitute these entities either to take up functions that local government is not assigned or to take on functions that local government is reluctant to take up. Curiously, in some States, tasks pertaining to administering schemes in urban poverty alleviation are entrusted entirely to these entities, with local government having little to do with the process. Much of the Swarna Jayanti Shehri Rozgar Yojna (SJSRY) programme, for example, the Government of India's flagship livelihoods programme for the urban poor, has been implemented through such agencies.

has meant that elected local governments have played a limited role in facilitating the exit of the poor from the trap of poverty

The disconnect of most elected local governments from land and housing markets has also contributed to a situation where piecemeal investments in housing and shelter are seen as sustained poverty alleviation measures. Land and fixed asset prices continue to rise unabated and the housing market for the poor can only be created by artificially depressing prices.

Local governments are also often disconnected in other ways that contribute to the incidence or persistence of urban poverty. In India, under the twelfth schedule, planning for economic and social development is cited as a discretionary function of the ULBs. The vacuum is usually filled by parastatal entities such as line departments which have 'template-based' approaches to schemes and cannot concentrate on the needs of any town or city in particular.

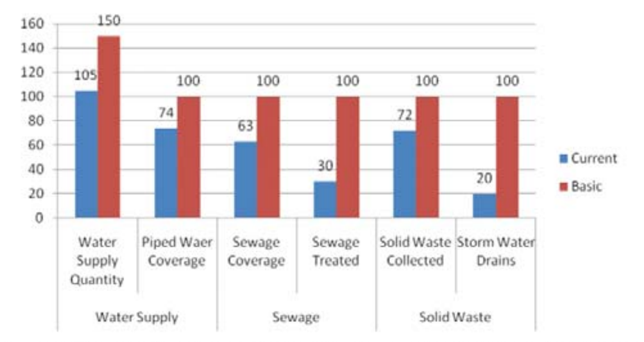
To help address this problem in India, central government has allocated a substantial increase in grant allocations for urban poverty and affordable housing schemes through programmes such as JNNURM and IDHSSMT. Funds under such schemes have been linked to the implementation of municipal reforms including earmarking of at least 25% of municipal budgets to spending on the urban poor. This has led to a positive move in many larger Indian municipal corporations where, in a state such as Madhya Pradesh for example, the four largest corporations have assigned 30% of the annual budget to spend on the urban poor.

Urban services

As mentioned above, there is a major infrastructure deficit across almost all urban local bodies in South Asia as in many parts of the developing world. As far back as 1964, the Zakaria Commission in India prescribed standards for per-capita expenditure on basic services to be offered by municipal governments. While the larger municipal entities such as those of metropolitan towns have exhibited some improvements in bridging the infrastructure gap, smaller cities and towns (which also comprise most of the newly declared 'statutory' towns) continue to fall far short of these standards. Most of these new urban local bodies are highly constrained in terms of manpower, fiscal resources and staff numbers and capabilities making it difficult to perform the 18 major statutory functions.

This problem is not confined to India. All South Asian countries have underinvested in urban services over the years which has led to a major gap in both the provision and coverage of basic services such as water supply, sanitation and solid waste sewage as well as other services including urban transportation and affordable housing. Residential piped water supply in India, for example, currently stands at just 105 litres per capita per day with only 74% coverage. Sewage infrastructure is considerably less developed in most of urban South Asia and India currently has around 63% coverage for both sewer and septic tank waste and treats only 30% of sewerage generated. Solid waste coverage in India averages around 72%.

In order to meet 100% coverage of basic services (water supply, sewage and waste) in India over the next 2 decades it is estimated that there will need to be a 3.3 times increase in water supply, a 2.4



Source: United Nations; City Development Plans (CDP; The Energy and Resources Institute (TERI); Planning Commission; Census 2001; McKinsey Global Institute analysis

Figure 5: Service levels in relation to service benchmarks in India

City Class	Water Supply		Sewerage		Storm drainage		Roads		Street lights	
	Capital	O&M	Capital	O&M	Capital	O&M	Capital	O&M	Capital	O&M
AA	968	161	1117	182	611	-	1207	37	447	45
A	700	152	968	177	432	-	1043	33	372	42
B	699	146	819	161	387	-	611	27	328	37

AA - More than 20 Lakhs population; A - 5-20 Lahks population; B - 1-5 Lahks population

Table 5: Cost per capita of basic services

2. Urbanisation in South Asia

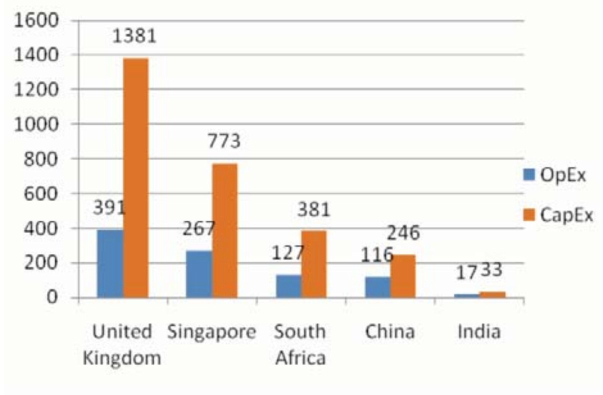
times increase in length of sewer mains and an 11 fold increase in waste water treatment, the ability to collect and dispose of a 6 fold increase in solid waste and sufficient investment to meet the needs and offset the congestion caused by a four fold increase in the total vehicle stock (roads, storm water drains and mass transit systems) as well as construction of 38 million affordable housing units to meet the current backlog and future demand in housing for the poorer sections of the urban population.

Figure 5 highlights some of the major gaps in provision against basic standards and illustrates the underlying need for new financing measures for infrastructure and services to help address the urgent needs of the urban poor.

Urban financing requirements

In 1996, the Report of the Rakesh Mohan Committee placed the annual average aggregate investment requirements of urban infrastructure under the categories of water supply, sanitation and roads at about Rs.282 billion for the period 1996-2001 and another Rs.277 billion for the period 2001-2006, at 1996 prices. However, the Report also observed that the planned investment was woefully inadequate for meeting the required operation and maintenance costs of core urban services, let alone for financing the additional requirements of core civic services and other urban infrastructure.

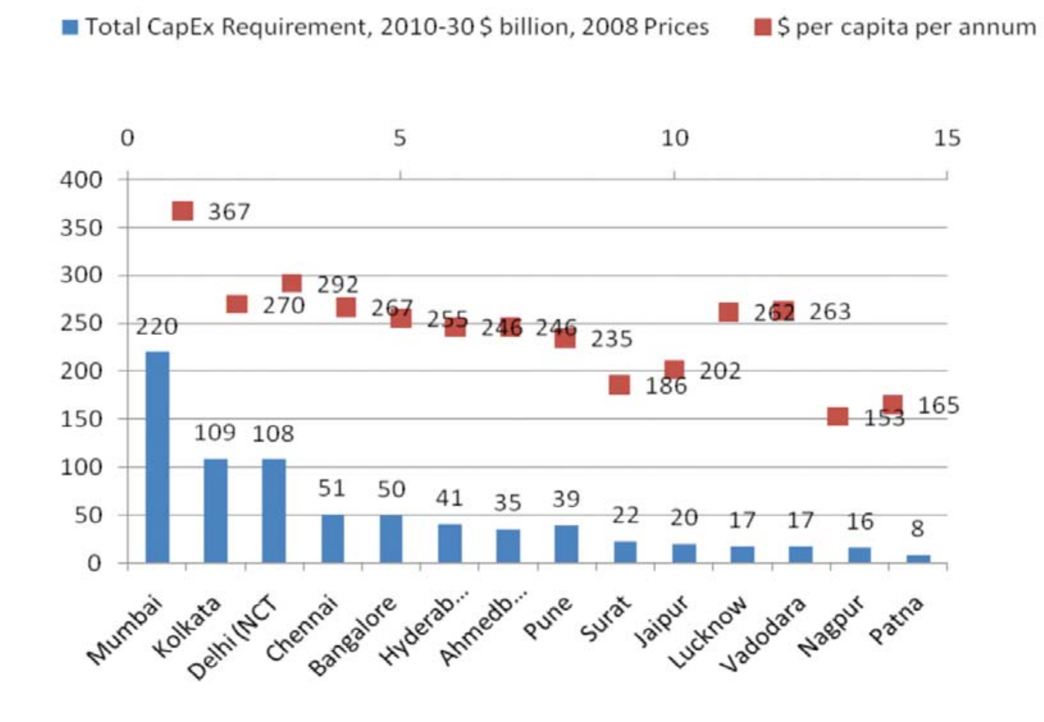
The estimated investment required to meet the additional service needs associated with current growth projections is very



Source: McKinsey Global Institute analysis

Figure 6: Comparative levels of investment in urban services

substantial and all the more challenging given the historic low levels of investment in capital and operating expenditure across almost all cities in South Asia. The annual per capita investment (including capital and operational expenditure) in India stands at around $50 as compared to $362 in China, $508 in South Africa and $1,772 in the UK. The disparity between levels of investment in India and elsewhere is even higher for urban capital investment with an annual capital spend on urban services at just $17 as compared to $116 in China, $127 in South Africa and $391 in the UK (see India's Urban Awakening, McKinsey 2010).



Source: India Urbanisation Econometric Model; McKinsey Global Institute analysis

Figure 7: Capital expenditure requirement of major cities in India

2. Urbanisation in South Asia

Main Functions of ULBs in India (12th Schedule)

1. Urban Planning including town planning;
2. Regulation of land use and construction of buildings;
3. Planning of economic and social development;
4. Roads and bridges;
5. Water supply for domestic, industrial and commercial purpose;
6. Public health, sanitation conservancy and solid waste management;
7. Fire services;
8. Urban forestry, protection of the environment and promotion aspects;
9. Safe guarding the interest of weaker sections of society, handicapped and mentally retarded;
10. Slums improvement and upgrading;
11. Urban poverty alleviation;
12. Provision of urban amenities and facilities such as park playground;
13. Promotion of cultural, educational and aesthetic aspects;
14. Burials and burial grounds; cremations, cremation grounds crematoriums;
15. Cattle pounds: prevention of cruelty to animals;
16. Vital statics, including street lighting, parking lots, bus public convenience; and
17. Regulation of slaughter houses and tanners.

The low level of investment in urban services is considerably worse in smaller cities in South Asia where average per capita capital spending in small towns in India stands at just $1 of low levels of spending. The investment requirement to meet the gaps in service provision highlighted above implies that larger metro cities in India will need to maintain an average per capita spend on infrastructure of anywhere from $40 - $50 in Chennai and Hyderabad and $135 - $200 for Delhi and Mumbai respectively.

As can be seen from the above, consistent underinvestment in urban services in countries such as India has created a major backlog of capital investment requirements for which substantial additional funding is required and this is even greater when taken together with the expansion of services that will be required to meet the projected growth in urbanisation over the next few decades. The McKinsey report estimates that India will need a total of $2.2 trillion investment ($1.2 trillion in capital investment and $1 trillion in operating expenditure) over the next 20 years to address the existing backlog and future growth requirements of its cities equivalent to an average annual spend of $250 per capita as compared to current levels of just $50. Around 50% of the capital requirement will be needed to address the existing backlog in infrastructure and the bulk of future capital expenditure being required for transport and affordable housing, while the bulk of operating expenditure being required for mass transit.

3. Municipal governance

3. Municipal governance

Municipalities in South Asia date back as far as 1688, when the East India Company established the Municipality of Madras to address issues of sanitation and public health. Subsequently, the Royal Charter of 1720 established a Mayor's Court in each of the three presidency towns of Madras, Bombay and Calcutta. Lord Mayo's resolution of 1870 provided municipal bodies with the power to raise resources to maintain public works and public health. However, it was not until the intervention of Lord Ripon in 1882 that the foundation of the present system of urban local government was formed. Ripon's initiative included establishing elected local representatives and an increase in local autonomy. The Bombay and Calcutta Municipal Councils were created in 1888 and 1876 respectively. The Government of India Acts of 1919 and 1935 further strengthened the institution of local self-governments including municipal governments. In effect, these early initiatives concentrated on the two parameters: of a) fostering a local political environment, and b) provision of services being governed from the local level. These powers and functions are contained in a range of Municipal Acts encompassing municipalities and or municipal corporations which define the precise powers and functions of the respective urban local bodies.

The basic pattern of urban local government which arose in India has prevailed across South Asia with some differences in line with the evolving political and administrative structures of the respective countries. In almost all cases, larger cities have traditionally been granted the status of Municipal Corporations and smaller cities as Municipalities or Urban/ Town Councils although Metropolitan Authorities have been formed in some cases to provide coordinating powers and functions over city corporation and contiguous municipal council areas. Whilst the basic pattern and structure of urban local government is similar across the region, there are obvious differences in the broader devolution frameworks governing local authorities in India, Pakistan and Sri Lanka. At the same time, whilst the frameworks confer a high degree of decentralisation to urban local bodies in the case of India and Pakistan, for example, in practice this has been curtailed by lack of adequate finances, staffing, capacities and other resources. In most of the region the largest cities are metropolitan or municipal corporations whilst smaller cities are municipalities or town councils (Tehsil Municipal Authorities in Pakistan and Pourashavas in Bangladesh). Municipalities are generally divided into different classes of city/ town depending on size, population or income. In Bangladesh, for example, Pourashavas are divided into three categories comprising: Class A – (those with income over Tk 60,00,000); Class B – (income between Tk 25,00,000-60,00,000) and Class C – (income between below Tk 25,00,000). In Pakistan the Municipal Committees vary in size from 30,000-40,000 population up to 200,000-250,000 whilst Municipal Corporations vary from 250,000 to 500,000 and Metropolitan Corporations from 500,000 to 1 million, 1-1.5 million, 1.5-3 million and above 3 million.

Public Health Engineering Departments

PHEDs are meant to ensure comprehensive provision of water supply through demarcation and planning of water sources, planning and implementing distribution, extension of connections to users and collection of water charges etc. Being a specialised and dedicated function, most PHEDs have performed better than ULBs which have retained these functions. However, these have no obligatory or contractual reporting to ULBs and continue to have discretionary powers in their own right.

In most of the region, legislation establishing the powers and functions of various urban local bodies has been accompanied by other acts which have created new authorities for functions such as development planning that were either traditionally under the municipal domain or were vaguely included as part of the municipal mandate thus eroding the scope of work and autonomy of urban local governments. This has been a common pattern across South Asia where urban planning and housing responsibilities often fall outside the mandate of local authorities. Town Planning Acts have also created local planning authorities, which are often separate from ULBs, and these in turn have fostered the creation of the Development Authorities to govern the spatial nature of development of a contiguous area, as well as implement such development through assembly, development and disposal of land and buildings.

Part of this problem has been addressed by new Constitutional provisions that empower local government in terms of functions and finances. Such provisions were brought about in India in 1992 with the promulgation of the 74th Constitutional Amendment Act which redefined the municipal mandate (see 12th schedule opposite) to help bring about a single window of accountability for urban administration and improve democratic governance through greater decentralisation and devolution of powers. This Act is widely regarded as landmark legislation with elected representatives having a decisive role in the planning, provision and delivery of civic infrastructure and services. The conduct of municipal elections is entrusted to statutory State Election Commissions, rather than being left to executive authorities. The mandate of the Municipalities

Maharashtra Regional and Town Planning Act, 1966

This Act serves as a basis for the model Town & Country Planning Act promulgated by the Ministry of Urban Affairs in 2002. As per this, the ULB is the 'owner' of a statutory plan, while a planning authority provides the expert judgement on what can or should be done with respect to spatial planning. The term 'owner' technically places the responsibility of implementation of the plan to such ULBs or to a Development Authority where the jurisprudence of the ULB no longer functions.

is to undertake the tasks of planning for 'economic development and social justice' and implement city/town development plans. This role encompasses a wider role as compared to what was traditionally perceived of them as the providers of 'services'.

To ensure that municipalities remain sensitive enough to the problems of the urban poor and women, the 74th Amendment provides for reservations for scheduled Castes (SCs), Scheduled Tribes (STs) and women in municipal councils. The seats reserved for SCs and STs are to be in proportion to their share in population of the respective cities/towns. A minimum of 33 1/3 per cent of per seats are reserved for women. Reservation was intended to provide a voice to those who were neglected in the past. The 74th Amendment also provides a range of institutional mechanisms for improved municipal governance through an institutional framework for the efficient delivery of urban services. This framework consists of a number of statutory institutions, which include:

(i) Municipalities to function as "institutions of self-government" – prepare "plans for economic development and social justice", perform functions and implement schemes as may be entrusted to them by the state governments, including those related to the Twelfth Schedule [Article 243W(a)];

(il) Ward Committees and other Committees to carry out the responsibilities conferred upon them, including those in relation to the Twelfth Schedule [Article 243W(b)];

(iii) State Election Commission to superintend, direct and control the preparation of electoral rolls and conduct all elections to the rural and urban local bodies [Article 243K(1)];

(iv) State Finance Commission to review the financial position of the rural and urban local bodies and make recommendations to the Governor regarding (i) the "principles" which should govern the distribution of resources between the state and local bodies, the determination of the revenue resources to be assigned to or appropriated by local bodies, the grants-in-aid from the State Consolidated funds to such authorities; (ii) the "measure" needed to improve their financial position; and, (iii) any other matter as the Governor may refer to in the interests of sound finances of the local bodies [Article 243(1)];

(v) District Planning Committees (DPCs) to" consolidate" the plans prepared by the Panchayats and the Municipalities in the district as a whole [Article 243ZD(1)];

(vi) Metropolitan Planning Committees (MPCs) to prepare draft development plan for the Metropolitan area as a whole [Article 243ZE(1)].

In practice however, many States have only conformed to the letter of the Amendment and not to its spirit. While elections have taken place in accordance with the provisions of the Constitution, little effort has been made to enlarge the functional and financial domain of the Municipalities. The State Finance Commissions have submitted their report to the state governments but there is a great deal of reluctance by the state governments to accept its recommendations. On the contrary, many states have further reduced the financial powers of Municipalities after the State Finance Commission reports were submitted. The states have made provisions in their legislation for the Ward Committees, District Planning Committees and Metropolitan Planning Committees, but these committees are still to be made functional in many states.

An interesting shift in the pre and post 74th Amendment is the focus of the ULBs from a predominantly function-based approach to an outcome based approach. The inclusion of the additional functions was essentially to make ULBs responsible for development outcomes as opposed to simple functional targets. While this certainly meant that ULBs would require additional capacity in terms of manpower, skills and capabilities, it predominantly meant that additional capacities were needed with respect to financial management, particularly:

- Budgets – that would reflect on achieving outcomes as a result of delivering one or more functions
- Projects – that would effectively lead to outputs that exhibit both discharge of functions as well as meeting of outcomes, and would offer value for money with respect to the budget
- Funds – in order to meet project and budgetary requirements
- Funds and account management techniques – that would ensure that fiscal resources could be used and accounted for appropriately.

Municipal finance

The main items of municipal expenditure are listed in table 6 and are typical of all urban local bodies across South Asia.

Expenditure category	Expenditure Items
Establishment expenditure	Staff salaries, allowances, wages, pensions and retirement benefits etc
Administrative expenditure	Rents, rates and taxes, office maintenance, communications, books and periodicals, printing and stationary, travel, law charges etc
Operations & Maintenance	Power and fuel, bulk purchases, stores, hire charges, repairs and expenditure, maintenence and interest payments made on loans
Capital expenditure	Buildings, water supply and sewerage, energy/lighting, solid waste management, roads, bridges, culverts, causeways, health and sanitation, parks and recreation spaces, furniture and fittings, tools and plant, equipment etc, principal repayments of loans
Other expenditure	Miscellaneous expenses not accounted for in the above

Table 6: Main items of municipal expenditure

3. Municipal governance

State Finance Commission – Uttar Pradesh

The First State Finance Commission (SFC) submitted its Interim Recommendations to the state government on 31st December, 1995 and Final Recommendations on 31st December 1996, which were accepted by the government in January 1998. The recommendations of the S.F.C. were made effective from 1st April, 1997. There are in all 61 recommendations of the S.F.C. which deal with the Urban Local Bodies, foremost amongst them are as follows:

(i) Devolution of 7 per cent of the proceeds of the total tax revenue of the state government to the urban local bodies.

(ii) The inter-se distribution of 7 per cent of net proceeds is, 3.12 per cent each for municipal Corporations and Municipalities and the remaining 0.76 per cent for Nagar Panchayats.

(iii) S.F.C. has recommended the criteria of 80 per cent population and 20 per cent area for devolution of net proceeds of state's tax revenue to the three categories of urban local bodies and determine their inter-se share accordingly in 3.12% of net proceeds earmarked each for Municipal Corporation and Municipalities and 0.76 per cent of net proceeds earmarked for Nagar Panchayats. The amount of 7 per cent devolution was Rs. 445.78 crore in 1997-98 while in 1998-99 it increased to Rs. 525.00 crore.

(iv) Unpaid electric bills (to 31st March) of the local bodies, which totals about Rs. 550 crore have been waived. State Government is paying the same amount to the U.P. State Electricity Board on behalf of urban local bodies.

(v) Loans sanctioned to the urban local bodies which were overdue on 31st March 1997 for under-water supply schemes, Integrated City Development Schemes, special component plans for Scheduled Castes and Scheduled Tribes, schemes for the beautification of the cities have been converted into grants by the state government.

(vi) Rates of non-tax revenue have been revised and as mentioned earlier the power to further revise these rates in future by framing or amending the bye laws has been delegated to urban local bodies.

(vii) To increase the own sources of tax revenue of urban local bodies the target has been agreed to fix the demand as per the estimated population of 1997, minimum per capita of Rs. 120 for municipal Corporations and Rs. 40 to 90 per capita in Nagar Palika Parishad (depending upon the population) and Rs. 20 per capita in Nagar Panchayats

(viii) Imposition of all types of taxes enumerated in the Act, has been made compulsory

Whilst respective State Finance Commissions across India have made a host of recommendations to increase revenues to ULBs , many of these have not been put into practice with the result that many ULBs continue to be under funded and under resourced.

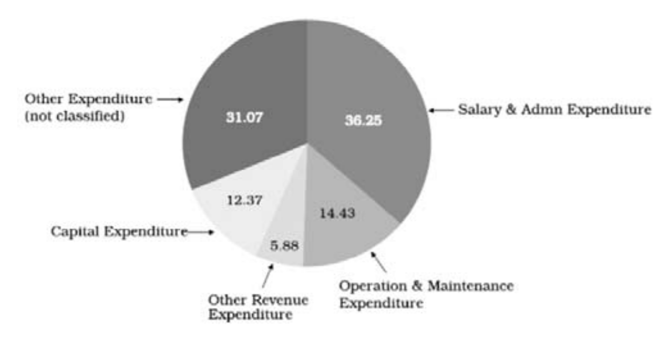


Figure 8: Main expenditure

In 2003-04, the Reserve Bank of India made a study of 25 municipal governments to determine how expenditure was being incurred. The main findings are summarised in the figure below:

Assuming that the expenditure patterns shown above reflect the level of functional devolution exhibited by municipalities, it is seen that the sum total of capital and revenue expenditure is less than non-classified expenditure and less than salary and administrative expenditure. Also, assuming the term 'other expenditure is to be classified as part of the non-Plan budget, we see that non-Plan to Plan budget ratio is less than 1. In effect, this means that the capital and revenue receipts of ULBs are primarily oriented to meet the internal and incidental costs and thereafter delivery through capital and revenue expenditure. In such a situation, seeking an outcome-based budget is as good as redundant.

Insofar as devolved funding in India is concerned, the 73rd and 74th Amendments to the Constitution: (a) provision for the constitution of State Finance Commissions (SFCs) every five years (Article 243-I as per the 73rd Amendment) and (b) amendment of Article 280 of the Indian Constitution by inserting section 3(C) which requires the Central Finance Commission (CFC) to suggest measures needed to augment the consolidated fund of the states to supplement the resources of municipalities devolved on the basis of the respective SFC recommendations. Whilst there have been many detailed recommendations arising out of the respective SFC reports, as can be seen from the box opposite, many of these recommendations have not been implemented by the respective State governments.

As a result, the aggregate revenues of ULBs in India, as elsewhere in South Asia, is very low at around 0.75 per cent of the country's GDP which contrasts sharply with rates found elsewhere such as 5% for Brazil and 6% for South Africa. The Twelfth Finance Commission reported that there were 3,723 ULBs in India, of which 109 were categorised as Municipal Corporations, 1,432 were categorised as Municipalities and 2,182 categorised as Nagar Panchayats. The total revenue of these ULBs grew from Rs.11,515 crore in 1998-99 to Rs.15,149 crore by 2001-02 at a compounded average growth rate (CAGR) of 9.6 per cent. Their total expenditure increased from Rs 12,035 crore to Rs 15,914 crore during the same period, registering a CAGR of 9.8 per cent.

The total revenue of ULBs has been growing at a lower rate (9.6 per cent during 1998-99 to 2001-02) than the growth of combined

3. Municipal governance

Central and State Government revenues (10.8 per cent during 1998-99 to 2001-02). This has reflected in a marginal decline in the share of municipal revenue in total government revenues from 2.5 per cent in 1998-99 to 2.3 per cent in 2001-02. Various studies have revealed broad trends on the structure and composition of revenue and expenditure. In 2004-05 tax revenue accounted for 45.2 per cent of total own revenue, followed by non-tax revenue (28.7 per cent). Establishment and administration expenditure accounted for about 36 per cent of total expenditure in the same period. Expenditure on public works accounted for about 44 per cent of total expenditure, with that on roads and parks and playgrounds accounting for about 19.5 per cent of total expenditure.

Analysis of the revenues and expenditure of a sample of Municipal Governments reveals that most generate some revenue surplus and that the overall resource gap is not particularly large. However, this has to be seen in the context of severe under investment in municipal infrastructure and services across most of South Asia where municipal bodies are still unable to provide basic services such as regular and reliable water supply and sanitation to more than half of the urban population whilst other civic infrastructure and public transport provision remains totally inadequate. This apparent contradiction of sound fiscal health and high level of under-spending is due to statutory obligations, whereby Municipal Governments are generally bound to restrict their expenditure to the resources available and are also not granted liberal permission by State Governments to incur debt. This effectively meant three things:

a. That the Municipal Governments had to raise funds from all possible sources
b. That financial management and propriety would have to be exercised in case capital receipts were to be asked for by the ULB from sources of debt, and
c. The Municipal Government had to enforce its writ in terms of recovering taxes and dues.

In practice, this means that:

a. Municipal Governments need to widen the net for taxes and other statutory levies
b. Municipal Governments need to institute measures for improved budgeting, accounting and revenue management
c. Municipal law and rules need to be amended to facilitate the above
d. Higher tiers of Government need to ensure a greater flow of devolved funds to the Municipal Governments.

Almost all municipal governments lack effective financial management systems and have weak financial management capacity. There is often little systematic and accurate recording of municipal assets and book keeping methods are very basic.

Over time, several records of municipal assets are lost thereby resulting in an incomplete asset inventory and value. Also, the manual method of book keeping technically means several levels of reconciliation of expenditure and an increase in errors. Only larger Municipal Corporations are in a position to update their opening balance sheet on regular basis. The average lag between last audited statement and the current year is usually three to five years.

Municipal reforms

The context of consistent underfunding of urban services and the need for substantial increases in investment to cater for the expansion of urbanisation across South Asia has led to a new focus on the implementation of a series of reforms to enable urban local governments to adjust to the changing needs and demands of municipal governance. It should be noted, however, that the primary focus of such reforms to date has been on financial management and planning and they do not as yet address many of the underlying structural weaknesses in urban governance which determine the nature of municipal organisation and staffing. In spite of this however, the array of reforms currently being undertaken across urban local bodies in South Asia represent an important step towards more effective urban governance. These reforms are aimed at removing inefficiencies that prevent the effective devolution of functions and funds so that the responsibilities mandated to urban local governments can be carried out more effectively in line with the Millennium Development Goal of promoting democratic decentralisation. The following section examines how, in the case of India, municipalisation has progressed over the various decades in meeting the responsibilities of local self governments.

In response to these issues there have been a number of initiatives over recent years to promote municipal reforms in South Asia. Such initiatives include the World Bank funded Municipal Management Programme (Phases III and IV) in Sri Lanka which began in the late 1980s through to mid 1990s. There have also been a series of reforms initiated as part of ADB funded urban upgrading projects in Bangladesh, Nepal and Sri Lanka (eg Secondary Towns Development) as well as urban reforms

Reforms Linked to Infrastructure Improvement Programmes

Numerous urban development programmes based on the provision of basic infrastructure (water supply, roads, drains, sanitation and solid waste) in countries such as Bangladesh, Nepal and Sri Lanka have included the implementation of select municipal reforms to complement infrastructure provision and contribute to the development of an urban sector road map. Such reforms have typically included:

- Formulation and select implementation of revenue improvement action plans based on improved property tax billing and collection, revision to assessment methods etc
- Preparation of financial management strengthening plans with activities in capacity building for updating asset inventories, (accrual based) double entry accounting
- Select organisational development improvements
- Strengthening of participatory planning processes

3. Municipal governance

supported by DFID: urban services for the poor in Pakistan (Faisalabad Area Upgrading Programme) and most recently in Bangladesh through the UNDP implemented urban poverty reduction programme with DFID funding. A similar trend can be observed in India with a range of municipal reforms being implemented as part of ADB funded urban development projects and DFID funded urban services for the poor programmes (formerly slum improvement initiatives funded under ADB.

Whilst these have all represented important steps in helping to bring about improvements in urban planning and management, one of the most significant of such initiatives is represented by the recent reform components of the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) in India. This programme was launched in 2007 and derives its main agenda from the 74th CAA which provides the main context for such reforms.

Jawaharlal Nehru National Urban Renewal Mission (JNNURM)

The JNNURM programme is one of the most recent, widespread and large-scale urban reform programmes in the world covering over 65 cities across 31 states/ union territories with an investment of $14.3 billion. JNNURM has been the flagship urban programme of the Government of India since its inception in in December 2005 with the main objective of promoting reform driven, fast-track and planned development of identified cities over a seven-year period.

The programme seeks to reform the existing urban policy environment and create basic infrastructure to enable cities to maximize their contribution to economic growth and poverty reduction. JNNURM comprises two sub-missions: Urban Infrastructure and Governance (UIG), and Basic Services to the Urban Poor (BSUP), and two schemes: Urban Infrastructure Development Scheme for Small and Medium Towns (UIDSSMT), and Integrated Housing and Slum Development Program (IHSDP). The UIG sub-mission and UIDSSMT scheme are directed at city infrastructure, while BSUP and IHSDP seek to promote integrated development of slums and housing and provision of basic services to the urban poor.

The programme requires all states and cities to implement 23 reforms over the seven-year period of the programme in order to qualify for funding (see list below). Participating states and cities are required to sign a Memorandum of Agreement (MOA), which is a tripartite agreement between the centre, states and ULBs, bearing a commitment of the state and ULB to implement the reform agenda according to an agreed timeline. According to the original design of the program, release of funds from the centre is conditional upon implementation of agreed reform milestones indicated in the MOA. This however, has not been strictly adhered to and large allocations have occurred before reforms were implemented.

Cities participating in JNNURM are entitled to receive a GOI grant to cover 35 to 90 percent of the approved project cost (depending on the category of recipient)[3]. JNNURM also requires cities to prepare a 'City Development Plan' (CDP), which is a perspective and vision plan for development of the city. All projects submitted by ULBs for funding from the centre have to be in conformity to the CDPs.

Mandatory and optional reforms

Using the implementation strategy in Madhya Pradesh (MP) as a case study, manadatory reforms comprise:

1. Implementation of the provisions of 74th CAA
   - All the Provisions of 74th CAA ie Constitution and composition of municipalities, ward committees, reservation of seats, duration of municipalities, powers, authorities, taxation and audit have been incorporated in the State Municipal Acts.
   - State government has constituted State Finance Commission, State Election Commission and District Planning committees as per the provisions of the Constitution.
   - All the functions of the 12th schedule have been incorporated in the Acts.
   - In addition to the function of the preparation of the Master Plan, all the functions of the 12th Schedule have been vested in the ULBs. ULBs have been empowered to prepare Zoning Plans.
2. Constitution of District Planning Committee and MPC
   - The MP Zila Yojna Samiti Act came in to effect in the year 1995.
   - District Planning Committees (DPCs) were constituted in 1995 and are fully functional.
   - Annual District plans are being prepared
   - No Metropolitan Area has been notified in the state as yet, hence the constitution of a Municipal Planning Committee (MPC) is not relevant in the present context
   - At the instance of GoI Madhya Pradesh has initiated action for setting up of MPCs in metropolitan areas. It is proposed to achieve this reform by the end of March 2012.

[3] JNNURM counterpart funding and national government grant commitments are as follows:

Category	Criteria	City Share (%)	State Share (%)	GoI share, i.e. Additional Central Assistance (ACA) %
A	Cities or urban areas with 4 million plus population	50	15	35
B	Cities or urban areas with 1 to 4 million population	30	20	50
C	Selected cities/ urban areas (state capitals, cities of religious/historic and tourist importance)	10	10	80
D	Cities or urban areas in the North East and Jammu & Kashmir	0	10	90

3. Repeal of Urban Land (Ceiling and Regulation) Act, 1996
   - The Government of MP repealed this Act in the year 2000.
4. Rent control reforms
   - The draft of a new Act for replacing the existing MP Accommodation Control Act is ready.
   - The draft being vetted by the Law Department.
   - Cabinet has principally approved to enact new MP Accommodation Control Act.
   - It is proposed to place the bill for enactment of law in the coming winter or Budget session of the Assembly.
5. Computerisation of registration process/ rationalisation of Stamp Duty
   - The prevailing rate of Stamp Duty was 8%, which was proposed to be reduced to 7% and 5% during 6th and 7th year of the mission period respectively
   - The rate is 2% less (ie 6%) for the properties registered in favour of women
   - Significant progress has been achieved towards computerisation of registration processes.
   - Reduction in the rates of Stamp Duty @ 0.5% took place from 1 April 2008; made effective in the current financial year.
6. Enactment of Community Participation Law
   - State Government issued executive instructions on 8 May 2006 to all the Urban Local Bodies in the State to involve the community in the process of decision making.
   - Mohalla Samiti Rules have been published in the Gazette.
7. Enactment of Public Disclosure Law
   - Executive instructions were also issued on 8 May 2006 to all the ULBs in the State for appropriate disclosure of information.
   - Necessary provision has been made in the Municipal Act.

Optional reforms comprise:

8. Provision for rainwater harvesting in all buildings:
   - Rainwater harvesting made compulsory in buildings on plot size of 140 sq.mtrs and above. Enabling provision has been made in the MP Bhumi Vikas Niyam, 1984.
9. Management urban transport by ULBs
   - ULBs are allowed to manage urban transport services. City Transport Service is managed by ULBs in Bhopal, Indore, Jabalpur, Ujjain and Gwalior.
10. Streamlining the process of building plans
    - The process has been simplified.
11. Simplifying the procedure for diversification of agriculture land
    - Necessary provision has been made in the MP Land Revenue Code. Now mere intimation by the owner to the competent authority is required for this purpose.
12. Provision of 20-25% plots for economically weaker sections (EWS) and lower income groups (LIGs)
    - Provision of earmarking of 15% of plots for the informal sector exists in the colonisation rules.
13. Introduction of a property title certification system in ULB
    - The Commercial Tax Dept is undertaking pilot projects in two districts
14. Introduction of a computerized process of registration
    - Completed
15. Bye-laws on the use of reclaimed water
    - Model bye-laws are being framed for circulation to all the Corporation towns in the state. Shall be circulated by the end of FY 2009-10.
16. Administrative /structural reforms
    - Completed/ continued
17. State Policy for PPP notified
    - Exploring PPP options
    - Options have and are being further explored in infrastructure development and commercially viable projects like solid waste management, water supply, housing for poor, bus rapid transport systems (BRTS) (rolling stock), etc.

The impact of this ambitious reform agenda has been variable across the country as one would expect. Interestingly, many states and cities have implemented technically difficult and politically important reforms that have made a real difference to their operational efficiency and institutional capacity in the JNNURM period. Reports on the progress indicate that where reforms found resonance locally the take up was more effective. For this reason, progress on many financial and technical reforms including the implementation of user charges, property tax, e-governance, accounting and administrative reforms have been noticeable in many cities and states. In contrast, reforms for conversion of agricultural to non-agricultural land and earmarking housing for the poor were accorded a low level of priority and were largely not operationalised, even after necessary legislative and policy steps were completed.

Experience to date has shown that progress can be substantially improved if municipal bodies have access to sufficient technical assistance resources to help implement these reforms. The table below indicates how DFID funding in the Madhya Pradesh Urban Services for the Poor Programme (MPUSP) has aligned to assist the State Urban Development Department and municipal corporations in carrying forward the range of reforms required under JNNURM.

The results expected at state level are:

- Implementation of the 74th Constitutional Amendment Act in letter and spirit, including constitution and timely elections for urban local bodies and the meaningful association of ULBs in the entire gamut of urban management functions
- Transfer of town planning functions to the urban local bodies

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- Establishing a system that balances the rights and obligations of landlords and tenants to encourage construction and development of more housing stock, as well as promoting an efficient and robust rental/tenancy market, so as to improve the availability of housing across all income categories
- Establishing an efficient real estate market with minimum barriers on transfer of property so it can be put into more productive use
- Repeal of the Urban Land Ceiling and Regulation Act (ULCRA) with the objective of increasing the supply of land in the market and the establishment of an efficient land market.
- Involvement of citizens in municipal processes, e.g. setting priorities, budgeting, exerting peer pressure on compliance with regulation, etc. through the implementation of the Community Participation Law (CPL)
- Reduced delay in the issue of building permits and to strengthen building control and enforcement mechanisms.
- Simplified legal and procedural frameworks for conversion of agricultural land for non-agricultural use and to free up land for urban development, thus assisting planned urban development and free, non-speculative and transparent land markets.
- Introduction of the Property Title Certification System and ensuring that property title registered in its system is genuine and legally valid. It is intended that this will reduce the incidence of land dispute, and strengthen enforcement against illegal settlements and master plan violations.
- Earmarking of at least 20-25% of developed land in all housing projects for EWS/LIG categories with a system of cross subsidisation. This will ensure that local governments/agencies take active steps to increase the supply of land and housing and to make them more affordable for the poor, with the long-term aim that cities can be slum free as affordable land/housing will be available.

The expected results at ULB level are:

- Enhanced financial management (transparent and self reliance) through
  - improved budgeting, internal controls and auditing;
  - re-engineering business processes to align with accrual-based accounting system;
  - integrating financial management systems with financial accounting system.
- Strengthened ULB revenue through more efficient and effective tax assessment, billing, collection and record keeping will reduce leakages, and at the same time, make the system more citizen friendly.
- Establishment of single window facilities for the delivery of (simplified and integrated) services to citizens, and to improve accessibility of information to citizens.
- Improved targeting of municipal expenditure on provision of basic services for the urban poor, and improved accountability of local bodies for the utilisation of this budget.

JNNURM reforms	MPUSP support
L1: Accounting reforms	■ State Municipal Accounting Manual prepared. ■ Opening Balance Sheets prepared by ■ Financial Management Manual ■ Financial and Accounting Rules ■ Double Entry Accounting System Training Manual ■ Double Entry Accounting System handholding support
L2: E-Governance reforms	■ Fully comprehensive and integrated E-gov system on SAP platform covering all ULB functions ■ Provision of on-line citizen services ■ Citizen Service Centers established ■ Centralised Tele complaints services launched
L3: Property tax reforms	■ Property tax surveys in all ULBs linked to GIS ■ Study on rationalisation of taxes completed. (L1,3,4) ■ GIS based maps.
L4: User charges	■ O&M initiatives taken up ■ Service Level Benchmarking initiated.
L5: Internal earmarking of funds to urban poor	■ Earmarking of funds for Urban Poor done ■ Community Initiative Fund in place ■ Social Economic Surveys of slums
L6: Provision of basic services to urban poor	■ Urban Livelihood Programme taken up ■ Slum development activities implemented ■ Community participation through Micro Planning
A8: Administrative reforms	■ Implementation of Performance Management System ■ Amendments to State Service Rules

Table 7: JNNURM reforms and support provided provided by MPUSP

- Provision of basic services to the urban poor including security of tenure at affordable prices, improved housing, water supply and sanitation.
- Improved quality of life for urban poor communities; improved urban environment; inclusion of the poor in city economic development; and participation of the poor in city planning and governance.
- Improved municipal capacity and operational efficiency, including improved human resources and personnel management, streamlined internal systems and processes, improved allocation of internal resources and better citizen interface systems.

4. Innovative financing mechanisms

As noted in the previous sections, the adequacy of finance in the urban sector in South Asia is has long been an important issue and is rapidly becoming a critical concern in the face of growing urbanisation a substantial backlog of infrastructure requirements and future needs. Whilst part of this problem may be addressed through a switch in the pattern of public grants from rural areas to urban and an increase in the proportion of funding to urban areas, this may prove extremely challenging to many South Asian nations with large rural populations and a substantial social investment requirement in education, health and poverty reduction. Whilst the experience of recent urban reform programmes such as JNNURM helps to demonstrate the potential of linking grant funding with reforms aimed at increasing own revenue generation and more efficient and effective expenditure management, there is nevertheless a substantial need to explore innovative mechanisms to finance the growing demands of cities across the region.

At the same time, one of the most significant criteria for continued growth in an emerging economy of South Asia is the level of provision of quality infrastructure. Many households and businesses lack access to services, and those that do have access suffer from unreliable and poor-quality service. Power cuts and shortages impose huge costs on consumers, with the biggest burden on industry and poor people. No city in South Asia has water available 24/7. Choked sewerage and sewage-polluted water systems pose serious health hazards. Neglected maintenance of roads causes congestion, many accidents, and excessive wear and tear on vehicles and congested ports and poorly maintained highways hamper trade. As already seen above there is a massive infrastructure deficit in South Asia which will require substantial additional levels of funding over the next 20 years to meet the backlog and future demand for infrastructure. In this context governments are evaluating options for involving the private sector. In India alone, it is estimated the infrastructure investment requirement at around 8% of GDP. The 11th Five Year Plan (2007-2012) of India identifies the infrastructure investment requirement at US $494 billion and it is estimated that India will need a total of around $2.2 trillion over the next 20 years to meet the total urban investment requirement.

Debt financing

Most urban infrastructure investments, especially environmental ones, are capital intensive, with long gestation periods which may generate considerable externalities across municipal boundaries. Moreover, their long life means that benefits accrue over at least a generation. These public good characteristics imply that user charges by themselves can rarely be expected to cover capital costs, maintenance and depreciation. Subventions are most often needed either as grants towards capital financing or subsidized interest rates. Furthermore, in smaller cities and in low income situations, the potential for full user charges is both politically and socially constrained. For example, a waste water system at best takes three years to build and involves construction and connection risks with little or no cash flows during this period. This implies the need for initial moratoriums and the need to blend debt and grant financing. In many small towns in the region, the number of connections would result in higher user charges for debt servicing.

These facts suggest the appropriateness of long tenure debt financing. It is also clear that debt for municipal, infrastructure would need to be denominated in a local currency since most of these assets do not earn foreign currency revenue and foreign exchange risks could pose major shock on overall financial viability.

The main source of long-term domestic debt would essentially be from insurance and pension funds and, in some cases, direct subscription by more affluent sections of the population. The depth of supply of long-term debt would broadly depend on two sets of factors including macro determinants such as the savings rate and dependency ratios etc as well as the policy variables such as fiscal incentives, which make available the use of these funds for longer term infrastructure investments rather than public consumption.

Equity investment

Equity investment is usually a preferred instrument if infrastructure investments can generate genuine third party sales with users paying for services. This is possible for certain types of infrastructure such as intercity toll roads, commercial complexes such as retail markets and shopping centres and other public real estate such as wedding halls and training centres. On the other hand, for the first two categories of investment (roads and water and waste water systems) the prospects for mobilizing equity are limited due to the following factors:

- the need for long term debt which influences the level of return on investment
- the prospects of realizing gains through listing will be low if the equity base is small
- multiple sources of other revenue income such as fees, taxes, licences may add risks

Institutional changes for equity investment

Institutionally, there needs to be a process of guidance in place for helping cities formulate the right kind of arrangement with the right kind of concessionaire along with a sound process of procurement in place, rules for handling multiple ownership (a city water concession may depend on adequate flows from a source owned by the state) and adequate security for lenders (step in rights etc). Given these facts, it is not surprising that equity investments in urban infrastructure in the region have been somewhat limited to date and in many cases have not worked as expected.

Firstly, on the demand side, the ability of cities to attract private domestic debt on a sustained basis is dependent on the stability of revenue streams over the life of the loan. This, in turn, crucially depends on the predictability of internal and external sources of revenue. Rational and rule based intergovernmental fiscal transfers and buoyant own sources of revenue bring stability to revenue streams and facilitate private finance ability to assess risks.

4. Innovative financing mechanisms

Secondly, on the supply side, is the availability of domestic savings (often generated by growth in cities) as long-term debt for urban infrastructure development. Factors that constrain supply include excessive borrowings by national and state government, especially for consumption which has the effect of reducing the fiscal space for cities to borrow locally and invest in infrastructure.

Accessing capital markets

Across the world, governments at all levels have begun to access capital markets as a means of financing certain types of public investment. Local governments in South Asia are largely dependent on intergovernmental fiscal transfers to fund priority investments. However, as funding requirements grow it will be increasingly necessary for local governments to seek new avenues of funding including domestic capital markets. Whilst larger urban local bodies with more buoyant revenues will find it easier to access such markets, alternative mechanisms will need to be developed to enable smaller local bodies to access such funding.

Traditionally, securitisations of borrowings by public entities has been undertaken by State sovereign reserves and provisions have been put in place to limit securitisation by public entities, particularly those with their own accruals. Since municipal governments fall under this category, their capability in this regard has been somewhat curtailed.

One of the sources of raising finance from capital markets has been through the raising of bonds and mirroring global trends, countries such as India have been experimenting with this model since the early 1990s. Direct access to capital markets by local government is generally in the form of a municipal bond issue with a specified (fixed or floating) interest rate, tax exemptions and in some cases with a government guarantee. Such bonds are usually for 7-15 years and generally based on a credit rating for Structured Obligations (SO).

Although there has been an increase in domestic bond market activity in recent years, the overall bond markets in South Asia tend to be small and fragile. Although the municipal bond market is nascent in India, there have been more than 20 Corporations that have raised investment funds in this manner, cities such as Ahmedabad, Hyderabad, Nagpur, Bangalore and Kolkata have

CITY and RATING		AMOUNT (INR Mill)	PURPOSE
Ahmedabad-1	AA-	1000	Water and sanitation
Ludhiana	AA+	100	Water and sanitation
Bangalore	A-	1250	City roads
Nasik	AA	1000	Water and sanitation
Nagpur	AA	500	Water and sanitation
Madurai	A+	300	By-pass
Ahmedabad-2	AA	1000	Water and sanitation
TNUDF	AA+	1100	Municipal infrastructure
Water Fund-TN	AA	300	Water and sanitation

Table 8: Ratings and purpose of debt instruments

What is Octroi?

Octroi is a tax which is levied on entry of goods for use/consumption within Local Authority boundaries.

Octroi tax has been an important source of revenue in India for the ULBs. Almost 33% of the total tax collected by Municipal Corporation of Greater Mumbai is in the form of Octroi.

raised debt for municipal infrastructure by accessing such capital markets based on a prior credit rating through issuing debt instruments of varying tenure on a non-guarantee mode. Meanwhile, urban reform programmes such as JNNURM encourage ULBs to become credit rated. Table 6 below highlights the ratings and purpose of debt instruments for various cities in India.

Insofar as the issue of bonds is concerned, one of the main incentives to invest in such bonds used to lie in their being non-taxable and the fact that many urban local bodies in India, in the past, had access to reasonably buoyant revenues in the form of octroi" (tax on the movement of goods) which helped to reduce their financial obligations or liabilities. The subsequent abolition of the octroi tax has removed a major source of revenue from municipalities and this has simultaneously reduced their ability to maintain a reserve for potential bond redemption. This situation has been worsened in some cases where cities and State governments have deliberately set out to limit the coverage of property tax and other revenues such as water charges in response to political pressures from various quarters.

As cities have seen their revenue base decline and, in the absence of a concerted effort to enhance own source revenues by capturing non assessed and under assessed properties as well as increasing tax rates, fees and charges, cities have found it difficult to support or sustain bond issues in any substantial manner as credit worthiness continues to be a serious problem. In these circumstances it is perhaps not surprising to find that there has been very modest progress in this area with only 10 to 12 Municipal bond issues to date in India, although there has been a substantial amount of activity on accessing credit ratings as a precursor to the issuing of bonds. In the absence of much progress in this arena, cities and States are looking to alternative mechanisms for raising capital, some of which are described in more detail in the following section.

Pool funding

Smaller municipalities have used pooled financing structures to develop a more sustainable method of financing. Clearly in a couple of states of India – Tamil Nadu and Karnataka, where demand-side reforms have tended to be better because of rational and predictable transfers. Improved empowerment for municipal governments means that they have found it easier to raise market finance at low cost on non-guarantee mode and where the borrower/lender relationship is well defined.

Bangalore-Financial Structuring Of Water Supply project

The Project promoted by Bangalore Water Supply and Sewerage Board, KUIDFC and USAID's FIRE project supported the Board in pooling the demands of local bodies and enabled them to raise resources from the market. The fund manager is KUIDFC, a state Level financing intermidiary and the security arrangements consist of an Escrow, Bond Services fund and guarantee by USAID. The total cost of the project is Rs. 3400 M and the sources of funds include:

Citizen Contribution	35%	Government Grants	22%
Municipal Bonds	30%	Subordinated Loans	13%

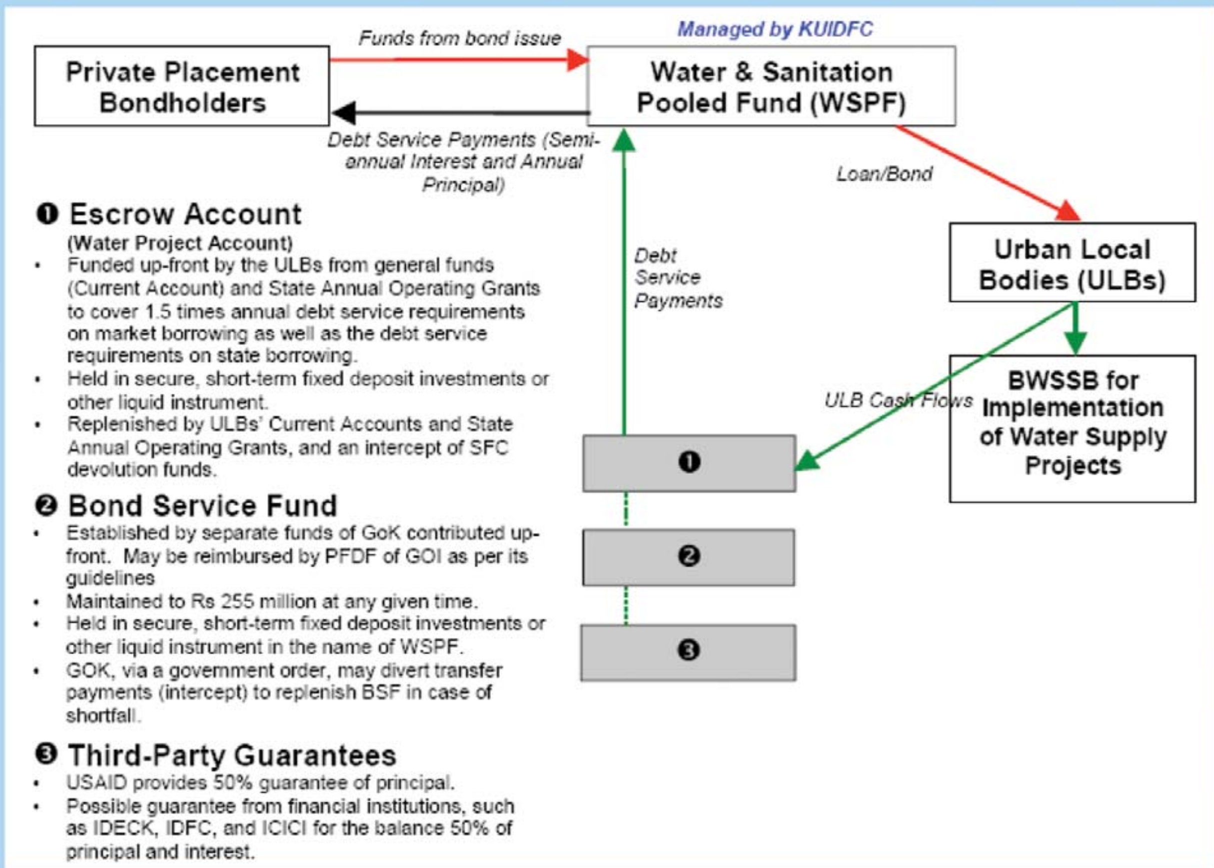

Figure 8: Bangalore water supply system – financing through pooled funds

Water and sanitation pool funding

Urban Infrastructure, especially water and sanitation investments require long term debt on account of externalities over time and space, severe fiscal constraints on the supply of equity from State and local Governments for new investments, and a substantial low-income population constraining the ability to pay for high financing costs. Municipalities also require short-term working capital in view of the lags between revenue and expenditure flows. Consequently, the need to link city infrastructure financing requirements with domestic capital markets is well understood. Debt finance is a pre-requisite for undertaking essential civic investments, and in the long run, domestic savings through capital markets would have to be a predominant source of supply.

In India, the sources of municipal debt have been limited usually to State Governments or financial institutions on the basis of guarantees issued by the State. However, since the 1990's, larger cities in India such as Ahmedabad, Bangalore and State level financial intermediaries such as Tamil Nadu Urban Development Fund (TNUDF) have raised debt for municipal infrastructure by accessing capital markets based on credit ratings through issuing debt instruments of varying tenure on a non-guarantee mode. These have tended to be debt for capital investments. The need for an institutionalised mechanism to raise low cost funds for water and sanitation needs is clear-cut along the lines of the US Bond Bank as a potential model.

Key issues for municipal borrowing

Unregulated local borrowing may lead to an undue rise in public debt and hence there is clear need for greater clarity in the placement of institutional responsibility for the regulation of securities. Any proposal for a new system of controls on local authority borrowing must be developed within the context of constraints on existing municipal systems. In the past, local

4. Innovative financing mechanisms

TNUDF Water and Sanitation Pooled Fund

A pooled entity has been created by Government of Tamil Nadu in the name of the Water and Sanitation Pooled Fund (WSPF) and registered as a Trust under the Indian Trust Act 1882. This trust would identify viable projects and fund them from concept to commissioning on a sustainable basis. The fund would make the Urban Local Bodies (ULB) a part of the active debt markets so as to avail the best interest rates available in the market.

As a pioneering effort for market access, certain ULBs and a few of their projects have been selected to be financed / refinanced by the proceeds of WSPF bond issue. The projects have been selected after careful consideration of their financial viability and commitment towards development.

Management of WSPF:
WSPF is managed by the Trust Manager, Tamil Nadu Urban Infrastructure Financial Services Limited (TNUIFSL). Besides the Trust Manager, the Board of Trustees of the fund comprises the officials of Government of Tamil Nadu and TNUIFSL as detailed below:

Chief Secretary	Chairman
Secretary to the Government Finance Department	Member
Secretary to the Government Planning and Development Department	Member
Secretary to the Government, Municipal Admin. and Water Supply Department	Member
Managing Director and Chief Executive Officer, TNUIFSL	Member - Secretary

Objectives of WSPF:
The main purpose of the Fund is to channel increased financial resources, including private financing, into high priority infrastructure investment, contributing directly to improved living standards of the urban population. The objectives of the Trust are to:

- Provide financial assistance for setting up urban infrastructure projects;
- Mobilize resources from the capital markets under pooled finance structure;
- Facilitate the participation of private sector in the water and waste water sectors through direct investment and through the joint delivery mechanism of public private partnerships;
- Enable ULBs to access debt finance from markets; and
- Act as a nodal agency on behalf of the Central and/or the State Governments for water, sanitation and/or any other infrastructure project.

Resource mobilisation:
The GoTN, recognising the need for widening the market for urban infrastructure financing, especially at the municipal level, have taken several policy measures. Accordingly, unsecured non-convertible redeemable bonds under the pooled financing framework have been floated for Rs.30.41 *crores* in the financial year 2002-03. This first bond issue saved a sizable amount in the debt servicing of the ULBs, thereby freeing up the resources of ULBs for further augmentation. USAID has extended a guarantee to the extent of 50% of the principal for this bond issue. The WSPF achieves the three fold purposes of funding infrastructure through an institutionalized mechanism, with affordable funding and a non-guarantee mode of raising resources for urban infrastructure. Thirteen ULBs participated in this consortium. This pooled financing structure is the first of its kind in India. The balance outstanding as on 31st March 2007 was Rs. 22.30 *crores*.

National River Conservation Project: NRCP
The GoTN nominated the WSPF as the nodal agency for the implementation of the underground sewerage projects under the National River Conservation Project (NRCP) in the financial year 2002-03. The WSPF pooled funds from various sources to meet the project expenditure. Under NRCP, a sum of Rs. 89.77 *crores* was mobilised and disbursed up to 31st March 2007.

Pooled Finance Development Fund: PFDF
The Government has designated the WSPF as the State Pooled Finance Entity under a Pooled Finance Development Fund (PFDF) Scheme of Government of India. It is proposed to mobilize resources of about Rs.45 *crores* by issue of tax free bonds under PFDF scheme to fund water and sanitation projects of seven ULBs. M/s. Fitch Ratings India Private Limited has completed the rating of the proposed bond issue and assigned in-principle rating of AA (ind) (SO) which denotes a stable investment grade.

Action Plan for institutionalizing WSPF in South Asia:
The fact that urban infrastructure investments require long-term finance is well understood. Especially well known is the fact that unless the domestic debt market has sufficient depth, the scope for large volume trades in municipal debt instruments is limited. Quite apart from these macro considerations, at a more micro level, capital markets even with sufficient depth could not directly, on account of economies of scale, service sector-specific small municipal projects. Hence, the needs for intermediation like WSPF.

authorities have had very little freedom with regard to investments and, therefore, have not undertaken long term capital investment planning. This makes it difficult to project and assess debt mobilisation needs against debt service capacities. Local capacity is also inadequate for project management and cost and time overruns are common. These are crucial issues as borrowers need to be in a position to utilize bond proceeds effectively. Recent experiences of bond issuance by municipal authorities have shown that projects have often not been in a position to absorb the funds mobilized. This may also lead to negative arbitrage.

Existing accounting and auditing practices also place major constraints on municipal systems. The cash based, single entry accounting systems followed by most municipalities makes it difficult to arrive at accurate financial information. In India existing municipal legislation does not require adherence to Indian accounting standards set by the Institute of Chartered Accountants of India, as does the Companies Act for the private sector. Most municipal legislation also does not provide for mandatory external auditing, which is also required under the Companies Act. These anomalies must be addressed, and the design of a regulatory system will require changes in legislation to ensure improved accounting practices and compliance with proper accounting standards. In this regard, the JNNURM in India has introduced Double Entry Accounting System as a mandatory reform to be implemented by all mission cities.

Framework for accessing capital markets

Rules on purpose of borrowing and capital investment planning:
A set of rules is required to limit market borrowing to specific types of investment in infrastructure which must be provided to meet the obligatory functions of a municipality and to other related investments which directly support this. Any design of controls must explicitly require the local authorities to undertake multiyear investment planning for water, sewerage, roads and other facilities. The experience of the Tamil Nadu Urban Development Fund, which requires local authorities to prepare a five year investment plan before availing finance, is very encouraging in this regard. The capital investment plan should be locally approved, audited and certified by independent consultants. In addition, appropriate project development to ensure timely utilization of bond proceeds from specific investments will have to be ensured.

A statutory ceiling on debt:
There should be a specific cap on municipal borrowing which is set in relation to the projected debt service coverage ratios for total municipal borrowing. This would include outstanding debt and all projected debt as reflected in the approved five year capital investment plan. Based on international experience, such ceilings would help to imitate market discipline by linking local borrowing to budget performance. Other norms, such as a debt equity ratio based on current and past performance, may also be used once a commercial accounting system is in place.

Compulsory credit rating and disclosure requirements:
Disclosure requirements for municipal bonds will need to be more stringent than for other issuers, due to the limitations in local accounting and auditing practices. It is thus suggested that an investment-grade credit rating for any municipal bond issue, as well as adequate and detailed disclosure requirements, are made mandatory by the regulatory agency regardless of the tenure and mode of issuance (private placement or public offer). Credit ratings of municipal bond issues without any state government guaranty will help to reduce the perception of a bail out; this will also ensure compliance with the legal framework suggested above. At the same time, disclosure requirements will help to gradually induce accounting and auditing reforms.

Private investment options and PPP mechanisms

Given the demand for increased infrastructure coupled with the high capital cost of provision, it is clear that there is an urgent need for more innovative models of financing which can leverage new funds from private and public sources to supplement traditional budgetary provision. Such models most often entail the establishment of partnerships between different entities in the public and private sector.

Private equity companies establish Project Companies (Special Purpose Vehicles) with recourse to project cash flows and other revenue streams (up-front capital grants or taxes to supplement user charges). So far, experience in South Asia suggests that this route is not a material source of financing. There are analytical reasons as to why this would always be a marginal source of finance. Most of the assets created through these special purpose vehicles are long lived assets which need long term debt, especially if user charges are constrained by low incomes. Given this fact, private equity concession periods need to be longer for dividends to be significant. Further, the institutional framework for these investments are not uniform, and are unclear with very little process guidance available for both the concessionaire and city governments.

Private debt by public authorities to design, finance and create infrastructure and repay debt from project and municipal revenues. Internationally, this is the dominant method of financing infrastructure and there are sound analytical reasons as to why this method of financing is in the long run sustainable. The institutional framework is usually well defined in developed countries and is emerging with increasing clarity in countries where there is coherent policy making.

Partnerships between municipalities and communities to share the costs (usually maintenance) of assets created in low income slum neighbourhoods. Although the institutional framework for these

What is a PPP?

Public private partnerships (PPP) are arrangements between a government agency and private sector entities for providing public infrastructure, community facilities, and related services. They are characterized by the sharing of investments, risks, responsibilities, and reward between partners and most often intended to assist in the financing, design, construction, operation, and maintenance of public infrastructure and services.

4. Innovative financing mechanisms

Khandwa water supply system on a Build Operate Transfer model

Khandwa is a district headquarters in Western Madhya Pradesh, with a population of 2.15 lakhs. Khandwa faces acute water scarcity and water is supplied in the area for just 2-3 days in a week, for only half an hour. To overcome this problem and to take care of its long-term needs, the Municipal Corporation explored the possibility of a separate and independent water supply system and to augment the existing water supply transmission network. The project has been planned as a Water Supply Augmentation Project under Urban Infrastructure Development Scheme for Small and Medium Town (UIDSSMT) through the PPP Mode, for the period of 25 years.

Project components:

- Independent source of water,
- A new treatment and transmission system,
- Rejuvenation of distribution system,
- 24 x7Water Supply and intends to meet the Minimum Standard of 135 lpcd supply to the citizens.

The population statistics and consequent water demand for Khandwa on which the current project has been planned are as follows.

Year	Mean population	Demand@135 LPCD (In MLD)
2010	215,373	29
2015	232,815	31
2020	251,817	34
2025	272,540	37
2030	295,163	40
2035	314,764	43
Source of water: Back water of Indira Sagar Pariyojana on Choot Tawa River near Chakarkheda village, 52 Kms from the Khandwa city.		

Various works involved are as follows:

Intake works	Treatment transmission work	Distribution works	O&M tasks
■ Intake Well 56 MLD Abstraction Capacity. ■ Raw water pumping machinery of 56 MLD pumping capacity. ■ Raw water raising main of size 900 mm and 600 meters length. ■ Pipe material - Ductile Iron K9.	■ WTP of 45 MLD Treatment Capacity upgradable to 56 MLD. ■ Clear Water Pumping Machinery of 44 MLD pumping capacity upgradable to 54.5 MLD in I phase. ■ Clean water pumping Main of size 750 mm and 52 Kms in Length 12Kms Feeder main up to ESR in the range of 20000mm size. ■ Pipe material - Ductile Iron K9 of 1750 mm diameter.	■ Distribution work. ■ 10 New ESRs of capacity range 4 - 20 Lakh Liter. ■ Distribution Network of 13 ms length in the range of 100-300 mm ■ Pipe material I- Cast Iron Pipes. ■ Deployment of adequate O&M staff.	■ Minimum average water supply level 01 135 LPCD with due pressure and quality for 24/7 duration. ■ 100% metering in phased manner. ■ New connections including connection, reconnection, repairs etc. ■ Manage regularisation of illegal connections in association with KMC. ■ Implementation a billing and collection system. ■ Recover capital investment. operation and maintenance cost of water supply from consumers base on price quoted in the bid. ■ Develop and maintain complaint and grievance redressal mechanism with 24 hours toll-free helpline. ■ Collection of supply related data and performance reporting.

Implementation agency Municipal	Corporation Khandwa
Concession Period	25 years
PPP Mode	BOT supply of water to consumers including supply of water upto the including consumers (revenue collected directly from consumers as bi-monthly bills)
Estimates Cost	Rs.103.61 crs (sanctioned cost under UIDSSMT)
Govt. Grant (UIDSSMT)	Rs.93.25 *crores*
Details	■ To bring Narmada water at a distance of 52 km from the Choti Tawa River (bacl water of Indira sagar Project near Chakerkheda village) through DIK9 pipe (750mm diameter) to Khandwa ■ At Choti Tawa River, Intake well, water treatment plant and electric sub station is to be structured ■ 10 overhead tanks to b e constructed at Khandwa to ensure 24 x 7 water supply ■ O & M responsibility : Concessionaire

Bid process, financing and risk allocation

- Two stage bid process
- Grant under UIDSSMT scheme of GoI (60%) and GoMP (10%): Rs. 93.25 crs.
- Balance investment from Concessionaire.

Risk allocation

- Demand risk: concessionaire,
- Construction risk: Concessionaire.
- Financial risk: Khandwa Municipal Corporation.

Role of PPP cell

- Vetting the bid documents. Including Concession Agreement.
- Project structuring in keeping with best practices in the sector and the relevant government guidelines and policies on PPP projects and facilitation of the process.

partnerships is often unclear they are important from a poverty reduction perspective and help to foster more inclusive investments in slums.

Types of PPP

A wide variety of types and forms of partnership have emerged to address the different needs and requirements of both parties in building and/ or operating infrastructure services in multiple settings, encompassing different political, administrative and local economic contexts.

South Asia has relatively low levels of private participation in infrastructure. In 1990–2004 the region's 224 infrastructure projects with private participation attracted about US$55.4 billion in investment commitments, far short of commitments in the leading regions of Latin America and East Asia. India accounted for much of that activity, with 152 projects and US$42 billion in investment (76 per cent of the total), followed by Pakistan (16 per cent) and Bangladesh (4 per cent). Investment flows in the region remained mostly steady over the 15-year period, by contrast with the steep declines seen in 1997–99 in East Asia and Latin America as a result of currency and economic crises. Indeed, investment flows in South Asia have been gradually rising since 2000 and surpassed investment in East Asia in 2004.

The recent trend of rising urbanisation has not been matched with a simultaneous expansion of infrastructure in most of the South Asian Countries. Much of the existing infrastructure stock is under severe strain with low provision of services and inadequate coverage with a particular negative impact on poorer communities.

The underlying logic for establishing partnerships The underlying logic for establishing partnerships is that both the public and the private sector have unique characteristics that provide them with advantages in specific aspects of service or project delivery. The most successful partnership arrangements draw on the strengths of both the public and private sector to establish complementary relationships and encourage 'best sourcing' to engage private sector providers in delivering services if it is more efficient to do so.

Types of PPP

- Build/Operate/Transfer (BOT) / Build/Transfer/Operate (BTO)
- Build-Own-Operate (BOO)
- Buy-Build-Operate (BBO)

Contract Services

- Operations and Maintenance
- Operations, Maintenance, & Management
- Design-Build (DB)
- Design-Build-Maintain (DBM)
- Design-Build-Operate (DBO)
- Lease/Develop/Operate (LDO) / Build/Develop/Operate (BDO
- Lease/Purchase
- Turnkey

Key issues in implementing PPPs

Currently, a PPP-based approach for development of urban infrastructure is in the process of evolution. ULBs currently lack the requisite skills and understanding to develop and implement PPP projects. PPP projects tend to focus on the economic aspects of any project rather than the social, or environmental aspects. Most PPPs suffer from the slow preparation of individual PPP projects which may take up to two years for the preparation of the project is to be of high standard. They also suffer from insufficient experience of the partners, particularly of the public sector while contracting such projects, where we can notice an informational asymmetry operating in favour of private companies, which naturally use their endeavour and potential to negotiate better conditions for themselves;

DPRs in ULBs are often prepared by the staff who are not technically competent and who lack sufficient knowledge of PPP options and arrangements. ULBs require substantial assistance and training in the development of projects on a PPP basis. There is often no authority which has been entrusted with the responsibility of undertaking a regulatory function for the PPP projects undertaken by the ULBs. The dispute resolution mechanism is also found to be weak in many of the ongoing PPP projects. In the absence of such a mechanism, if disputes (between the private developers and the ULBs) remain unresolved, there is a risk that the smooth provisioning of the services would be affected.

The final success of PPP will depend on whether governments adopt the right policies, regulatory instruments and institutional reforms to support this kind of approach to development. There is often little consensus among stakeholders on the benefits of involving the private sector in infrastructure, especially in water utilities, in part because of ideological opposition and in part owing to limited experience with private participation. Moving ahead successfully with PPP projects in the medium term will require continued efforts to build awareness of the positive experiences with PPPs, hold consultations with policymakers and other key stakeholders on the range of options for PPPs, and address stakeholders' concerns up-front during the planning and design stage.

Public and political opposition to involving the private sector often rests on concerns about price increases and exclusion of the poor. To be politically acceptable, a move toward cost recovery is likely to be gradual and must be accompanied by efforts to reduce inefficiency. In addition, the design of PPP projects should include innovative ways to deliver subsidies to the poor. To ensure the viability of the PPP projects, Governments should provide some funding during the transition to full cost recovery through user charges.

Procurement policies should encourage competition and transparency for all stakeholders. They should make the objectives of the transactions explicit and it use well-defined selection criteria and be designed to achieve fair, cost-effective, and timely outcomes. A number of countries pursuing PPP models have set up dedicated, cross-sectoral professional units to support their

4. Innovative financing mechanisms

The Indian government's "viability gap fund" subsidizes up to 40 per cent of the capital cost to improve commercial viability and facilitate private participation.

implementation, with responsibilities ranging from disseminating information and preparing guidelines to designing and implementing transactions. These units can guide and complement the efforts of line ministries and provincial governments in developing frameworks for PPPs, methodologies for evaluating PPP options and associated fiscal costs, standard contracts, guidance on managing the bid process, and monitoring and evaluation tools.

There are many challenges to implementing effective PPP projects which include ensuring commercial viability of the projects concerned, ULB capacity to manage such projects, problems of hidden debt, long term pay back, managing partnerships, institutional frameworks, transfer of risks and focus on economic benefit. The main issues are.

- *Commercial Viability:* Projects in water supply and sanitation are yet to demonstrate their commercial viability as they are perceived as 'public goods' that need to be provided at affordable prices.
- *Limited Capacity to Manage PPP in Public Sector:* There is a lack of capacity in public institutions and in local government to manage the PPP process. Since these projects involve long term contracts covering the life cycle of the infrastructure assets being created, it is necessary to have the skills to be able to manage this process so as to maximize the returns to all stakeholders.
- *Hidden Debt:* A consequence of the long-term character of PPP projects is that as expenditures and operating expenses grow a significant hidden debt may arise which can affect viability of the institution and burden future stakeholders.
- *Long Gestation Period:* The preparation of individual PPP projects may take up to 2-3 years (depending on project size and complexity). This long gestation period along with its attendant uncertainties can dampen private sector enthusiasm;
- *Varied Institutional Framework:* Divergent regulatory frameworks as to the purpose of PPP and type of infrastructure and services that may be covered prevents fast tracking of projects since major clearances may still required over a multiplicity of arrangements
- *Transfer of Risk:* Risk transfer from the public to private sectors may create a possible a new set of risks such as bankruptcy of the private player;
- *Focus on Economic Benefits:* PP projects tend to focus on the economic benefits of projects sometimes to the detriment of social and environmental aspects.

State assistance on PPP

Madhya Pradesh, one of the states in India has set up PPP cell at state level which provides technical assistance to all the government departments in implementing PPP projects.

Fostering effective regulation

Private investors' perception of regulatory risk in South Asia has been among the main factors limiting their investments in infrastructure. There are concerns about lack of clarity in roles, high levels of discretion, and uncertainty in regulatory rules. To counter such concerns, clear separation of policy and regulatory functions and an institutional framework that fosters independent and effective regulatory oversight are critical. To enhance the effectiveness of regulatory institutions, their autonomy, accountability, and independence should be written into law. Also a priority is technical assistance to build regulatory capacity.

Benefits of PPP

Experience in India and elsewhere in South Asia has shown that various forms of PPP can bring substantial benefits to citizens by providing additional funds for infrastructure provision as well as more efficient and higher quality processes of construction and operation. Such arrangements help to solve the problem of limited availability of funds for capital investment in municipalities by leveraging capital from private sector entities for projects whose execution would not be possible without such partnership. This has led to a faster development and implementation of projects and lower costs.

Where such arrangements are in place there is often an additional benefit in terms of improved public administration and management since municipalities have to engage at various levels with commercial partners on a professional basis. In these circumstances, many municipal corporations have had to strengthen contract management processes to ensure all contractual terms and conditions concerning the quantity and quality of services are met and that the arrangement is continuously evaluated and efficiently controlled. Substantial part of the risk is transferred to the private entity.

Municipal development funds

Many South Asian counties have experimented with establishing Municipal Development Funds (MDFs) to finance infrastructure, especially for smaller urban local bodies. Currently, MDFs are operational in India, Bangladesh, Pakistan and Sri Lanka. The fund is established as a legal entity and in some cases includes a professional company to manage the fund. Most MDFs have evolved as extensions of central government infrastructure financing policies, albeit funding projects at the local level. Only

PPP legislation

- In Korea, legal support with the "Act on Private Participation in Infrastructure (2002)"
- In Philippines, "The Philippines BOT law" enacted in 1993 is being followed
- In Ireland, the legal coverage has been provided through State Authorities (Public Private Partnerships Arrangements)

4. Innovative financing mechanisms

MCD claims carbon credit success through PPP

The Municipal Corporation of Delhi become the first civic body in the country to win carbon credit through its municipal solid waste compost plant at Okhla in South Delhi. According to the civic body, an advance of Rs.5 lakh against net Carbon Emission Reduction (CER) earning at the plant was handed over to the MCD. The Okhla compost plant has been revived in public-private partnership between the MCD and IL&FS wherein an agreement was signed to upgrade it in May 2007 with Clean Development Mechanism (CDM) benefits which allow net global greenhouse gas emissions to be reduced at a much lower global cost by financing emissions reduction projects in developing countries where costs are lower than in industrialised countries.

recently have they been viewed as possible avenues to access local 'private' capital markets or facilitating direct access by ULBs. As local government borrowers become stronger, there is a possibility for municipal funds (and other government owned financial institutions) to access these innovative sources. The LGUGC (Philippines) is a good example of this. In general though, there has been relatively low progress in raising debt from local markets or actively engaging with private-sector financial institutions in co-lending programs to leverage funds.

Many South Asian countries are now contemplating involving commercial banks, mutual funds, insurance and other financial institutions to participate in such funds. Commercial banks, especially government owned banks have excess deposits in countries such as India and Bangladesh and are thus willing to participate. The success of a typical MDF depends to a great extent on the quality of urban governance and financial management.

Along with capital for developing infrastructure, Municipal Development Funds can also provide technical assistance and training to municipalities thereby increasing their capacities.

Municipal lease (sale)

Another mechanism which most of the local bodies are adopting is to lease out their properties on a long-term lease. An up-front lease premium is collected which is generally used by the local bodies to fund their major infrastructure projects. Kolkata Municipal Corporation in India has used this mechanism and raised over Rs. 90 *crores* in up-front finance which it used to fund other infrastructure projects.

Bangladesh Municipal Development Fund

To address the financial constraints of the local bodies in the country, Bangladesh created a fund called **Bangladesh Municipal Development Fund (BMDF)** which is a ***Government owned company*** established under the Companies Act 1994 to provide financial support to Urban Local governments for urban infrastructure development. BMDF was created in 1998 with a seed fund of US$70.00 million from World Bank and US$ 8.00 million from the Government of Bangladesh. The BMDF is open to finance municipal governments for all most all kinds of urban infrastructure and services. The fund expects participation of the recipient's urban local government in the project cost. The scale of participation is more in case of richer municipalities. The rate of interest is 9%. It has the provision of supporting loan from 50% to 90% of the total cost of a scheme depending on their capacity of generating revenue.

Conditions to avail the funds under BMDF:

- Holding tax collection is more than 50% of the estimated revenue;
- Accounting system is converted to double entry system;
- Prepare budget to a realistic stage;
- Prepare an asset register;
- Track tax defaulters;
- Computerise accounts and office management and train of staff; and
- Stakeholders are allowed to participate in projects.

Financing policy:

Financial assistance from BMDF will consist of a blend of grants and loans, and a municipal contribution whose proportions will be determined by the nature of the sub project for which financing is sought.

- For non-revenue generating projects – Maximum 90% grant from BMDF and minimum 10% contribution by the ULB.
- For revenue generating projects - At least 50% loan and up to 40% as grant from BMDF and minimum 10% contribution from the ULB.
- Percentage of grant to total financing by BMDF to any ULB will not exceed 85%.
- Loan from BMDF is to be repaid over a period of not exceeding 20 years.
- Eligible sectors for financing include Water Supply, Urban Roads, Drainage, Sanitation, Solid Waste Management, Kitchen Market, Bus/Truck Terminal, Municipal Office Buildings, Community Centres, Parks and Street Lighting.

Benefits:

Municipal Development Fund is raising considerable finances for the debt stricken municipalities of Bangladesh. Despite having to cost-share, and to repay a proportion of the funding, almost 150 local bodies have already benefitted from it. To date work has started in 51 municipalities and project proposals have been approved in 73 municipalities. Further, Flood Damage Rehabilitation works have also been undertaken in 52 municipalities with funds reallocated for this component. The basic infrastructure investments are mostly complete and operational.

4. Innovative financing mechanisms

Sri Lanka local loans and development fund: legal background

Local Loans and Development Fund (LL & DF) is a statutory body established under the Ministry of Local Government and Provincial Councils with a Vision "To be a leading financial institution for infrastructure financing".

Goal

The transformation into a full financial intermediary, through a step-by-step approach to fill the gap in the finance market, where there is no special financial institution that is capable of providing funds needed by the Local Authorities for basic infrastructure facilities.

Objectives

- To be the prime financial institution for channeling of foreign aid/grants for the development activities in Local Authorities.
- To provide project development advisory services to facilitate a consistent supply of bankable projects.
- To assist in capacity building of Local Authorities in order to develop them sustainable and viable organizations.
- To provide a broad range of financial products in the Local Government sector like broking, capital market and pool banking advisory services.
- To provide credit enhancement of local authorities for market borrowing like guarantees, debt service reserve funds (DSRF) etc.
- To assist in obtaining a credit rating facility and access alternate financing mechanism including a range of capital and debt market products.
- To explore the possibility of obtaining registration as a specialized financial intermediary (SFI) with the Central Bank of Sri Lanka.

Loans are granted to local authorities for following projects:

1. Solid waste management
2. Development of eco-tourism
3. Improvement of the weekly fair
4. Water supply and sewerage
5. Construction of libraries
6. Construction of crematoria
7. Purchase of equipment for road maintenance and sanitation
8. Construction of office buildings
9. Construction of the market complex
10. Other income generating projects

Loan Category	Interest Rate (per annum)
[a] Loan for construction and improvement of weekly fairs	7.50%
[b] Loan for solid Waste Management and Environmental Sanitation	
- Waste Disposal Sites	6.50%
- Water Schemes/Sewerage Projects	7.00%
- Purchase of Equipment	8.00%
[c] Loan for Construction of Crematoria	7.50%
[d] Loan for Establishment of Maintenance Units	
- Roads and Bridges	8.00%
- Purchase of Equipment	8.00%
- Purchase of Backhoe Loader/Motor Grader	8.00%
[e] Loan for Development of Scenic Resources	6.50%
[f] Loan for Construction of Office Buildings and Libraries	
- Libraries	7.00%
- Office Building	8.00%
[g] Loan for Construction of Markets	10.00%

5. Capacity building for innovative financing

Economic and social development and environmental protection are interdependent and mutually reinforcing components of sustainable development. Economically buoyant, socially vibrant and environmentally sound human settlements under conditions of continuing and rapid urbanisation will increasingly depend on the capacity of all levels of Government to reflect the priorities of communities, to encourage and guide local development and forge partnerships between the private, public, voluntary and community sectors.

The general experience with municipal management in South Asia has been that, there is a vast pool of municipal personnel lack proper education and training to do justice to their functional responsibilities. It is widely accepted that professionalisation of local bodies is an urgent need in addressing a wide range of critical issues be they citizen service related issues, financial issues, planning related issues or organisational issues.

It is all very well to contemplate new roles for local government - and changing paradigms from service provision to facilitators of growth - but such enthusiasm must be tempered with the realities of some local governments, especially smaller ones, to actually do anything more. It is difficult to envisage a local authority "being a facilitator, pacesetter and regulator of socio-economic development in order for them to contribute effectively towards the nation's competitiveness" when it is unable to provide even basic financial accounts.

Experience in Sri Lanka suggests that, although the law has given wide powers to "create a sustainable and habitable environment in the urban/city areas", local authorities do not have the capacity to achieve it. So too in Pakistan where, despite the legislative and organisational provision for local government to play an extensive role, the reality is that beyond basic services of garbage, road maintenance and street lights. The ineffectiveness of Participatory Decentralised Administration due to lack of local capacity may be noted. Local authorities are incapable in three areas: weak administrative capacity, limited financial and human resources and little public participation (Ahmed, 1997)

Human resource development

The critical need for human resource development is acknowledged in all South Asian countries. Starting points and methods of developing their people varies between countries. Appointments of staff and training are discussed in the subsequent paragraphs.

Appointments

There is a mixed arrangement of elected and appointed officials in Bangladesh. While the government does not "earmark" officers exclusively for local government, some civil servants and technical staff will be seconded for specified periods, normally three years. As part of the reforms in Sri Lanka, local government personnel are absorbed into the provincial service, becoming officers of the Provincial Public Service. Regarded as a better system than the previous local government service, the change also permitted transferability between local authorities. Regardless of the improved system, Sri Lankan local authorities still lack senior officials in functions especially in finance, administration and engineering.

> Capacity-building should to be directed towards supporting decentralisation and the participatory urban management process.

Training

Just as appointing good staff is essential, so too is their ongoing training and equipping. This is particularly so during periods of paradigm shift and major reform. New paradigms of local self-government will demand people with new knowledge and skills. This will place undue pressure on local authorities, such as some in Bangladesh that are still trying to redress deficiencies in their existing knowledge and skills base. Or, as in Pakistan, where due to resource constraints, training facilities have been closed, which means that, at least for the lower cadre, training opportunities are few and far between. A national approach has been allowed in both Bangladesh and India. India has several renowned national training institutes that provide training for both elected and executive personnel.

Moving to greater local autonomy will demand greater education and training of the elected arms of local authorities. Some training institutes, like those in India, have a long tradition of training for elected personnel. It will be important that other countries provide similar resources. One recent study found that despite the considerable effort put into public sector management training some doubt the benefits. Training should be treated as a technical, non-threatening and widely-popular answer to the political problems. All stakeholders will embrace training and extol its virtues whereas many may offer resistance to restructuring or more participatory modes of management.

An enabling strategy, capacity-building and institutional development should aim at empowering all interested parties, particularly local authorities, the private sector, the cooperative sector, trade unions, non-governmental organisations and community-based organisations, to enable them to play an effective role in improving and consolidating the financial position of the ULB. Concerted efforts in human resources and leadership development, institutional reform, organizational and management development and continuous training are necessary at all levels. In developing countries and countries with economies in transition, Governments should accord a high priority to implementing a comprehensive policy for capacity-building. The international community should help them to develop their capacity, identify and assess their institution-building priorities and strengthen their management capacity.

Enabling framework for capacity building

It is important to provide an enabling framework within local

5. Capacity building for innovative financing

authorities to support and encourage capacity building. This will involve efforts to:

- Strengthen, as appropriate, the capacity of local authorities to attract investments;
- Adopt macroeconomic policies and frameworks that encourage increased domestic savings and facilitate their use in housing, basic infrastructure and other aspects of social and economic development in human settlements;
- Develop efficient, fair, equitable and buoyant sources of national and local revenue, including taxation, user charges, tariffs and betterment levies, to promote national and local capacity for capital investment in housing, infrastructure and basic services, and devise, as appropriate, new fiscal instruments that penalize environmental damage from both production and consumption activities;
- Enhance local tax collection capabilities and expenditure controls to contain costs and enhance revenues;
- Strive for full-cost recovery for urban services, through user charges, while at the same time addressing the needs of the poor, inter alia, through pricing policies and, where appropriate, transparent subsidies;
- Support local efforts to encourage voluntary private and community sector partnerships and participation in the building, operating and maintaining of open green spaces and basic infrastructure and of services that, inter alia, are gender-sensitive, empower women and address the needs of marginalized groups;
- Facilitate and rationalize, where appropriate, local authorities' access to national, regional and international capital markets and specialized lending institutions, including, inter alia, through measures to establish independent municipal credit ratings and credit systems, bearing in mind the borrowers' capacity to repay the debt in accordance with relevant domestic laws and regulations;
- Facilitate the role of local authorities in forming partnerships with the private, voluntary, community and cooperative sectors and institutions for local enterprise development;
- Institutionalise budget mechanisms, (where appropriate), and accounting to enable local authorities to engage in medium- and long-term investment programmes;
- Establish transparent systems and procedures to ensure financial accountability;
  - Institutionalise, where appropriate, transparent intergovernmental transfer mechanisms that are timely, predictable and performance- and need-based;
  - Attract private and community investment to urban development.

Need for municipal capacity building

Management of complex urban development is an extensive and complex task requiring a host of qualified personnel. Effective management depends upon adequate availability of administrative, professional and technical personnel. Capacity building is a process of acquiring new ideas and knowledge to strengthen an organization's vision, structure, direction and talent and enable it to contribute to common goals. In the case of ULBs, capacity building is expected to make the administrative machinery more efficient, accountable, people-friendly, responsive and transparent with a view to improve the delivery of services to the people.

Capacity Building Initiatives in India

a. Hubs and Networks: Schematic arrangement of six empanelled Region Hub Institutions (RHIs), and a range of Network institutions aligned to the Hub Institutions, to meet the demands for training on the ground.

b. A Rapid Training Program (RTP) for the slow performing cities on the basis on JNNURM implementation on three prioritized modules, Governance & Reforms, Supervision/Preparation of Detailed Project Reports (DPRs) and Project Management and Implementation has been launched

c. The Peer Experience and Reflective Learning (PEARL) program has been launched to foster cross learning among cities and institutions, clustered into five groups based on similar socio-economic profiles. For each Group a Knowledge Manager (selected institution), coordinates and provides technical support

d. UNDP-GOI initiative for Capacity Building for Decentralised Urban Governance This time- bound programme of 14 months spread over 4 states and 16 ULBs to handhold the ULBs in the areas of Accounting Reforms, Property Tax Reforms and City Development Plan.

e. Programme Management Unit (PMU) To strengthen the capacity of State Level Nodal Agencies to effectively co-ordinate the implementation of projects and reforms under JNNURM, the Ministry of Urban Development is supporting a Programme Management Unit (PMU) at the State level. A typical PMU is proposed to comprise a team of professionals recruited from the open market on a contractual basis.

f. Support is being extended to establish Project Implementation Units (PIUs) at ULBs to enhance their capability to effectively implement projects and reforms under JNNURM.

g. World Bank assisted Urban Strengthening and Transformation Project: The JNNURM Urban Strengthening and Transformation (JUST) Project is proposed as a Central Scheme to strengthen the capacity of selected Urban Local Bodies to implement urban reforms mandated under JNNURM and Urban Infrastructure Development Scheme for Small and Medium Towns (UIDSSMT).

6. External assistance in South Asia

South Asia is the second largest region in terms of population in the developing world with 1.4 billion people. Although it has been among the world's fastest growing regions, it remains a region with second highest share of population living below the poverty line. External aid has played an important role in the urban sector in South Asia over recent years through direct loan and grant support for urban infrastructure improvement as well as grant assistance for the implementation of municipal reforms. Agencies such as the World Bank, Asian Development Bank (ADB), UNDP and UK DFID and GTZ have been amongst the most active supporters of urban development in the region. These agencies have not only assisted in addressing city wide infrastructure gaps in water supply, roads, drains and sanitation but have also invested considerable resources in supporting inclusive development through slum improvement projects and pro-poor reforms. In almost all cases donor agencies have included municipal management and finance reforms as conditional or complimentary aspects of urban sector support.

After years of inward-looking economic policies and tight regulation, intensive reforms, which started in the 1990s, have been contributing largely to the acceleration of economic growth of the region. South Asian nations reduced tariffs, removed trade barriers, dismantled restrictions on domestic and foreign private investment, and reformed their financial systems. As a result, the region experienced rapid growth during the 1990s, averaging 5.9% per annum. Trade liberalization has been an important component of structural reform efforts among the South Asian countries since the mid-1980s, with Sri Lanka leading the way. Merchandise trade as a share of GDP has nearly doubled in some countries in the last decade. Trade liberalization played a positive role in supporting GDP growth rates of 5% and higher.

In spite of these developments, South Asia still has the lowest proportion of foreign direct investment to GDP in the world at just 0.5% of GDP. Despite great improvements in nutrition, reproductive as well as children's health and education, it remains a region with many serious problems. Child malnutrition still rates amongst the highest in the world with almost 50% of children are below the standard weight by age. South Asian illiteracy rates, 45%, are still the highest in the world.

Nature of external assistance received in India

- Assistance from the IBRD was largely project specific, and was extended both to the public and private sector.
- UK provided both project and non project assistance, but, non project aid was stopped after 1979-80 in India.
- Soviet assistance was largely by way of export credits for equipment and materials required from the Soviet Union.
- Items of shortage were imported from countries like Australia and USA. The rupee proceeds derived from the sale of these commodities were utilised for financing mutually agreed development projects. Counterpart funds were also generated from the sale of wheat given as emergency food aid.
- Besides food aid under PL480, USA also provided non project assistance that was not designated to a special project but was used for financing important development sectors.
- Private philanthropic agencies like the Ford Foundation also provided funds for procurement of equipment and for hiring technical experts.
- Other forms of assistance included suppliers credit on deferred terms of payment and debt relief.
- Aid was largely received as tied aid.

Source: DEA: position Paper on External Assistance received in India – March 2008

Importance of external assistances to South Asia

The initial periods of development in South Asia was marked by balance of payments difficulties and shortage of foreign exchange resources. Planners had to rely on external assistance to make available adequate supplies of foreign exchange for supplementing the existing investible resources in the country. External assistance was received from various countries and international institutions in the form of equipment and commodities, technical assistance in the form of the services of experts and training facilities. Assistance came as loans, grants and deferred payment facilities detailed in the above box. Some of the major areas of assistance in the initial years of planning included community development, irrigation and power, industry and mining, transport and communication, social services, assistance for miscellaneous projects, food aid and aid for import of agricultural commodities.

Tied funds

The initial external assistance received by South Asia was mostly 'Tied Funds'. Even though the tied funds provided benefits to recipient these were often less than optimal.

Recent trends in external assistance

- Overall ODA levels are increasing after a decline in the 1990s.
- 70% of the total ODA is in the form of bilateral ODA and 30% is from multilateral institutions. This 70-30 ratio for bilateral and multilateral ODA has remained virtually constant since 1995.
- Over time, bilateral ODA has moved towards a stronger emphasis on grants, with the amount of bilateral grant aid rising from 89% in 1995 to 98% in 2002 in contract to 66% three decades ago.
- Change in composition: Bilateral ODA has shifted further towards special purpose grants such as technical cooperation or emergency and debt relief which often carry less flexibility in

6. External assistance in South Asia

Year	Bangladesh		Pakistan		India		Sri Lanka	
	Workers' Remittances (US$ Billion)	% of GDP	Workers' Remittances (US$ Billion)	% of GDP	Workers' Remittances (US$ Billion)	% of GDP	Workers' Remittances (US$ Billion)	% of GDP
1995	1.20	3.17	1.71	2.82	6.22	1.75	0.81	6.21
1996	1.35	3.31	1.28	2.03	8.77	2.26	0.85	6.13
1997	1.53	3.61	1.71	2.73	10.33	2.51	0.94	6.24
1998	1.61	3.64	1.17	1.88	9.48	2.28	1.02	6.48
1999	1.81	3.95	1.00	1.58	11.12	2.47	1.07	6.85
2000	1.97	4.18	1.08	1.45	12.89	2.80	1.17	7.14
2001	2.11	4.48	1.46	2.02	14.27	2.99	1.19	7.53
2002	2.86	6.01	3.55	4.92	15.74	3.10	1.31	7.65
2003	3.19	6.15	3.96	4.76	21.00	3.50	1.44	7.62
2004	3.58	6.34	3.95	4.03	18.75	2.68	1.59	7.69
2005	4.31	7.16	4.28	3.91	21.29	2.63	1.99	8.16
2006	5.43	8.77	5.12	4.02	25.43	2.78	2.18	7.73
2007	6.56	9.59	6.00	4.20	35.26	3.29	2.53	7.81

Table 9: Total private sources at external financing in South Asia and relative share of remittances

their use and/or do not necessarily transfer real resources of equivalent value.

- As per the 2004 Global Monitoring Report only a third of bilateral ODA goes for "structural" development programmes and project expenditures. These areas are dominated by multilateral assistance.
- Multilateral institutions provide almost the same amount of programme and project aid as bilateral donors. The bulk of multilateral ODA flows through the UN system, MDBs like IBRD, IDA and Regional Development Banks (RDBs) such as the ADB and IDB.
- In terms of the sectoral distribution of ODA, recent years have witnessed a shift away from productive sectors such as industry and agriculture, and an increased focus on the social sectors.
- Social infrastructure and services have been an important area for all donors, given that the needs are immense, and the objective of attaining MDGs all too imminent. IDA devotes 40 per cent of its resources to this area, with the RDBs, UN and bilateral donors providing upwards of 30 per cent of their support in this category.
- Recent shifts in priority areas towards climate change and a green development agenda.
- Urban Services such as Solid Waste Management, Urban Transportation have become new areas of funding with a lot of potential being realized in these sectors.
- Millennium Development Goals: Funding from all agencies is available for assistance in achieving MDG targets.

Problems of tied funds:

Poor countries need aid that is delivered without too many strings attached and in ways that minimise transaction costs and maximize value for money. However, all too often, they get aid that is unpredictable, hedged with conditions, unco-ordinated and tied to purchases in donor countries. Recipient countries lose out from tied aid on several counts. The absence of open market tendering means that they are denied an opportunity to get the same services and goods at a lower price elsewhere. Tied aid can result in the transfer of inappropriate skills and technologies. Also the full extent of tied aid is unknown because of unclear or incomplete reporting by donors. Procurement policies are often non-transparent and biased towards contractors in the country. Estimating these costs is difficult because of the restricted nature of donor reporting and the exclusion of technical cooperation.

External debt

Many countries in South Asia resorted to External Debt finance during the 1980's which increased the level of external debt many fold. Although the external debt of South Asian countries is high in real terms, the proportion of external debts to GDP has been declining. The problem of indebtedness basically arises from difficulties associated with meeting debt service obligations. The debt-service ratio, which expresses debt-service payments as a proportion of current receipts, is one of the standard measures for

India's debt management

India's prudent debt management policy and buoyant export growth has led to a steady decline in its debt-service ratio from 35.3% in 1990-91 to 4.8% in 2006-07(QE).

6. External assistance in South Asia

Overall external assistance in India			
Total assistance: Loan + Grant in Rs. *Crores*			
Year	Authorisation	Utilisation	% Utilisation
1980-81	3,847.00	2,161.80	56.19
1990-91	8,123.40	6,704.30	82.53
2000-01	18,124.70	14,254.30	78.65
2005-06	18,937.90	18,888.40	99.74
2006-07	31,789.9	19,419.0	61.09
Source: Economic Survey 2007-08, External Assistance Manuals			

Table 10 : Use of overall extenal assistance in India

judging the debt problem of a country.

Debt is classified into government and non-government debt. Government debt includes multilateral and bilateral borrowing on government account under external assistance programmes as well as borrowings from IMF, defence debt and FII investment in government securities. All others including short-term debt are part of non-government debt.

Utilisation of external assistance

Although South Asia has been one of the biggest beneficiaries of external assistance over the years its utilisation of external funds has remained low. The primary reasons for low utilisation of external assistance are as follows:

- Time lag between commitments and conclusions of specific credit arrangements
- Time consuming procedures governing procurement of stores and equipment
- Delays in land acquisition for construction work
- Rehabilitation and resettlement of displaced persons and domestic budgetary constraints in providing counterpart funds.
- Providing exclusive officers for execution of the projects.

A number of steps have been taken to improve fund utilisation. In India these include:

- Waiver of DGTD clearance for import of capital goods under all externally aided projects
- Enhancement of additional central assistance to the States to 100% in the case of social sector projects
- Formation of standard bid documents and simplification of other procedures.
- Passing of the entire External Assistance to the States as additional central assistance in respect of all sectors
- To release advance central assistance to meet the initial liquidity requirements of State Governments

Improving aid effectiveness

There is a consensus in the global economy on the need to improve aid effectiveness and more specifically in South Asia. More aid, of better quality and more effectively used are important goals for improving the international aid system. The problems relating to aid quantity and aid quality undermine aid effectiveness and impose huge transaction costs on recipient governments.

Steps to be taken to improve aid effectiveness in South Asia:

- Without a sustained increase in aid, the Millennium Development Goals (MDGs) will not be achieved. If donor countries are serious about tackling global poverty, reducing inequality, the targets of delivering 0.5% of their national income in aid by 2010 and 0.7% by 2015 have to be met.
- Higher aid volumes need to be matched by improvements in the quality of aid. Several factors influence aid quality and effectiveness, like harmonisation and alignment of aid, the modality through which assistance is delivered, the allocation of aid, and the volatility and predictability of aid flows.
- There is a need for sharing of information on planned donor activities. Better coordination among aid delivery channels—bilateral funds, multilateral funds, global funds, and private funds is essential for delivering aid effectively. Donor harmonisation is essential for reducing transaction costs.
- Predictable aid flows are especially critical in South Asia where the income is low and where aid flows are large relative to government revenues and budgets.
- All donors stress the virtues of "country ownership", of giving recipients more control over how aid is spent. Yet most link aid to stringent conditions which need to be done away with.
- There is need for a shift away from tied aid as it often raises transaction costs for recipients.
- Some donors apply restrictive procurement rules to meet their own requirements, creating multiple procurement structures and weakening coordination.
- Aid is most effective when it is channelled through budgets and expenditure frameworks that reflect priorities set out in poverty reduction strategies.
- Innovative financing mechanisms could augment aid flows and development investment and also improve the predictability and flexibility of aid. Several of these mechanisms are in early stages of implementation. [Ex: The International Finance Facility for Immunisation (IFFIM)] is being established as a pilot.
- Senior managers of donor agencies need to work with politicians and civil society to build broad and effective support for moving forward on the Paris framework.
- Technical cooperation (TC) continues to be a key donor tool for supporting capacity building, although there are issues surrounding its effectiveness. Untying TC and providing it as budget support could yield savings through the competitive hiring of experts.

Glossary

Glossary

BRTS	Bus Rapid Transport System
CAGR	Compound Annual Growth Rate
CAA	Constitutional Amendment Act
CDP	City Development Plan
CFC	Central Finance Committee
CPL	Community Participation Law
DFID	Department for International Development
DPC	District Planning Committees
DPR	Detailed Project Report
EWS	Economically Weaker Section
GDP	Gross Domestic Product
GIS	Geographical Information System
GoI	Government of India
IHDSSMT	Integrated Housing Development for Small and Medium Towns
JNNURM	Jawaharlal Nehru National Urban Renewal Mission
LIG	Lower Income Group
LL & DF	Local Loans and Development Fund
MPC	Metropolitan Planning Committees
MPUSP	Madhya Pradesh Urban Service for the Poor
NOIDA	New Okhla Industrial Development Authority
O&M	Operations and Maintenance
ODA	Overseas Development Agency
PPPPublic	Private Partnership
RHI	Region Hub Institutions
SCsSchedule	Caste
STc Schedule	Tribe
SFC	State Finance Corporation
Sq KM	Square Kilometer
SWM	Solid Waste Management
TC	Technical Committee
TERI	The Energy and Resource Institute
TNUDF	Tamil Nadu Urban Development Fund
UK United	Kingdom
ULBs	Urban Local Bodies
ULCRA	Urban Land Ceiling and Regulation Act
USA	United State America
Lakh	Calculation unit equivalent to 100,000
Crore	Calculation unit equivalent to 10,000,000

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