

Municipal Finance

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Abstract:

This note culminates from a recently concluded 'Karachi-2014: South Asian Cities Conference' held on 10-12 January, 2014. The theme of the conference was "Managed Urbanization: The Road to National Development". The author attended one of the sessions titled 'Municipal Finance'; and provides the appraisal of the proceedings. The concept of municipal finance is relatively new and growing rapidly in the context of emerging markets like Pakistan and the idea of this short note is to give insight to the audience as to how cities, districts, and towns could generate their own funds for the provision of public services and remain sustainable.

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1. Introduction

Recently, a conference was held in the city of Karachi on urban planning. The author attended the session on municipal finance.² The concept of municipal finance and / or sustainable cities is relatively new in Pakistan. With local government (LG) elections³ already held in the province of Balochistan and sooner or later the same are going to be held in the other three provinces viz. Sindh, Punjab, and Khyber Pakhtunkhwa (KPK). Therefore, judicial allocation and generation of funds to provide necessary services to the public at district level will gain currency.

In Pakistan, there is a greater reliance on inter-government fiscal transfers (or grants), i.e., allocation of funds from federal government to provinces and further distribution to districts. While very little attention is being given to the need that districts should become financially sustainable and rely less on government grants. For example, raising funds through borrowings to initiate large infrastructure projects and generating revenues to cover the costs of provision of public services. In 2001, Provincial Finance Commissions (PFCs) were established in all four provinces of Pakistan. The commissions have a mandate to devise a formula for the distribution of resources among the districts in their respective provinces in

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² Interested audience can go to <http://puf.urbanunit.gov.pk/index.aspx> for further details.

³ The terms local government (LG) elections and local bodies' (LB) elections refer to the same thing.

order to ensure smooth functioning of the local governments and reduce the level of deprivation among the districts Ahmed and Lodhi (2008) commenting on the performance of PFCs suggested that the connection among different indicators used in the formula for inter-governmental fiscal transfers is of utmost importance. They find some correlation between funds allocation and poverty indicators in Punjab and KPK provinces. However, Sindh and Balochistan provinces have a very low level of correlation.

With rapid urbanization through continuous migration from rural areas to cities, the concept of ‘sustainable cities’ in social sciences, and municipal finance in Pakistan are becoming more and more important. Hence the author felt the need to attend the sessions and learn from the experiences of urban planners. The session on ‘Municipal Finance’ comprised of three presentations followed by comments and feedback. The first presenter was Dr. Salman Shah (referred to as the Presenter-1 hereafter in the paper). He gave an overview of how cities can provide better services to the people and remain sustainable through efficient inter-government transfers. The second presenter was Ms. Suneetha Dasappa Kacker (referred to as the Presenter-2 hereafter in the paper). Ms. Suneetha talked about the feasibility of five water projects in India under public-private partnerships (PPPs). The third and last presentation was delivered by Mr. Abdul Razzaq (referred to as the Presenter-3 hereafter in the paper). Mr. Abdul gave an overview of successful GIS based computerization of immovable property in district Sialkot and subsequent expansion to other big five districts of Punjab.

At the end of the session, a fruitful discussion ensued from the experiences of Presenter-2 and 3. The note is structured as follows. Section 2 summarizes the presentations of all three presenters. Section 3 provides an appraisal of the conference session and some ‘food for thought’ from feedback session, while section 4 concludes this note.

2. Presentation

Dr. Salman Shah–Sustainability of Services through Effective Municipal Transfers

Presenter-1 defined the municipal finance as management of funds at the level of metropolis. He suggested that without adequate sources of funding, it is not possible to run projects of urban infrastructure. Further, the capital-intensive projects are run by organizations with expertise and manpower. Hence, availability of funds is a crucial issue. However, he reiterated that it is not only about availability of funds, but it is more about sustainable finance.

Local governments generally provide water, sewerage, housing, etc. Generally they do not have sufficient funding. However, funds are generated from taxes (e.g., property tax), user fees, inter-government transfers, etc. Most of the time municipal corporations’ issues revolve around addressing the expenditure matters. With the involvement of money, a high level of accountability is also needed.

Pakistan is rapidly turning into urbanized cities. Large cities have greater fiscal capacity compared to small cities and towns. Now cities have to compete globally by attracting

businesses, tourists, provision of infrastructure, to become business cities. Further, a regulatory environment should encourage enforcement of public services.

Presenter-1 briefly talked about the issues and challenges:

- a. Heavy dependence on revenues / grants and inadequate capacity to generate own funds.
- b. Local government inability to fix taxes and enforce them.
- c. City government taxes are very political.
- d. Idea of free benefits among local population is a serious issue.

Dr. Shah appraised the audience about the trends in municipal finance; such as: 1) public private partnership is becoming more important; 2) Financial responsibility is demanded by consumers / users from service providers; 3) Public involvement at budgetary levels becoming important; 4) Performance based budgeting; evaluating service providers performance by public sector and local governments becoming popular; and 5) allocation of funds as per performance and quality of services provided to people.

Presenter-1 discussed some of the avenues for generating funds. These include user fees from provision of water, sewerage system, garbage picking, transit facilities, fire-fighting services, street lights, and social housing. He also talked about provincial transfers to meet city / district deficits, clearing backlogs, etc. Later, he highlighted the best practices adopted in some of the cities across the globe to generate revenues. These cities are: Cape Town, Toronto, Madrid, and Mumbai. These cities have various sources of revenues that include property taxes and borrowings to finance capital expenditures. Auditing systems are in place that are considered as a backbone of sustainable finance. Similarly, credible databases, and accounting systems are in place. Due to proper systems, these cities have access to capital markets to raise funds by issuing bonds that are first rated by rating agencies. Ratings based on surpluses, feasibility of long-term projects etc. However, presenter-1 warned that in the case of Pakistan, in the first place, systems need to be established / strengthened before going to capital markets. There should be appropriate inter-government transfers: general purpose, special purpose among federal, provincial, and district/city level. Since, some cities are lowly endowed, whereas some are highly endowed. Hence a greater need of fiscal transfers from provinces is necessary to help execute projects. The objectives of urban planning should be synchronized with political motives i.e., political rationale.

Presenter-1 emphasized on principles of sustainable cities. These are efficiency of services, equity towards the citizens, stability of systems, adequate stream of revenues, and certain level of autonomy to take decisions and execute various projects. Further, the local governments have to be responsive to grants to change the behavior of decision makers and service providers that 'nothing is free'. Lastly, Dr. Shah discussed some of the problems in the Pakistan scenario, such as distortion of information at different hierarchical levels, no incentives to district governments to raise funds, inefficient working of Provincial Finance Commissions (PFCs) in all four provinces since 2001 and non-development of comprehensive databases. Moreover, he showed a small chart to the audience, as to how the provincial governments are providing funds to districts under different parameters. For

example, Punjab extend funds with 60 percent weight to the district population, KPK apportion funds based on tax collection efforts along with population; whereas Sindh and Balochistan apportion funds based on area, backwardness, and performance, etc.

Ms. Suneeta Dassapa Kackar – PPP Models in Urban Infrastructure

Ms. Suneetha discussed some of the lessons learned from India. Initially she highlighted the exponential growth of public-private partnership projects in India. During the 1990s five projects were initiated but only one was implemented. She and her team studied water distribution projects implemented through period 2005 to 2011 (7-years). During that time 16 projects were initiated but only 12 implemented. The total value of all these projects was around US\$ 170 million and roughly 10 million people were impacted by the PPPs. Presenter-2 gave some background of Jawaharlal Nehru National Urban Renewal Mission (JNNURN) launched by Government of India under Ministry of Urban Development, whereby private sector efficiency was recognized. Another good thing in the case of India was the bottom-up demand for PPPs.

Next, Presenter-2 posed a question to the audience as to why cities are pursuing PPP. Some of the factors are: 1) Improvement in service delivery and efficiency; 2) setting-up service delivery benchmarks e.g., cost recovery to be 90 percent, etc., and whether the benchmarks were met; 3) Cities realizing that they need private expertise to execute operational and maintenance tasks; and 4) Greater need of improving service delivery and access to private capital. Ms. Suneeta shared her experiences of five Water Distribution Projects studied from five different cities of India viz. 1) Khandwa; 2) Aurangabad; 3) Nagpur; 4) Latur; and 5) Mysore. The water PPPs have six to twenty year contracts. Each project cost between US\$ 70,000 and 1 million. Government grants covered 90 percent of the cost. The scope of projects' appraisal comprises of: 1) Performance targets and accountability level; 2) How successful is the project considering financial sustainability; 3) How well they ensure providing funds to private operators; and 4) Linkage of operator incentives to performance.

Some of the findings from Presenter-2 review process were that the link between private operators' performance and penalties is very weak, i.e., only 5 percent of the total revenues are deducted as a penalty for lack of performance. Estimating capital investment requirement, her team find that: 1) All projects lacked a practical mechanism to finance the additional investment required; 2) Cities are taking up projects beyond their financial capacity, making them vulnerable to variations in scope and cost, since water distribution projects are extremely prone to variations; 3) There is little base information available, hence projects are renegotiated within first 18 months; and 4) Cities total reliance on government / donor grants. Ms. Suneeta suggested that generation of own funding should be encouraged; cities need to expand projects scope, better accountability for efficient use of funds, and performance phasing has to be stringent / encouraging.

Commenting on the government grants and providing operation and maintenance costs, presenter-2 mentioned that government grants reduce the tariff pain on the city, but this has also permitted cities to postpone financial reforms. Such scenarios are not good for PPP. In effect PPP initiatives should be seen as catalyst for reforms and were not taken-up in that

spirit. Moreover, Presenter-2 highlighted some more problems in five water related PPPs. In all cases (5 projects), her team observed weak financial performance, operating cost recovery is low, tariffs are low and not revised regularly, and again cities rely on government grants to meet capital investments. Lastly she elaborated on the need to meet future challenges. For example, well designed PPPs, cost effective performance improvements, reasonable phasing of implementation, stronger incentives for performance, ensuring financial sustainability of water operations, and building an institutional structure for water distribution and aligning with the objective of PPP.

Mr. Abdul Razzaq – GIS-Based Computerization of Urban Immovable Property Tax (UIPT)

On the onset, Presenter-3 gave an overview of the project implemented in district Sialkot. He told the audience that the revenues generated from property tax are shared, with 15 percent going to finance department of Punjab and 85 percent to Tehsil Municipal Administrations (TMAs). The project is transparent with robust controls covering four subdivisions of districts i.e., Sialkot, Sambrial, Pasrur, and Daska. Mr. Abdul highlighted the historical milestones of the project, i.e., initially data collected on PT-1 forms, development of in-house software by the urban development unit of the Government of Punjab. Approximately 70,000 computerized forms delivered to houses / owners to deposit property tax. Excise and Taxation department (E&T) scanned registers, rectified data according to the computerized data. Further, training was provided to employees and stakeholders. GIS mapping conducted and linked with the computerized system.

Presenter-3 explained that after the successful commission of GIS-based computerization of UIPT in Sialkot district, similar projects were launched in five large districts of Punjab, viz. Faisalabad, Lahore, Multan, Rawalpindi, and Gujranwala. He told that currently maps and imageries are prepared; forms prepared, printed-out, and distributed; computerized data entry of received forms is in process, and digitization of duly-filled forms is also underway. Mr. Abdul informed that field survey progress is also closely monitored. Overall, this project suggests that such initiatives bring more revenues for districts and also generate employment at local level.

3. Comments/Feedback

Following the presentations, a useful discussion occurred among presenters and audience. Ms. Suneetha answering one of the questions agreed with the comment that if we cannot hold private operators responsible for performance then there is no difference between publicly executed projects and PPPs. Further, she re-emphasized in the case of water distribution projects that loss of 5 percent revenues is not a good disincentive, i.e., flaws in legal documents / contracts and enforceability issues.

There is greater need to make linkages strong between performance of private operators and revenues. Efficiency improvement and attracting funds through private sector partnership is a good idea, whereas monitoring is extremely important. Generally, there is better human resource capacity available at Federal / Provincial level but not at city / district level to

monitor results achieved by PPPs. However, there are no easy solutions, public sector reforms are the need of the hour. Presenter-2 answering another question affirmed that PPP is only one option, not the only option to execute capital intensive projects or to develop urban infrastructure.

While discussing some of the flaws in legal documents, she informed the audience that in one case only water pipes were laid underground and funds were released by the government. However, no one was bothered whether it reaches to the household taps or for the pressure of the water, etc. These things are to be kept in mind like 24/7 availability of water and adequate pressure. Hence the need to design performance parameters is of utmost importance; penalties should be imposed if parameters are not met. Only in such a way can better results be achieved.

Mr. Abdul Razzaq while answering questions agreed with the audience that Human Resource constraint was a big issue while executing a GIS-based UIPT project. He informed that inspectors of Excise and Taxation (E&T) department were trained by IT experts. Total process re-engineering was adopted in UIPT cases, but still skilled manpower constraints do exist. For example lack of coordination between IT personnel and personnel working in the field. Presenter-3 further pointed out that even the objectives of the project were not clear to employees because they were not deeply involved in the project. Hence frequent interaction is required. Lastly, Mr. Abdul ended the discussion with a positive note that GIS mapping and computerization gave strength to the department about transparency, responsibility and accountability issues.

4. Concluding Remarks

Ahmed and Lodhi (2008) using rank correlation and running different simulations find that provincial allocation of resources to districts is seriously flawed and suggested a range of policy options to devise a formula for funds distribution based on poverty and deprivation levels in Pakistan. Due to issues with inter-government fiscal transfers there is greater need to tap other sources of financing. Kholjigitov (2013) believes that the concept of public-private partnership (PPP) is becoming more and more popular as one of the key elements of financing big public infrastructure projects.

The author has summarized the session proceedings held in Karachi on the Asian Cities Conference, organized by Urban Forum. People living in cities or towns have to deal with the problems of transportation, water availability, sewerage, open spaces, etc. Similarly, now cities across the globe are competing to become environment friendly and investor friendly destinations. With the growing importance of such aspects, the author was motivated to write a note. Specially, in case of emerging economies like Pakistan the importance of PPP and municipal finance is of utmost importance. However, the risks associated with large public infrastructure projects cannot be ignored. Hence, the brief from three presentations depict that a thorough legal framework is required to deal with various issues and risks.

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