

**Part I**

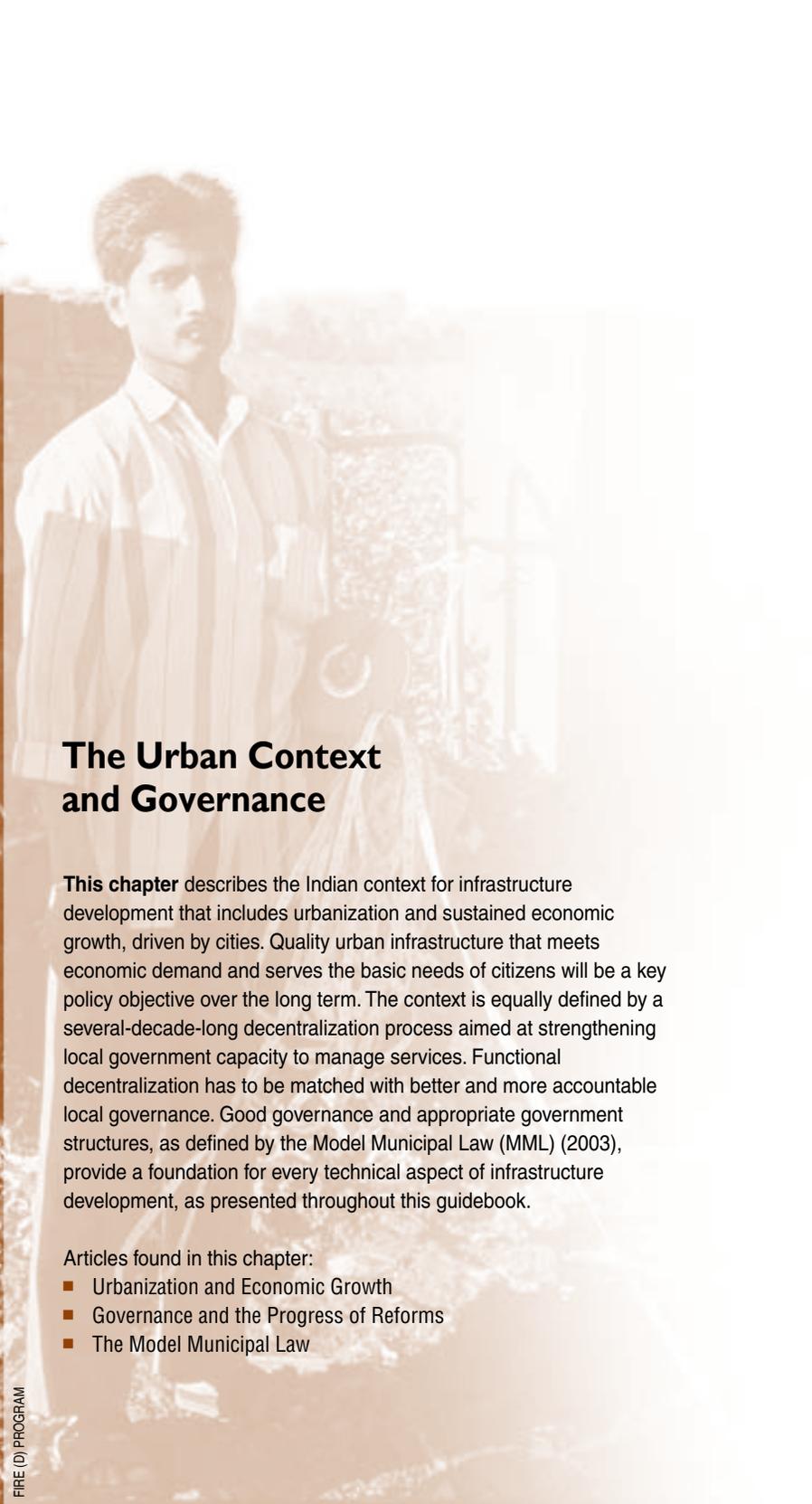


# Indian Context for Infrastructure Development





# The Urban Context and Governance



## The Urban Context and Governance

**This chapter** describes the Indian context for infrastructure development that includes urbanization and sustained economic growth, driven by cities. Quality urban infrastructure that meets economic demand and serves the basic needs of citizens will be a key policy objective over the long term. The context is equally defined by a several-decade-long decentralization process aimed at strengthening local government capacity to manage services. Functional decentralization has to be matched with better and more accountable local governance. Good governance and appropriate government structures, as defined by the Model Municipal Law (MML) (2003), provide a foundation for every technical aspect of infrastructure development, as presented throughout this guidebook.

Articles found in this chapter:

- Urbanization and Economic Growth
- Governance and the Progress of Reforms
- The Model Municipal Law



## ARTICLE I.1

# Urbanization and Economic Growth

## Urbanization

While cities in India are filled with vibrant activity and energy, they are also chaotic, complicated, and too often congested. There is immense wealth and opportunity, side-by-side with immense poverty and deprivation. And the scale is enormous: India's urban population is larger than the entire United States, and is second only to China's. It is clear that India's urban population will continue to grow, probably doubling in the next couple of decades. To meet the challenges of this inevitable urbanization, India needs well-performing cities. This guidebook examines urban performance from the perspective of improving governance and infrastructure development. Most people now recognize that helping cities function better is central to India's future; global trends from the World Bank's 2009 World Development Report (WDR) support this realization.

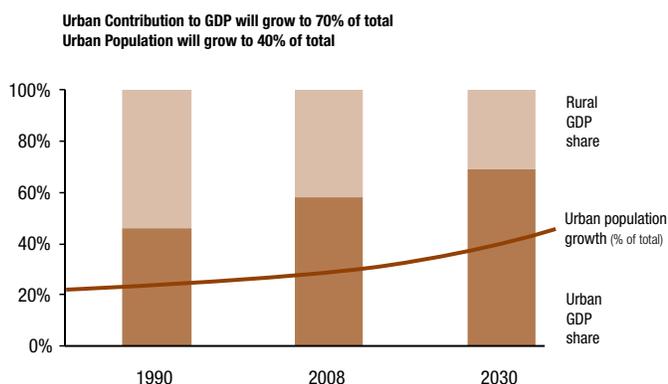
1. No country has grown to middle-income status without urbanizing and industrializing. Countries **become at least 50% urbanized before reaching middle-income status**, and all high-income countries are 70%–80% urbanized.
2. The "place" (as in connectivity to other people and markets) where people live is the most important correlate of a person's welfare. This includes both economic-related connectivity and quality of life. **There is a strong connection between urban liveability in terms of security, congestion, opportunity choices, etc. and a country's gross domestic product (GDP) per capita.**<sup>1</sup>
3. The economic density found in cities improves productivity, which is the key to modern economic growth.

In India, the urban transition is taking place. The pattern is similar to what Europe and the United States experienced in the late 19th century, Latin America experienced in the 1970s, and East Asia experienced more recently. From the economic growth and income perspectives, that is a good trend, as the above points suggest. Approximately 60% of GDP is derived from the Indian urban economy now, while less than 30% of the population lives in cities. The urban contribution will likely rise to 70% of GDP over the next couple of decades (see Figure 1-1).

Without a doubt, the urban population will continue to grow, close to doubling in the next couple of decades. The Registrar General of the census has projected the urban population will reach 534 million in 2026 (38% of India's total), up from 286 million in 2001 (28%) during the last census. It is interesting to know that 67% of the total population growth in India during the next 25 years is expected to take place in urban areas.

<sup>1</sup> Gill, I. and Kharas, H., 2007, "An East Asian Renaissance: Ideas for Economic Growth," World Bank.

**Figure I-1. Long-Term Changes in India**



Source: McKinsey Global Institute, 2010.

**Table I-1. Projected Urban and Total Population in India**

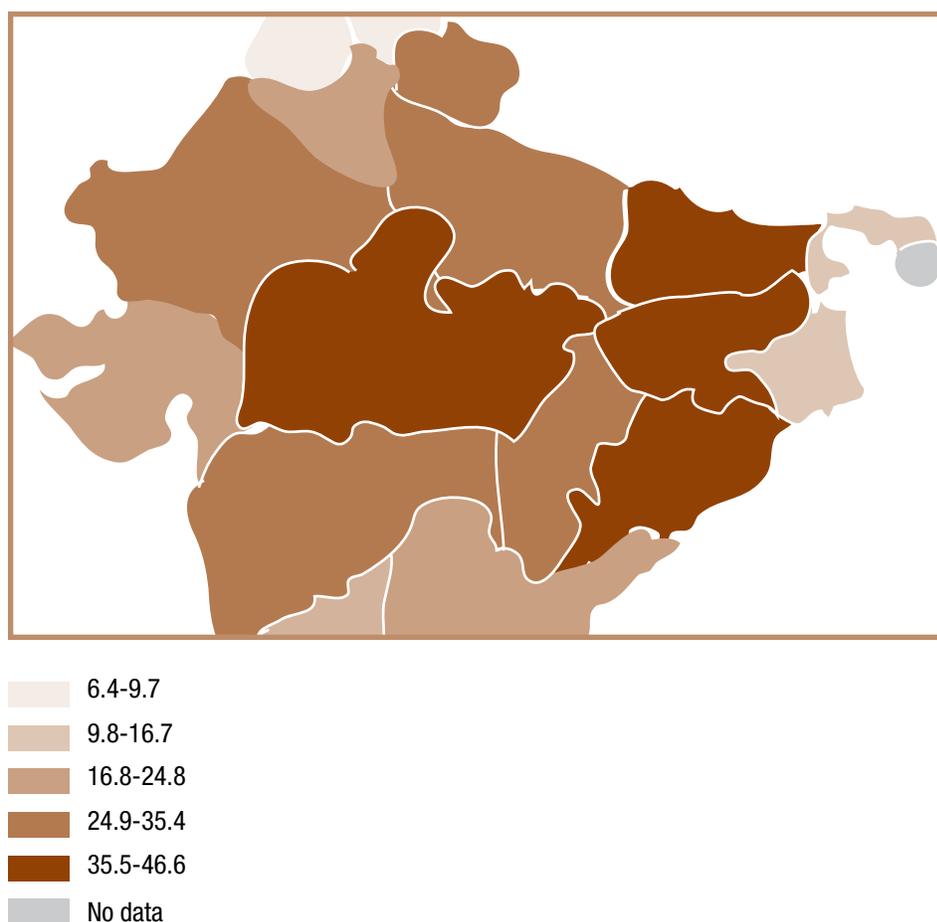
	Year			
	2001	2011	2021	2026
Total Population (million)	1,028.61	1,192.50	1,339.74	1,399.83
Urban Population (million)	286.12	357.94	432.61	534.80
% Urban	27.82	30.02	32.29	38.21
Total AEGR (%)*	1.48	1.32	1.23	1.16
Urban AEGR*	2.24	2.07	2.50	1.89

\* Annual Exponential Growth Rate  
 Source: Population Projections for India, 2001–26, Registrar General of India, 2006.

2 This should not be confused with increasing access to services for all, whether rural or urban. For example, the massive expansion of state-bank branches into all corners of the country by Indira Gandhi after 1969 contributed to a sharp rise in savings and investment rates. See Basu, Kaushik and Maertens, Annemie, 2007, "The Pattern and Causes of Economic Growth in India," *Oxford Review of Economic Policy*.

At the same time, rural-urban disparities have increased. Some 60% of India’s poor now live in the lagging central states, with low urbanization (see Figure 1-2). Because of their immense agricultural wealth, the first great Indian civilizations located in these regions. Over time, they have prospered, currently supporting 400 million inhabitants and feeding many more throughout the country. Yet these areas lag in almost every development indicator, including economic growth over several decades (see Figure 1-3). The fact is that economic growth has shifted from the rural areas to cities, and, unfortunately, policies that attempt to reverse this (such as subsidized finance to businesses for opening facilities) tend to have little long-term impact.<sup>2</sup> Instead, economic opportunities have shifted to cities.

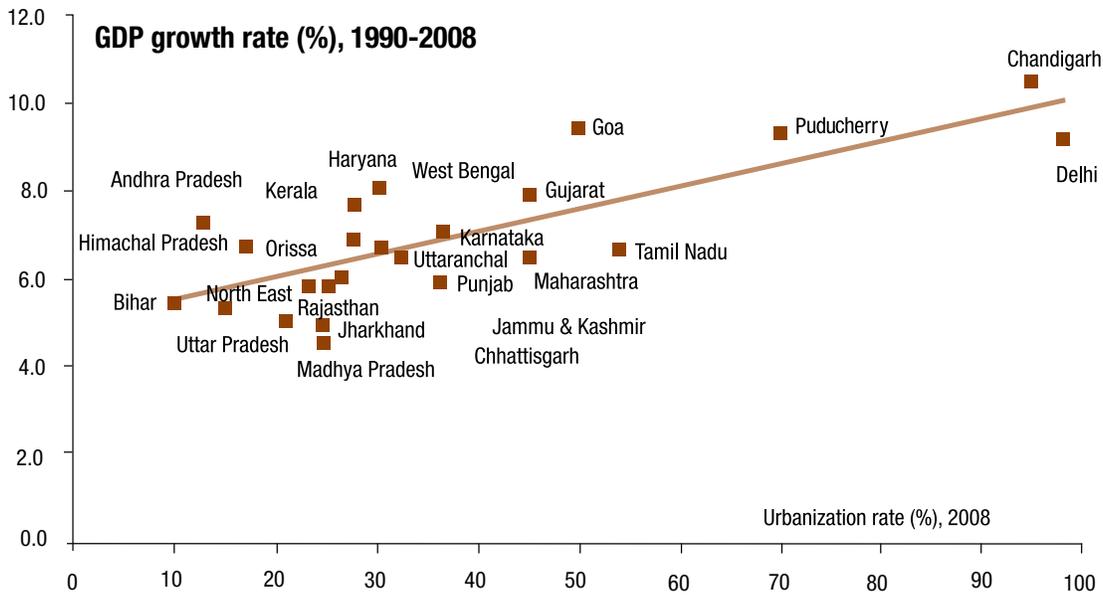
**Figure I-2. Poverty Rates Are Highest in Central India**



Source: World Development Report, 2009.



**Figure I-3. Fastest-Growing States Are More Urban**

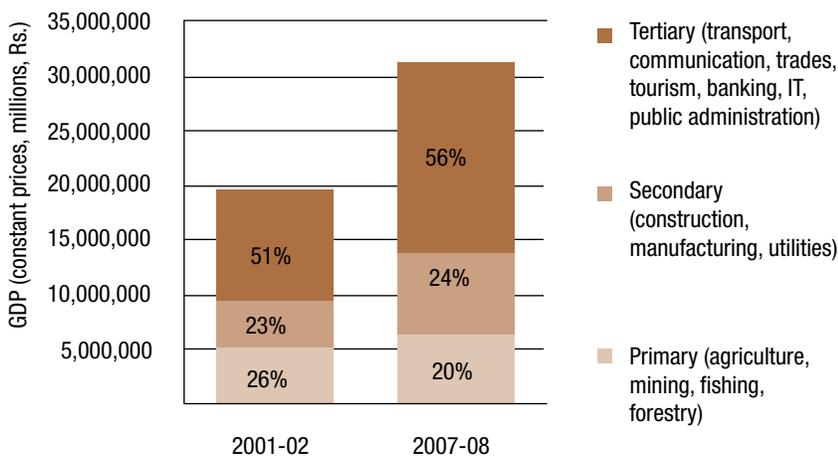


Source: McKinsey Global Institute, 2010.

## Urban Economics

Modern economic growth is not exactly synonymous with industrialization, because the economy also includes service sectors and other innovative areas that result from technological advances, new ideas, and investment. India is certainly transforming, with high-level industry, manufacturing, and information technology (IT) services having greater importance (see Figure 1-4). From the end of 1990s to 2006, the IT sector increased from 1.2% of GDP to 4.8%. During the first decade of the 21st century, India’s economy experienced real growth of 8% on average, with financial services, transport, communication, and construction experiencing double-digit growth. These sectors tend to agglomerate in cities, where the operating conditions, including proximity to larger markets, deep supply chains, and diverse intermediaries like financial institutions, are conducive to growth.

**Figure I-4. Composition of India’s Economy**



Source: Indicus Analytics.

Although competition between firms helps drive efficiency in capitalist societies, it is the economic infrastructure that allows the urban economy to thrive. The economic infrastructure connects people to markets through telecommunications, ports, rail, airports, and roads. Infrastructure systems also allow large populations to live in close proximity; without water supply and sanitation systems, electrical grids, hospitals, and schools, cities would not be safe places to live or offer the opportunities that they do.

Apart from physical infrastructure, economic growth is strongly influenced by enabling conditions that include business regulations, such as contract enforcement, taxes and fees, legal procedures, and general “ease of doing business.” Most economists agree that India needs to improve its enabling conditions for business. India ranked 122 in a list of 181 countries surveyed by the World Bank in 2009 (see Annex 1-1). Efficient enabling conditions decrease transaction costs. Both physical and nonphysical aspects allow people to exchange ideas, as well as goods and services, with one another, and allow them to specialize in enterprises that provide the best opportunities available. Productive economic interaction between people is the key to development, and it occurs more readily in cities, which by definition are dense.

A country pursuing modern economic growth is implicitly pursuing greater urbanization. It does not matter whether explicit policies in the past tried to stymie rural-urban migration by restricting access to urban land or by funneling investment to rural areas. If opportunities exist in cities, the urban pull is strong. The resulting economic benefits to the country are equally evident. Two important spillovers are increased investment and improved living standards. This is why 70% of new jobs will be generated by cities and the number of middle-class households in cities will quadruple in the next two decades.<sup>3</sup>

The spillover into rural areas is an important characteristic of Indian growth. The rural population will remain large in India, and rather than simply migrating to existing metropolitan areas, the growth of small- and medium-sized cities significantly contributes to the urbanization trends: By 2030, 1,000 villages will urbanize, and 26 small cities will grow to more than 1 million people.<sup>4</sup> Connecting rural areas to cities, through better transportation and education networks, will allow the urban growth phenomenon to benefit a larger group of people, dominated by the rural poor. The State of Tamil Nadu offers a good example of how quality roads and connective infrastructure expanded job opportunities to rural areas that otherwise were not well endowed with natural resources. The major challenge is whether India can successfully manage this growth; the new urban areas have minimal infrastructure, management expertise, or financial resources.

If urbanization is such a major trend in development, how does a country encourage the phenomenon in a way that is beneficial to all people, over the long term? Can the urban economic driver, with increased investment and improved living standards, become a sustainable cycle? Or does increased population inevitably mean more congestion and urban squalor?

How limited public resources get utilized is a key part of government’s policy-making process. Often a tension exists between urban and rural investment. With infrastructure development, tensions also exist between expanding networks outward from a city’s core and upgrading current systems and improving quality within the city. Budget allocations for infrastructure, or for any of a number of other issues, can become contentious because vested interests permeate government systems. Transparent and accountable governance helps ensure local officials spend resources more wisely in ways that benefit the widest range of people. Community participation and market orientation of services at the local level effectively prioritize investment needs. And a system where planning is linked directly to implementation, as well as to operations and maintenance, provides more sustainable services. At this point, however, it is questionable how well local governments in India can manage their urban spaces. The proliferation of slums—areas underserved with municipal infrastructure and services, including water, sanitation, housing, education, and healthcare—increased from approximately 17% of the urban population in 1981, to 22% in 2001, to 30% in 2010. This is a good indication that city officials are having difficulty managing the complexity and speed of urbanization.

3 McKinsey Global Institute, 2010, *India’s urban awakening: Building inclusive cities, sustaining economic growth*, [http://www.mckinsey.com/mgi/publications/india\\_urbanization/index.asp](http://www.mckinsey.com/mgi/publications/india_urbanization/index.asp).

4 Ibid, page 45.



The Jawaharlal Nehru National Urban Renewal Mission (JNNURM) represents a realization that urban reforms are necessary, if not mainstream. The 11th 5-year plan elevated urban awareness by significantly increasing budget allocations for urban infrastructure, thereby allowing JNNURM to take shape. The program aims to improve urban management. But for this to happen, much more deepening and institutionalization of reforms clearly has to occur (see Chapter 7).

Now is a good time to address the weaknesses of local government, since the increasing urban population and economic prospects of Indian cities are such major, driving forces of the country. Improved business access to global markets, as well as rapid advances in technology, are fueling the economic engine. For now, it is very possible that economic growth is happening in spite of a lack of good management and governance in Indian cities. During 2001–02, the Financial Institutions Reform and Expansion Program—Debt & Infrastructure, known as the FIRE (D) Program, conducted a capacity needs assessment of local government and found tremendous deficiencies in financial management, resource mobilization, and project development, among other things. Based on this assessment, several donors incorporated institutional strengthening into their work and prepared training manuals to help improve urban performance.<sup>5</sup>



FIRE (D) PROGRAM

As the urban population surges, there is concern that any one of the many challenges—affordable housing supply, congested roads, limited water, and sanitation services—will amplify and undermine India’s economic growth. Under current investment levels, infrastructure services will deteriorate, which could seriously threaten the urban living environment. Perhaps India is at a critical moment where it can preserve and build on the gains from the first major wave of economic reforms that occurred in the late 1980s.

## Infrastructure and Growth

During the last two decades, research into economic growth has shifted from broad, macro-level factors (like national savings and investment rates) to more nuanced, sector-specific study. Since the 1980s, with wider data sets and greater computing capacity, economists have been eager to understand what sectors (e.g., education, health, and infrastructure) affected economic productivity the most. What economists call endogenous growth theory examines the dynamism of productivity and technology across sectors. The theory provides strong economic justifications for policy measures toward R&D, education, and healthcare. This guidebook is most interested in how infrastructure broadly, and water and sanitation more specifically, affect economic growth.

Researchers have tried to examine the impact of safe water, sanitation, and hygiene (or lack thereof) on economic growth indicators. The reasons why economists are interested in the water and sanitation sectors are obvious: In 2007, the World Health Organization (WHO) found that more than 10% of worldwide deaths are due to just two environmental risk factors, namely, (1) unsafe drinking water and poor sanitation practices, and (2) indoor air pollution from cooking. Children are the largest group of victims, with 74% of child deaths due to these two issues (more than 2 million children die of diarrhea each year).<sup>6</sup> Unsafe water and sanitation adversely affect the economy in the following ways.

- **Some 443 million school-days are lost each year globally** due to water-related illnesses.
- At any given time, 50% of all people in developing countries suffer health problems due to poor quality water and sanitation, causing **people in low-income countries to lose about 20 more years of healthy life** as compared to high-income countries.
- Water-related afflictions **reduce GDP in sub-Saharan Africa by approximately 5% annually**—a figure far exceeding total aid flowing into this region.<sup>7</sup>

5 The USAID FIRE (D) Program, the World Bank, and the Water and Sanitation Program (WSP) prepared several manuals for inclusion in the regional Indian Administrative Service Institute. Similar needs assessments were carried out prior to launching JNNURM in 2005.

6 WHO, 2007, <http://www.who.int/mediacentre/news/releases/2007/pr30/en/index.html>.

7 *Finance & Development*, December 2006, International Monetary Fund.

It is clear that good infrastructure provides basic services and improves quality of life. For instance, the link between water-borne diseases and environmental infrastructure is direct. Infrastructure is also supposed to stimulate economic growth by allowing businesses to operate more efficiently, and for workers to be healthier and more educated. The McKinsey Global Institute suggests that, with better infrastructure, India's economic growth rate could improve by 1.0%–1.5% for a sustained period. This is a significant increase that would accelerate progress around the country. Many economists have looked at how large infrastructure systems positively affect economic growth, but the statistical results paint a more complicated story than policy makers would like. For policy makers, infrastructure development makes a big statement. But since it is expensive, there are tradeoffs in spending public resources on new roads, electrical grids, or water pipes versus other areas, like education and health. Although several studies<sup>8</sup> have made strong links between infrastructure and long-term growth, inconsistent results occur across countries and between different types of infrastructure. For example, in Thailand, major road construction had a big impact on productivity growth from 1975 to 1995, whereas, in Indonesia, roads did not show significant impact, but telephones and electricity expansion did.<sup>9</sup>

Infrastructure development, per se, may not lead to optimal growth, because of competing demands on limited resources (investment tradeoff) and because quality of infrastructure varies. The key challenge is making good investment decisions to serve the needs/demands of the population, minimize resource wastage, and eliminate bottlenecks in the economy. The more stylized argument emerging is that infrastructure most significantly contributes to economic growth when it is combined with other necessary elements, such as good management, an expanding business sector, poverty alleviation, and financial surpluses available for investment. The following reveals a more nuanced story of infrastructure development.<sup>10</sup>

- Countries do not invest in infrastructure before it is needed and affordable. The productivity gains from infrastructure may not be worth the cost for poor countries. Actually, rich countries, not developing countries, tend to invest more in infrastructure (e.g., the UK spends more than 20 times more per capita on infrastructure each year than India does).
- The quality of infrastructure is more important than the amount (e.g., paved roads have a bigger impact than the total length of the road networks).
- Infrastructure has to be utilized properly to ensure productivity, and therefore should respond to market-oriented demand.
- Investment in infrastructure should focus on removing constraints to other economic drivers, such as allowing business transactions to take place more efficiently.
- The enabling conditions (e.g., ease of use, quality regulations, safeguards, and good operations and management) determine whether infrastructure is utilized efficiently and productively.

From a practitioner's point of view, these critiques make intuitive sense. The FIRE (D) Program quickly realized that good governance and management had a huge impact on the utility of an infrastructure project. The infrastructure aspirations of India will surely require stronger financial and regulatory support from local government up through the center. Sustainable and large-scale advances in urban infrastructure cannot take place without improvements in the revenue base, or without competent urban management. Otherwise, projects will remain small in scope, ill conceived, poorly executed, and unprofessionally operated and maintained. The fact that infrastructure development does not automatically lead to more prosperous development should present some caution, lest the move to invest heavily in infrastructure be wasteful. For practitioners, this caution means that infrastructure planning (see Chapter 3) and project development (see Chapter 5) need to be pursued properly. Funding allocations and decision making should be more transparent, results oriented, and tied to the democratic process. This helps ensure better accountability over funding decisions. In a transparent and accountable system, a poor decision would at least be vetted appropriately by the wider community.

8 See Easterly, W. and Servén, L., 1993, *The Limits of Stabilization, Infrastructure, Public Deficits and Growth in Latin America, 1980-2000*, Princeton, NJ, Princeton University Press; and Calderón, C. and Servén, L., 2004, "The Effects of Infrastructure Development on Growth and Income Distribution," Central Bank of Chile, Working Paper 270.

9 See Straub, S., 2007, "Infrastructure and Development: A Critical Appraisal of the Macro Level Literature," mimeo, World Bank.

10 Straub, S., Vellutini, C., and Warlters, M., 2008, "Infrastructure and Economic Growth in East Asia," World Bank, Policy Research Working Paper.



## ARTICLE 1.2

# Governance and the Progress of Reforms

### Introduction

In 2005, urban development and infrastructure investment became a significant part of the Government of India's agenda. The Prime Minister's Independence Day speech for 2006 emphasized urban development in reference to JNNURM, the massive new national development program.<sup>11</sup>

*Cities and towns are centers of growth and generators of employment opportunities. Our cities need to have a new look for which they need massive investment and renewal. They need basic amenities like sanitation, drinking water and proper housing for the poor. They need public transport, parks and playgrounds. We need cities in which the working poor can live with self-respect and dignity; cities in which children and women feel safe and secure. In order to ensure that our cities have better infrastructure and that they have better living conditions, we launched the Jawaharlal Nehru National Urban Renewal Mission...I see a glorious decade of city development ahead of us.*

*The challenge before Government is to implement these programs. We have to improve the way governments function and deliver public services. How do we do this? How do we ensure that higher financial outlays translate into better outcomes?*

In his speech, Prime Minister Singh explicitly links improvements in (1) urban living conditions to (2) increased urban investment and (3) better management and governance. Each of these links has been a focus of the FIRE (D) Program since its inception in 1994. Creating healthy and vibrant cities—and cities that will continue to stimulate the economy—requires an integration of these three issues. With Rs. 100,000 crore (US\$22.2 billion) of investment over 7 years (half of that coming from the central government), JNNURM is a bold step. JNNURM's multi-pronged approach covers governance-oriented reforms, pro-citizen (including the poor) engagement, and city-wide project funding for 63 cities.<sup>12</sup> Cities receive funding packages if they commit to pursue key reforms and create a broad-ranging, participatory development plan (city development plans). The infrastructure grants encourage cities and states to implement reforms that attempt to link:

- Development planning
- Good governance practices
- City investment
- Civil society and pro-businesses policies
- Basic services for the poor

The new approach to reform-linked funding from the Government of India represents a culmination of two decades of active debate and experimentation on various reform items in the country, ranging from measures that support and strengthen decentralization based on the 74th Constitution Amendment Act (74th CAA) to improving service delivery through a number of commercial modes and innovative pro-poor pilot projects. Along with government schemes, many local initiatives from civil society organizations have become worthwhile avenues. JNNURM has provided a unique platform to bring together different approaches and innovations already tested and promoted by the FIRE (D) Program and others over the years. If implemented fully, these will indeed change the way in which local governments function by adding transparency, increasing financial viability, and improving the lives of urban poor (see the full list of reforms in Annex 1-2).

JNNURM signifies a nationwide scale-up of some of the most successful urban pilots over the last decade. There is also recognition that the 74th CAA has not been fully implemented almost two decades later. JNNURM tries to reignite the decentralization process. In reality, it is fairer to say that the “spirit” of the amendment has not been implemented because much of the content is not actually mandatory. Although the amendment recognizes and protects the political autonomy of municipalities for the first time, and establishes the parameters for their creation and electoral representation, it does not change the process for assigning functional responsibility and fiscal powers. Local government elections for creating a city council, among other things, are compulsory and therefore implemented more or less by the prescribed deadline. However, the degree of functional

11 Independence Day Speech by Dr. Manmohan Singh on August 15, 2006, [http://www.theholidayspot.com/indian\\_independence\\_day/speeches\\_by\\_prime\\_minister/address\\_2006.htm](http://www.theholidayspot.com/indian_independence_day/speeches_by_prime_minister/address_2006.htm).

12 Megacities with populations of more than 4 million (7), cities with populations between 1 million and 4 million (28), and other selected cities like state capitals and cities of religious/historic and tourist importance (28).

and fiscal decentralization is still at the discretion of each state, since legislation has to be passed at the state level. The 74th CAA language specifying that state governments “may” devolve power to local governments has been used by many states to defeat the true spirit of decentralization.

If newly established and elected local governments have only limited taxing powers and authority to set service rates, they can never be autonomous and “self-governing.” Weak fiscal authority makes it particularly difficult to provide effective city-wide services. Without such functions, local governments cannot respond to the demands of their citizenry, and their credibility quickly declines. If local government is fundamentally constrained with weak finances and/or limited mandate, it has minimal influence in shaping development, and cannot be seriously held accountable for improving the living conditions in the city. Currently, the expectations placed on local government far exceed the institutional and government realities.

## The Decentralization Imperative

The “spirit” of the 74th CAA rightly identifies local government as the best institution for delivering services to urban residents and encouraging city development. In 1989, Prime Minister Rajiv Gandhi, who initiated the decentralization process, believed that a centralized government system could not deliver prosperity for a country as diverse as India over any long term because too many divergent aspirations and cultures exist to be accommodated by a top-down and inflexible, central system.<sup>13</sup>

In many ways, state-level institutions and local communities have fundamentally opposing goals. State governments, by definition, are most concerned with overall performance of the state. As a result, state governments prioritize projects and utilize their limited resources based on a much larger geographic area than what matters to many urban residents. For example, the most important road networks for a state might be interstate highways. In contrast, local services are the utmost importance to urban residents: parks and schools in their neighborhood; water, sewer, and electrical supply to their houses; and job opportunities, transport, and culture throughout their city.

In addition to divergent objectives, the “representational distance” between citizens and state governments is too great to deal with everyday issues. A state capital is often physically too far away for average citizens to engage with regularly. But more importantly, state government officials do not have enough time to resolve local issues in every town or city. Only the most prominent local issues could affect state elections, and those are the ones politicians become involved in.

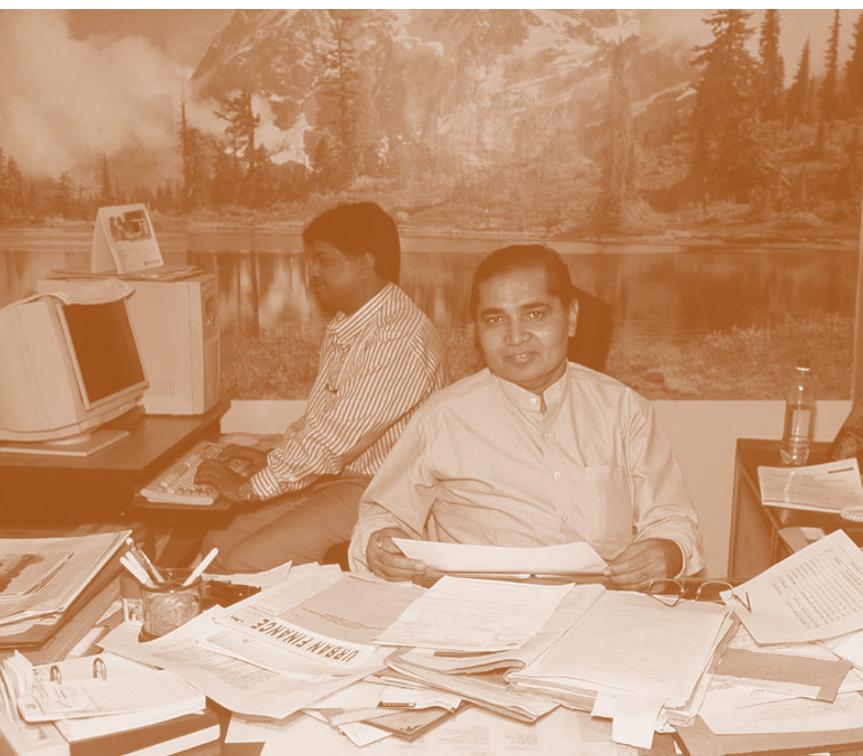
The small, everyday issues, vital to running a city effectively, are important to an entirely different group. Prime Minister Rajiv Gandhi articulated that the wide gap between citizens and central or state representatives creates a relatively small and privileged group of high-powered brokers, which encourages trading money for access.<sup>14</sup> This system discouraged accountability. Prime Minister Gandhi concluded his 1989 speech to *Lok Sabha* saying, “We are bringing to an end the Kafkaesque nightmare through which the people at the grassroots live. Their problems can now be solved at their doorsteps, answerability will be within the village and accountability will be nailed to the door.”<sup>15</sup> Decentralization and greater transparency in urban management and fund utilization can help tackle issues of corruption, which is of increasing concern in the country.

Being able to resolve local issues quickly and effectively is one of the most practical reasons why decentralization makes sense. A locally elected official, with real decision-making power, will care much more about improving the everyday quality of life of his/her neighbors and

13 Sivaramakrishnan, K.C., 2000, *Power to the People? The Politics and Progress of Decentralisation*, Konark Publishers PVT LTD: New Delhi, page 17.

14 As highlighted by the Government of India Vohra Report in 1993, corruption became a major concern across the country and helped drive economic liberalization and decentralization.

15 Ibid, page 52.



FIRE (D) PROGRAM

constituents. This translates well into managing city-wide services and infrastructure because many of the parameters for infrastructure are based on the local attributes, such as environmental conditions, topography, human density, and the spatial layout of the city. Furthermore, the customers are all local, and the long-term maintenance of services will have to stem from local initiatives. This often leads to more sustained interest in an initiative. The surprisingly fast success of introducing door-to-door garbage collection in Durgapur and Asansol, West Bengal, highlights the benefit of local services. Without door-to-door collection many people pitch their trash in the street, creating an environmental hazard. It was never clear who or when the trash would be cleared. But, with local government encouragement, communities began forming microenterprises to take on this work, a direct link formed between the household beneficiary and the new service provider, who could be monitored closely by each household. A pilot for Durgapur and Asansol quickly expanded to 50% coverage in less than 1 year, with easily verifiable results: Streets were cleaned, with households paying Rs. 15 per month to the sweepers.

Although most people agree with the logic that advocates local service delivery, various technical, financial, and political concerns help retain authority within state governments, which often represents the status quo. Low capacity of local governments is a real concern, but it will remain a problem until the institutional structures change to encourage improvements internally. There is little internal incentive for local governments to reform so long as finances flow generously from the center and state governments, service responsibility remains outside local governments, and electoral accountability does not have a strong connection to urban management (few cities have mayors with executive powers).

One of the fundamental administrative difficulties in many cities is that municipal commissioners, who still retain most management power, are neither locally elected nor accountable to mayors. Municipal commissioners, first and foremost, report to state or national cadres.<sup>16</sup> Second, they can be transferred at a moment's notice. And, despite the long-term nature of implementing urban projects, their tenure is relatively short, usually between 6 months and 3 years. The well-known case in Lucknow demonstrates this challenge: The city had eight commissioners in 2 years. The lack of continuity and absence of local accountability of city management is very disruptive to implementing urban reforms and projects.

## The Importance of Local, Good Governance for Infrastructure

Most international institutions define good city governance using similar jargon about citizen participation, accountability, transparency, responsiveness, effective rule of law, consensus-driven, and equity in services across the city.<sup>17</sup> Much of this makes intuitive sense, because city managers need the authority and structures to deliver services, while also gaining the trust of local businesses and civil society to which those services will be delivered. A city has to continually demonstrate that it is a creditworthy partner for investors and lenders of all type. Making a city work is especially about ensuring that both today's and tomorrow's needs are met. Still, listing these governance principles does not provide a practical framework to build on. A central question is how the governance principles translate to making a city thrive over the long term?



FIRE (D) PROGRAM

- 16 Kapoor, R.M., 2002, *Policy Options for Framing New Municipal Laws in India: Volume 1 Part on Governance of Municipalities*, FIRE (D) Program: New Delhi, India.
- 17 The international institutions with similar definitions include the World Bank, the United Nations, the Asian Development Bank, AusAID, and the Organization for Economic Cooperation and Development. See "An Exploration of Sustainability in the Provision of Urban Services in Indian Cities," 2008, The Energy and Resources Institute (TERI), with Sustainable Urbanism International and Arghyam: New Delhi.

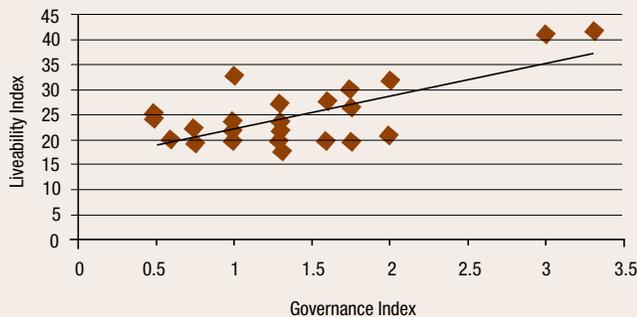
# Do city improvements relate to governance?

The availability and quality of city-level data is poor in India. But for the first time, a number of recent studies of Indian cities are beginning to allow useful data comparisons. The diversity of geographic areas, urban agglomerations, and municipal performance provides a great opportunity to test the changing landscape. An urban indicator system is critical for monitoring reform progress and prioritizing interventions. At this time, there is not enough information for creditable conclusions, despite apparent trends (with moderate statistical correlation).

These graphs compare governance, infrastructure, and urban financial performance. Three studies have examined relevant factors: NeolT used the Offshore City Competitiveness Index in 2004; more recently Ernst & Young with the Federation of Indian Chambers of Commerce (FICC) looked at factors affecting real estate investment decisions in 2007; and the Institute for Competitiveness designed an Indian-specific index for liveable cities in 2010.<sup>18</sup> Furthermore, the Ministry of Urban Development (MoUD) commissioned the credit rating agencies (Fitch, CRISIL, ICRA, CARE) to rate 59 of the JNNURM cities. Some simple comparisons show interesting trends (higher index values signify better performance).

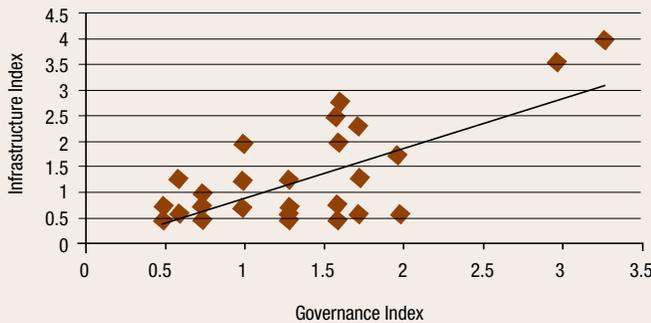
Credit Rating Key				
Non-Investment Grade	D	1	BBB-	9
	C	2	BBB	10
	B-	3	BBB+	11
	B	4	A-	12
	B+	5	A	13
	BB-	6	A+	14
	BB	7	AA-	15
	BB+	8	AA	16
Investment Grade			AA+	17
			AAA	18

## Governance to Liveability

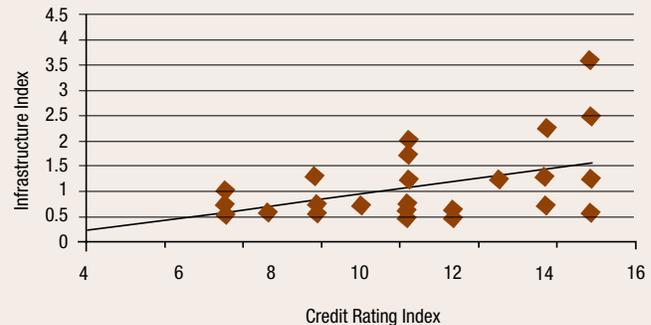


The governance index is based on both the reforms that local governments have been undertaking and their budget outlays, as analyzed by Ernst & Young in 2007. The infrastructure data set is also from the 2007 study and compiles indicators on water, roads, rail, airports, IT/telecommunications, social infrastructure, and proposed construction. The 2010 Liveability Index looks at a wide set of quality of life factors influencing people's decisions to live in a particular city, but does not directly look at governance or municipal budgets (and is therefore a good point of comparison).

## Governance to Infrastructure



## Credit Rating to Infrastructure



Recent studies of Indian cities suggest that governance, as well as financial management more specifically (including credit ratings), does affect infrastructure development and urban quality of life. The FIRE (D) Program encourages good governance in the areas most relevant to infrastructure development: (1) promoting **institutional structures** that provide incentives for management efficiency and investment; (2) creating a **policy framework** that furthers decentralization and empowers local government sufficiently; and (3) **equipping local governments/utilities with necessary tools** for successful urban management in modern India (e.g., accounting reforms, e-governance).

Good governance policy pays a lot of attention to the creation of regulatory structures and transparent rules and procedures that encourage competition and the ability of private actors to invest efficiently. Traditionally viewed as a natural monopoly and government sector service, telecommunication liberalization and deregulation throughout the 1990s, at the time of expanding mobile phone technology, is a great example. Households could stop pleading with their government

18 Confederation of Indian Industry (CII)/Institute for Competitiveness, n.d., "Liveability Index 2010: The Best Cities in India," <http://www.competitiveness.in/wp-content/uploads/2010/03/Liveability-Report.pdf>; and Ernst & Young, 2007, "Indian Real Estate: Growth and New Destinations."



phone company for a landline connection; instead, private firms recognized market demand, invested heavily in the sector, and simplified connection procedures. Telephone connections increased from 5.07 million in 1991 to 671.69 million in 2010, making India the fastest growing market in the world.

A problem with the traditional, centralized development model is suboptimal investment from government into services. A mere 20% of annual, new urban investment requirements can be funded by revenue surpluses and external support (intergovernmental transfers and foreign aid), including JNNURM expenditures. The local system of governance has to change to encourage private investment.

In addition to setting simple and incentive-based rules, government can encourage private investment by accommodating a wide range of choices in how the private sector spends its money and accesses services. Choices allow people to act in their own best and most desirable interests; it encourages efficient delivery of services because people often choose the superior and best valued product. Even in natural monopolies like water or sewerage, people have choices: Many drill individual bore wells that are often illegal and deplete the water table, others might purchase expensive tanker and bottled water, and many people are forced to defecate in the open because the community lacks sanitation facilities. These are not necessarily great alternatives, but people choose them because the government system for delivering services is so convoluted and complicated that they encourage noncompliance.<sup>19</sup> A high percentage of informal settlements result in this manner. For example, in Ahmedabad, SEWA microfinance institution recently assisted slum dwellers, who already had Right of Resident documents, to access full property titles so that they could collateralize and leverage them for self-investment in home improvements, service connections, etc. The process entailed more than 15 discrete steps, across the city, in various offices, over many months. Without nongovernmental organization (NGO) assistance, it would have been nearly impossible; even with SEWA's help, the task was unfeasibly difficult.<sup>20</sup> Complex government rules act as a disincentive for legal, private investment. Real estate development in India shows how convoluted rules (e.g., strict master plans, high stamp duties, complicated registration process, and near monopoly power of development authorities) discourage legal investment.<sup>21</sup> Now, in parts of Delhi, up to 70% of the real estate costs are part of informal, "black money" transactions.

*It is easier to create an enabling environment to incentivize positive growth and investment if one institution has authority over urban planning, financing and budgeting, and service delivery.*<sup>22</sup> With all these functions under the jurisdiction of one institution (e.g., the local government), a single set of rules can emerge to govern the whole development process. In contrast, multiple institutions with overlapping authority (local, state, central, and autonomous) tend to create their own rules that become fragmented and potentially contradictory. In Kolkata, for example, the Metropolitan Development Authority, the Kolkata Municipal Corporation, and the Irrigation Department of the Government of West Bengal (each operating under different legal provisions) all had roles in drainage functions of the city, making effective day-to-day coordination very difficult.

Furthermore, if the same institution has both financial and functional authority across the entire metropolitan area, it can better influence the development path of the city. This is all the more relevant when that institution has responsibility over all the key physical infrastructure sectors contributing to land development (e.g., water, sewer, electrical, solid waste, and roads/transport). These infrastructure services, in addition to authority over planning approvals and building bylaws, constitute the built environment of a community. With adequate authority over the built environment, a local government can guide the look, feel, and liveability of its area. In contrast, as is more often the case, a fragmented governance structure translates into growth trends that do not correspond well with service provision.

There are roles for varying levels of government in service delivery, but the jurisdiction and responsibility of services has to be clear, ensuring that there are no overlaps in responsibility and that the institution in charge has adequate fiscal powers. Professional skills within an institution also have to match those required to manage the services. In Bhubaneswar, the capitol of Orissa, the city's new growth pattern is to the northeastern corridor toward Cuttack, where no water system and few paved roads currently exist. Although the commissioner is aware and interested in this, his team does not manage planning or water investment. Those powers reside in the parastatal Bhubaneswar Development Authority and other state-level agencies. The effectiveness of delivering municipal

19 The idea of rules and choices stems from the economist Paul Romer's case for Chartered Cities.

20 Presentation to international workshop, January 29-30, 2010, "Scaling up Upgrading and Affordable Housing: From National Policies, to State Programs, and Citywide Slum-Free Interventions," Udaipur, India: World Bank.

21 Billand, Charles, 1990, *Delhi Case Study: Formal Serviced Land Development*, USAID, New Delhi, India.

22 Responsibility for a function does not automatically mean that the institution undertakes it itself. The recent dialogues about "responsibility platforms" suggest that the function can be outsourced so long as a performance mechanism is in place, like a contract or funding. See the Chapter 4 article on water sector reform in Orissa as an example.

services ultimately affects economic development because businesses need buildings and services for their operations, and they need access to markets. For these reasons, the World Bank argues that responsibility for the built environment is much more important to remain at the city level than are other critical services like healthcare, education, and welfare.<sup>23</sup>

At the same time, it can be argued that primary healthcare and education should be a locally provided service. The best way to determine whether the local, state, or central government should be responsible for a particular service is where, geographically, the infrastructure is based (with respect to both inputs supplied and services delivered). If the urban challenges and solutions are locally based, then the local government should be responsible. If, however, trans-jurisdictional issues exist, such as watershed management or metropolitan rail systems, then a regional/state authority would likely play a role (e.g., metropolitan/district planning commissions or sector-wide regulation). Trans-jurisdictional issues are always complex for ensuring clear accountability across institutions. Service unbundling has worked very well with some types of sectors, like energy. The institution that produces the power does not need to be the one that delivers it to households. Unbundling also opens avenues for private sector participation in specific aspects of service delivery (e.g., electricity generation), but not necessarily privatization of the whole sector.

## Good Governance Framework Based on Accountability

Many aspects of good governance affect sustainable and inclusive infrastructure development. The FIRE (D) Program focused on one of them: urban management reform. At the same time, a good governance framework can promote democracy as well as improve the quality of local services. Accountability, as defined as being held responsible for decisions, administrative actions, and policies, is probably the most relevant governance theme. Real accountability helps direct, restrain, and motivate the public sector to deliver services. It becomes a real force when combined with other good governance principles like transparency and citizen participation to create effective institutions of self-government as envisaged by the 74th CAA.

The 74th CAA makes a revolutionary change by recognizing local government's right to exist through the following mandatory provisions: (1) constitution of municipalities, (2) composition of municipalities, (3) holding of regular elections, under the supervision of the state election commissions, (4) protection against arbitrary dissolution of local elected bodies by higher levels of government, (5) constitution and composition of ward committees to ensure greater proximity to citizens, and (6) reservation of seats for women and other marginalized groups.<sup>24</sup>

The second main component of the 74th CAA calls for state legislatures to devolve whatever responsibilities they deem necessary to empower local governments for planning economic development and social justice, and for implementing development schemes required of them, as institutions of self-government. To facilitate this empowerment, the 74th CAA recommends devolving 18 key functional responsibilities, listed in the 12th schedule of the Constitution. Considering the size of the country and the diverse conditions of local governments, the devolution process was left to the states to decide. Unfortunately, most states have not approached this very objectively. Finally, the 74th CAA mandates two elements of regulatory oversight for municipalities: the formation of state finance commissions (SFCs), in line with the Central Finance Commission, to identify avenues for municipal finance and criteria for transferring resources from states to local bodies; and the formation of District Planning Committees and Metropolitan Planning Committees (led by elected officials) to consolidate multijurisdictional development plans. All together, these provisions encourage functional and financial autonomy, within a more democratic government structure, and try to make local governments directly accountable to citizens.

**Civil society participation as a pillar of accountable governance.** In relationship to accountability, decentralization of authority means government is *answerable to the people through elections and other forms of participation*. At the local level, the city government should be answerable to the desires, priorities, and well-being of its residents. Those priorities are usually improved services, economic opportunities, and safety. It comes as no surprise that water, sanitation, and health typically rank very high on urban residents' concerns. In addition to electing city officials,<sup>25</sup> there are other important avenues to encourage government accountability. As a prerequisite, the *public needs to be informed* if they are expected to meaningfully participate in governance. Awareness campaigns

23 Hunter, Roland and Ryneveld, Philip van, 2009, "Financial Management of City Services: Enhancing Creditworthiness and Organizational Effectiveness in Indian Cities," World Bank.

24 This refers to historically discriminated castes in India, including scheduled castes, scheduled tribes, and backward classes.

25 Elections for executives arguably only happen directly in mayor-in-council types of local government, which exists in the states of West Bengal and Madhya Pradesh.



as well as transparency and disclosure laws help create a better informed public. In this regard, how a city operates financially is one of the most relevant pieces of information, and that process needs to be transparent, made public, and monitored by the taxpayers.

Residents will always want to *participate on issues directly affecting their everyday lives*, and can do so easily through citizen report cards, neighborhood-/ward-level meetings, or a variety of other ways. Through direct citizen participation, the decentralization process can extend to the sub-city level, to neighborhoods across the city. Formal interaction at the neighborhood or ward level connects city officials directly to communities that can express local priorities, concerns, and aspirations, as has been successfully demonstrated with Delhi's Bhagidari system. Starting in 2000, the municipal corporation, with implementation support of local NGOs, defined sub-ward neighborhoods throughout the city where communities could gather to raise concerns and tackle problems as a group, even receiving small budgets to implement their suggested changes. The FIRE (D) Program found how critical local participation was while planning for slum upgrading and creating local area development plans.

*Clarity of the roles and responsibilities of all the institutions in the city helps dictate just how accountable local government is in service provision*

**Improving internal operations as a pillar of accountable governance.** It seems inappropriate to discuss local government accountability if the city is not empowered with fiscal and functional authority over particular services. If the city is not responsible for paying for and delivering services, then, by definition, it is not accountable. Clarity of the roles and responsibilities of all the institutions in the city helps dictate just how accountable local government is in service provision. It is very confusing and inefficient when multiple institutions work in the same functional space.

## Unclear Authority Delays Service Connections

Connecting slum households with legal water and sewer services in Bhubaneswar proved challenging for the FIRE (D) Program for several reasons. The municipal corporation seemingly had to approve and then verify infrastructure works although it had no practical role in the service delivery. Municipal officials themselves became unsure of their role when they started processing a no objection certificate (NOC). At first, the NOC acted as verification that low-income households all had rights of residence. But then it was discovered that municipal engineers had to inspect road cuttings. With the water utility repairing all the roads, the city engineers did not know how to treat a zero damage assessment. In the end, this delayed a seemingly simple procedure by more than 3 months. Government roles and responsibilities need to be clear to everyone.

Another key principle in creating accountable local governments is matching *functional and fiscal authority with capacity improvements*. There is little benefit of transferring responsibilities for services to local governments if they are too weak to effectively fulfill those responsibilities. This has been endemic in many cities in which the FIRE (D) Program works. City managers require significant training, institutional support, and continuity of staff. In modern India, city management relies on technical and professional skills, like accounting, IT, and engineering, that many cities currently lack. One technology partner offered to compile all the property tax information of a city onto a single geographic information system (GIS) mapping platform for a systematic approach to tackling noncompliant property owners. Although this service was offered on a success-fee basis (without any budget outlays), the conversation stopped short because the city official did not understand the concept and seemed unsure what questions to ask to gain more information. Maintaining local government's current status quo will have increasingly negative effects on internal operations, as outside urban dynamics continue to change rapidly (technology, economics, migration, etc.). Better human resource policies will need to help change the incentives to hire, train, and retain more qualified employees. In Jabalpur, Madhya Pradesh, for example, the local government started assessing employee performance each month against a work plan, and having discussions about how tasks can improve incrementally. This information could be tracked over time, and performance could even be tied to bonuses or other incentives.

Improvements in capacity and performance also stem from accurate information flowing to the right decision makers, in a timely fashion. To build capacity in this respect, local government could borrow advancements in business processing from private sector companies that use integrated information management systems and data flow to inform decision making.<sup>26</sup> Financial management reform and e-governance are two key parts of this broader business process. Again, it is difficult to hold individuals or government accountable if they lack accurate, real-time information. In the absence of accurate information, decisions, no matter how well intentioned, may get made without a true picture of the conditions. Luckily, recent technological advancements have made implementing these systems much easier. However, government officials run the risk of treating technology as a panacea; new technologies themselves will not provide much advantage if they are not accompanied by thorough hands-on training.

**Regulatory oversight as a pillar of accountable governance.** A final pillar to explain how accountability is a unifying theme of good governance is oversight. While civil society can help ensure elected officials are accountable through participatory structures, there are many technical areas affecting urban services in which the public cannot usually engage. For example, residents might be concerned with water quality and demand improvements, but most people will not understand the specific contaminants or bacteria cycles that pollute water. A third party with technical competence should monitor water quality and other infrastructure specifications. A good regulatory framework ensures safety and sustainability of services, while at the same time encouraging optimal utilization. Regulatory oversight must include:

- Clear, unambiguous, and transparent rules that promote safety, sustainability, and development
- Quantifiable benchmarks and standards that are widely agreed upon
- Specific indicators that can be monitored, audited, and evaluated objectively
- Enforcement mechanisms with real consequences for violators

This third-party oversight has the same relevance in fiscal issues, such as debt management, intergovernmental transfers, or tariff setting for services. In this way, regulation holds government officials to certain standards that are considered fair by society. It is possible to design appropriate and transparent regulatory institutions at either the state or central level, or as autonomous organizations. What is important is that regulation is based on fair, clear, and agreed upon standards that are enforceable. If flouting regulations does not lead to financial penalties, court rulings, or voluntary change in behavior, then oversight is meaningless. The violator who acts above the law is no longer accountable.

The interplay among (1) civil society participation, (2) internal government operations, and (3) oversight provides a strong framework for accountability and good governance (see summary table below). The framework highlights the most relevant aspects of good governance with regard to infrastructure development and urban management. The FIRE (D) Program supports all three of these pillars in varying degrees, focused on internal operations of local governments and utilities. In its early stages, the FIRE (D) Program realized that a focus on project development and financing would have to go hand-in-hand with changes in policies, improved urban governance, and staff capacity building. Thus, the FIRE (D) model holds both financial sustainability of infrastructure projects and improved local governance at its core. Keys to the model's success, explained throughout this guidebook, are the ability of municipalities to generate sufficient revenues to cover not only their operations and maintenance costs, but also future investment in infrastructure needed to service the fast-growing population.

This article provides a good governance framework to orient urban initiatives appropriately, whether drafting a MML (see Article 1.3 below), improving creditworthiness of cities, or designing e-governance (see Chapter 4, City Financial Viability). This governance framework helps provide the overall orientation to the process for developing infrastructure.

<sup>26</sup> Known as "enterprise resource planning" (ERP) systems.



Table I-2. Good Governance Framework Centered on Accountability

Pillar of accountability in democracy	Key strategies applied by the FIRE (D) Program	Examples of local government initiatives <sup>27</sup>
<b>Internal Operations</b> <ul style="list-style-type: none"> <li>Empowerment/ executive mandate over the built environment of the entire city space (functional and fiscal)</li> <li>Internal business processes, capacity, and improved decision making, including administrative reforms</li> <li>Information and data management (management information system [MIS])</li> </ul>	<ul style="list-style-type: none"> <li>Improved creditworthiness of cities through improved resource mobilization, financial management, and accounting reforms</li> <li>Institutionalization of best practices through the training network and city managers associations to build implementation capacity and achieve impacts</li> </ul>	<ul style="list-style-type: none"> <li>63 cities received credit ratings under JNNURM by the Government of India</li> <li>Sub-city decentralization in Surat, including providing simple fiscal and functional authorities to zonal officers, opening 16 civic centers with single-point services, and an effective grievance system</li> <li>Human resource changes in Ludhiana that utilize monthly performance appraisal of staff</li> <li>Organizational restructuring in Indore, Bangalore, Bhubaneswar, and Asansol to improve efficiencies in establishment costs</li> <li>Improved mobilization of internal resources by Indore, Nagpur, Bhubaneswar, Asansol, and Durgapur</li> </ul>
<b>Civil Society</b> <ul style="list-style-type: none"> <li>Transparency, disclosure, and citizen education</li> <li>Structures to encourage participation in governance (e.g., further decentralizing to wards/neighborhoods, planning and prioritizing programs)</li> <li>Electing an executive and council directly</li> </ul>	<ul style="list-style-type: none"> <li>Incorporating pro-poor orientation in project planning</li> <li>Establishing and fostering partnerships with national government and private organizations</li> <li>Constant information sharing and feedback from partners, including local, state, and central governments</li> <li>Household surveys/willingness-to-pay studies</li> </ul>	<ul style="list-style-type: none"> <li>E-governance initiatives that increase information availability to the public: Hyderabad and Secundrabad have 43 “e-seva” centers, serving 35,000 people a day</li> <li>Citizen’s charter in Guntur to publicize the expectations of local government and citizens alike that increases awareness and sets a standard for accountability</li> <li>Bhagidari or community partnership in Delhi, where citizens contribute to prioritizing issues in their areas, receiving small budgets for improvements</li> <li>Citizen report cards in Bangalore, Nagpur, and elsewhere to rate services and communicate priority areas for improvement</li> </ul>
<b>Oversight</b> <ul style="list-style-type: none"> <li>Sector regulations (quality and fiscal standards, monitoring and evaluating performance)</li> <li>Enforcement of rules, i.e., “rule of law”</li> </ul>	<ul style="list-style-type: none"> <li>Encouraging municipalities to structure performance-based contracts for operation and maintenance of urban services</li> <li>Regulatory oversight for infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>Performance contracts in Navi Mumbai water and sewer sectors for incentive-driven regulation of private service providers</li> <li>State Finance Commission in Tamil Nadu provides excellent oversight of municipal fiscal framework</li> </ul>

The FIRE (D) Program has learned that prior to assisting cities in improving revenue generation, municipalities should first have transparent accounting practices so citizens can trust that their taxes and user charges are not being mismanaged or misappropriated. Next, citizens must be charged reasonably for services such as water, charges that are affordable, adequate to cover costs, and based on a willingness to pay. With better communications, transparency in government operations, and real improvements in service delivery, most people are willing to pay more reasonable and sustainable user fees.

<sup>27</sup> These examples are drawn from FIRE (D) work and TERI, 2009, *An Exploration of Sustainability in the Provision of Basic Services in Indian Cities*, New Delhi: TERI Press. See Chapter 6.



FIRE (D) PROGRAM

## Governance and Policy Initiatives of the FIRE (D) Program

Some of the key legislation and policy changes that the FIRE (D) Program was instrumental in supporting include:

- The **MML**, which provides guidance for Indian states to fully implement the mandatory 74th CAA, empowering local bodies through decentralization
- Contributing to the design of multiple reforms included in the **JNNURM** to encourage decentralization and better urban management
- **Pro-poor policies and strategies** that ensure the urban poor have universal and affordable coverage of water and sanitation service through private house connections and individual toilets
- **National Municipal Accounting Manual**, which promotes better financial management and governance through double entry, accrual accounting to introduce transparency and accountability into municipal finances
- **Municipal Credit Rating** methodology to assess the financial strength and borrowing capacity of cities
- **Tax-Free Municipal Bond Guidelines**, which encourage investment in urban infrastructure through capital markets and interest rate write-downs
- Policies on structuring bankable urban infrastructure projects to help make them attractive to private sector investment
- **E-governance policy** to provide a design for the re-engineering and automation of key municipal services
- **Pooled Finance Development Fund** guidelines and toolkit to help enable smaller and medium-sized municipalities raise funds from the market to fund urban infrastructure needs

## JNNURM and Good Governance

Many of the JNNURM reforms fit into the above-mentioned framework, while others relate to specific activities in the city, such as liberalizing land markets,<sup>28</sup> improving access of the poor,<sup>29</sup> and enabling rain water harvesting in building bylaws.

From the perspective of improving local governance, the reforms could be designed/sequenced to address the most significant gaps at the local level. See Annex 1-3 for a list of the JNNURM reforms and how they are grouped into the good governance framework.

The JNNURM reform measures have stimulated a tremendous dialogue among stakeholders concerning implementation and linkages to improved service delivery. However, the Planning Commission's mid-term appraisal of JNNURM pointed out varying degrees of reform performance across participating states and cities.<sup>30</sup> Many states were willing but lacked sufficient capacity at the state and local government level to develop, plan, and execute reforms and projects. The experience from the FIRE (D) Program shows that infrastructure and service delivery projects have a long gestation period, especially if they involve acceptance of new ideas and major policy and institutional reforms. Successful execution of pilot projects helps gain local buy-in and consensus. This is essential for broader acceptance and lasting change. For example, the FIRE (D) Program designed and successfully tested a resource mobilization methodology with the Indore Municipal Corporation before publicizing it nationally. With time, it gained broad acceptance and is now incorporated by the Government of India as part of the national JNNURM initiative. The 13th Finance Commission has also recognized the important role of municipal accounting reforms and municipal bonds in improving the financial situations of local governments.

A major reason for slow progress is that the reforms most closely related with good governance are predicated on state government actions through legislation. Apart from improving tax collection efforts by local governments, all the reforms require states to change the municipal acts and/or individual regulations before local initiatives can begin. For example, cities are still dependent on the state government to change their property tax rates and assessment methodology to one that is area-based.

In practice, it is difficult and time-consuming to implement many of the reforms. Most local governments operate in a fire-fighting, reactionary mode. Further, they do not have internal capacity and need dedicated commitment from government officials at the city and state levels, as well as substantial technical support. In Orissa, the FIRE (D) Program heavily supports the state's

28 Repealing the Urban Land Ceiling and Regulation Act, reform rent control laws, and rationalization of stamp duties.

29 Internal earmarking for the poor, basic service provision, and earmarking 20-25% of land for EWS & LIG income categories.

30 Sen, Amiti, "JNNURM Phase-II to Target States Stepping Up Urban Reforms," *Economic Times*, 19 April 2010.





FIRE (D) PROGRAM

comprehensive water sector reform—from initial conceptualization of the new system to legislative reforms and now to detailed changes in institutions and operations. All said, implementing this reform will likely be a 5-year continual process (see Article 4.4). This close day-to-day, trust-building partnership and working relationship helps pave the way for institutionalizing good governance and financial management reforms that become the foundation for better management and performance.

It is almost impossible to evaluate the progress of JNNURM reforms because program auditing is still in its early stages. A benchmarking and indicator system is just now being tested,<sup>31</sup> but it would need to become a regular occurrence to provide long-term evaluation. States need to move beyond “check boxes” to build a robust monitoring system into JNNURM. Occasional site visits provide a qualitative view for central government, but without a systematic approach this is only anecdotal.

JNNURM has certainly elevated the importance of Indian cities in the national consciousness and provided impetus, if not consensus, on urban governance reform. Undoubtedly, it will take significant effort and many years to accomplish the decentralization vision. The FIRE (D) Program conceptualizes the long-term outlook as a pyramid with the right policies and enabling environment as the foundation. Other aspects, like strengthening internal capacity, build on the legislative framework. This in turn sets the conditions for attracting infrastructure investments and improving the living conditions of the city, including the poor. A strong legislative foundation for decentralization helps propel subsequent reform efforts. In this respect, the MoUD requested that the FIRE (D) Program investigate policy options for strengthening municipalities. In 2003, this effort culminated in the MML to act as a guide for states to review their own municipal acts (see Article 1.3 below).

31 Basic information on service delivery and deriving performance assessment is not yet common in Indian local governments. MoUD commissioned credit ratings for 57 cities, and WSP is assisting in establishing water sector benchmarking. The Government of India has begun Standardized Service Level Benchmarks on a pilot basis in a few cities across the country; its state-wide replication in two states—Gujarat and Maharashtra—through the Performance Assessment System (PAS) project of CEPT University will provide a useful information base to monitor service level and quality. A state-wide PAS is being developed for all cities in Gujarat and Maharashtra with support from the CEPT University through a 5-year action research project. See [http://spcept.ac.in/pas\\_project.aspx?pg=pas&sub=pas](http://spcept.ac.in/pas_project.aspx?pg=pas&sub=pas).

## ARTICLE 1.3

### The Model Municipal Law

The MML is a tool for transforming cities into institutions of self-government. It sets the structure, functional areas, fiscal powers, and oversight that would be necessary for establishing viable and more autonomous local self-governments. In so doing, the MML helps cities and states implement, in totality, the provisions of the 74th CAA, as well as other decentralization objectives of JNNURM and recent Government of India policy statements. The legislative objective is to devolve urban management authority from state to local governments in a manner that encourages good governance, as framed in the previous article of this chapter.

That objective essentially means that local governments will be accountable to urban residents for providing better services, while balancing fiscal and functional imperatives. Without needing to seek permission from state governments on every issue, local governments will have the prerogative to generate revenues, program spending on capital projects or maintenance, and plan for new projects as appropriate. Citizen participation in ward committees, by electing a council with executive powers, among other avenues of involvement, will demand better services from their local governments, and this will build accountability over time. Local government will also have the power to build internal capacity as required for delivering better services.

State government agencies will also change from managing day-to-day aspects of cities to providing oversight, regulation, and advancement of strategic policies. This represents a significant shift that is necessary to ensure that the underlying governance principles of participation, decentralization, autonomy, and accountability of representative urban local governments are kept in view.

The conformity legislation passed by all state governments, as part of the 74th CAA ratification in 1992, compelled states to create local, democratic governments by holding elections and constituting state finance commissions. The less straightforward aspects of functional decentralization, however, were not mandatory, and have since proved very difficult to accomplish.

It is well known that the old municipal laws cover a very wide canvas. Unlike many other laws, the municipal laws in India are greatly influenced by state-wide politico-socio-economic and cultural environments, as well as local perceptions and traditions. These laws are often voluminous and may run into 500 sections or more. Many were drafted more than a century ago and have undergone very little modernization. Instead of trying to update them piecemeal, the MoUD felt it would be more helpful and efficient to provide a comprehensive guide that appreciates the interconnectedness of issues relating to managing modern cities.

The FIRE (D) Program, with the National Institute of Urban Affairs (NIUA) and the Times Research Foundation, supported MoUD to create the MML as a user-friendly resource for state governments

to evaluate and then use as the basis for redrafting their own municipal acts. Most states have initiated the redrafting process, although few have taken the comprehensive approach that the MML encourages. The State of Kerala, for example, has changed its municipal act to decentralize functional and fiscal powers in such a way that only a new/revised act can supersede. Other state-level laws, policies, and rules cannot infringe on the new powers of local governments. In contrast, many states decentralized functions, piecemeal, through rule or policy changes that can be altered again at any time by the state government, which technically means that local governments remain in the legislative domain of the state.

The MML offers an alternative to the somewhat irregular approach to decentralization that many states have pursued. The FIRE (D) Program's team worked for 2 years (2001–2003) to provide careful analysis and build legislative consensus.



FIRE (D) PROGRAM

1. **Policy issues, options, and legislative intentions.** It was necessary to assess current municipal acts across India to understand the existing and diverse municipal structures. The team reviewed acts of West Bengal, Maharashtra, Tamil Nadu, Punjab, Karnataka, and Madhya Pradesh, among others. The assessment evaluated how states deal with the main aspects of municipal structure and management, categorized into four groups: (a) constitution and government, (b) municipal finance and financial management, (c) supply of urban infrastructure, and (d) regulation of, among other things, community health, environmental management, and development planning. The paper examines the existing policy context of these issues and how they can be reoriented to pursue decentralized good governance.
2. **Policy options for framing new municipal laws in India.** The team presented the main findings of the assessment paper as the primary legislative topics that state governments would have to consider and act on. To assist state governments in this task, several policy options accompanied each key issue. The policy options were based on good experiences from many states in India, as well as on lessons learned from working in the sector. For each issue, the preferred option is highlighted by a technical review team led by MoUD.<sup>32</sup>
3. **Model Municipal Law.** Grouped together, the preferred policy options provide the content for the MML. To help state governments form new legislation, the team drafted a complete law in October 2003.

The objective of this exercise was to create a resource from which states could tailor their own municipal acts to empower local governments. The following are salient features of the MML.

### Constitution and Government

- The MML offers a unified law suitable for all the three types of local governments,<sup>33</sup> while also recognizing that small towns and village *panchayats* might require a different governance structure and potentially be exempted from a municipal act.
- Executive powers are vested in an elected mayor-in-council. The empowered council would be elected directly by municipal residents and the mayor would be elected indirectly through the council.
- Ward committees promote decentralization at the neighborhood level and better ensure proactive community participation.
- Functional responsibilities for services vary depending on managerial, technical, and financial capacities across different types of municipalities. Functions can be classified as: (a) *core functions* that municipalities are first and foremost responsible for delivering (including water supply, drainage and sewerage, and solid waste management); (b) *additional functions assigned by the state government*, which would be undertaken subject to the financial and technical capacity of the concerned level of government (e.g., health and education); and (c) *other functions* of mutual agreement by state or central government and local government.
- Dissolution of an elected body in case of corruption and abuse of power occurs through a due process and review by a state committee. In such cases, a new election is to be conducted within 6 months of dissolution.
- The MML also has provisions for recalling municipal councilors.

### Financial Management of Municipalities

- A modern system of accounting is based on the national municipal accounting manual. Local governments are required to prepare an inventory of and then value all immovable municipal properties/fixed assets.
- Financial statements containing an income and expenditure statement, receipts and payment account, and a balance sheet for assets and liabilities must be prepared and published.
- Receipts and expenditures must be maintained under separate accounting heads/funds for water, drainage and sewerage, solid waste management, road development and maintenance, and general account. These separate funds will be reflected in the annual budget.
- A municipal accounts committee<sup>34</sup> facilitates transparency and accountability.
- Internal auditors will be professional chartered accountants appointed by a state government panel.
- A debt limitation policy replaces the normal requirement for state government approval for borrowing. The debt limitation policy would lay down the general principles for borrowing based on a local government's financial capacity.
- Provision for credit ratings and bonds issuances allows local governments access capital markets and financial institutions.

32 The review and consensus process was captured in a paper titled "Specimen Municipal Law for Municipalities in India," June 2002.

33 Municipal areas have been classified on the basis of population into three categories: (1) larger urban areas having a population of more than 3 *lakhs*; (2) smaller urban areas—Class A: municipal areas having a population of more than 1.5 *lakhs* but not exceeding 3 *lakhs*, Class B: municipal areas having a population of more than 75,000 but not exceeding 1.5 *lakhs*, and Class C: municipal areas having a population of more than 25,000 but not exceeding 75,000; and (3) transitional areas having a population not exceeding 25,000. State governments have been empowered to exempt Class "C" municipal areas/*nagar panchayats* and industrial townships from the provisions of the act.

34 The municipal accounts committee is similar to a public accounts committee that provides scrutiny and disclosure of local government financial statements.

## Rajasthan Municipalities Act 2009

The Rajasthan Government circulated a new municipal law on September 26, 2008, and enacted it the following year. It is mainly based on the MML. It also has many enabling provisions in line with JNNURM reforms: (1) transferring various functions to local governments; (2) introducing taxes on land and buildings on a unit area basis; (3) forming Area Sabhas for community participation; (4) establishing metropolitan/district planning commissions; (5) making town planning a municipal function; (6) introducing rainwater harvesting; (7) encouraging public-private partnerships (PPPs); (8) introducing improved accounting; (9) mandating public disclosure; and (10) setting up a mechanism to implement state finance commission recommendations. There are also some very innovative enabling provisions for municipal bonds, comprehensive debt limitation policy, and setting up a municipal service cadre. The law also divided various municipal functions into core, government-assigned, and other functions. However, water supply and sewerage are not identified as core functions for local government, and instead will assigned by the state should local capacity be sufficient.

### Internal Revenue Generation by Municipalities

- Diverse revenue-generating powers in the MML include taxes, surcharges, user fees, rents, and development charges (e.g., transfer of lands/buildings and tolls on roads and bridges).
- For property tax reform, several methodologies are suggested, including an area-based system with unique premise numbering and self-assessment.
- More authority is given to state finance commissions for implementing their recommendations.

### Provision of Urban Infrastructure Services and Managing the Environment

- Local governments can undertake projects to improve and maintain services in core functional areas.
- The MML authorizes private sector participation (company/firms, NGOs, trusts, or community-based organizations) for financing, construction, operation, and maintenance of urban services.
- Subsoil water resources are vested with municipalities.
- A municipal regulatory commission at the state level oversees quality of municipal services, sets service standards, and authorizes tariff rates.
- A legislative mandate is proscribed to meet the Hazardous and Bio-medical Waste Handling Rules and Solid Waste Handling Rules of the Government of India's Ministry of Environment and Forests (2003).
- Local governments are responsible for community health, which includes safe disposal of the dead and eradication of pests.

### Regulatory Powers, Offenses, and Penalties

- Membership on metropolitan or district planning committees allows local governments to have greater influence in preparing regional development plans.
- Local governments have planning authority over the core functions as well as slum upgrading, poverty alleviation, and disaster management.
- Sanctioning and enforcing building regulations and imposing necessary fines is a local responsibility.

The highlighted aspects above show the extent to which local government would gain authoritative powers under the MML. While the core functional authority focuses on the built environment that affects physical development (roads, water, drains, sewer, slum improvement, markets, etc.), local authority could expand over time to schools and healthcare, depending on internal capacity. To provide adequate resources for these functional areas, local government is empowered to raise revenues and debt and to contract with private sector firms. On one hand, these decisions will be increasingly determined by elected officials who are answerable to local residents through ward committees, at the ballot box, and with other forms of participation. At the same time, state-level oversight is important to set more objective standards for services based on safety, reliability, and environmental protection. The same oversight committee also regularly monitors service delivery.

For the most part, this new framework is a stark contrast from the previous municipal government structure typical across the country, where decision making was concentrated in either a state-appointed municipal commissioner or directly by the state Housing and Urban Development Department or parastatal agency. State governments largely controlled municipalities, not citizens



and their locally elected representatives. Under the MML, the mayor-in-council sets priorities and is responsible for execution. The municipal commissioner is in charge of day-to-day city functions and reports to the mayor. Although the mayor can delegate authority to the municipal commissioner as he or she sees fit, there is no direct accountability. The municipal commissioner is still appointed by and reports to the state government. The mayor cannot extend, promote, or cut short the municipal commissioner's term.<sup>35</sup>

The new framework empowers local government but does not resolve every issue that city and states are dealing with. For one, there should be a standard way for measuring urban performance over time. Accounting reforms may address financial data, but cities are not evaluated on finances alone. Equally important is service coverage, quality, fairness and customer satisfaction. Service performance indicators need to be standardized, measured regularly by local government, publicized, and used for long term planning and service improvement.

Planning and building regulations is another example where the MML needs further attention because the Town and Country Planning Acts, and not municipal acts, currently govern urban planning. Inconsistency now exists between these two areas. Where local governments should have integrated planning powers over the city space, current land use planning and formation of municipal byelaws continues to be a state-level responsibility. In many states, parastatal agencies draft the byelaws and land use maps but require local government to enforce them, no matter how inappropriate they may be relative to the ground realities. The MML by itself cannot resolve this conflict but does encourage an increased role for local governments in development planning through proposed metropolitan or district planning committees (see Chapter 3).

Another area worth noting is the absence of a human resource/employment section of the MML. Most local governments are not empowered to set independent human resource policy, including salary schedules, benefit packages, and termination procedures. Tying promotions to employee performance, as is the case in Ludhiana Municipal Corporation, is a very good way of providing incentives for building internal capacity and professionalism in the work place. Instead, state governments set the salary and benefits schedules for all municipalities based on the civil servant system. This practice undermines the ability to attract technical skills (like finance, engineering, and IT) that are required to manage modern cities.

Many of the MML's key components highlighted above did become part of JNNURM in 2005. However, JNNURM did not explicitly direct states to implement the MML as a mandatory reform. As a result, many states are still passing legislative reforms on a piecemeal basis, and seem uncertain how to proceed. As an alternative to the comprehensive approach offered by the MML, the FIRE (D) Program followed a process cycle approach when addressing urban challenges. The next chapter discusses this alternative approach and how it is applicable for cities and states.

35 For a short time, Maharashtra allowed mayors to write the "Confidential Report" for municipal commissioners, which does affect postings. However, this practice ended after strong lobbying from civil servants.

# Chapter I Annexes

## Annex I-1. Ease of Doing Business: India Ranks 122 out of 181 Countries, 2009

Category	Rank	Indicators	Category	Rank	Indicators	
Starting a Business	121	Procedures (#)	Protecting Investors	38	Disclosure Index	7
		Duration (days)			Director Liability Index	4
		Cost (% GNI per capita)			Shareholder Suits Index	7
		Paid in Min. (% GNI per capita)			Investor Protection Index	6
Dealing with Construction Permits	136	Procedures (#)	Enforcing Contracts	180	Procedures (#)	46
		Duration (days)			Duration (days)	1420
		Cost (% of income per capita)			Cost (% of claim)	40
Registering Property	105	Procedures (#)	Closing a Business	140	Time (years)	10
		Duration (days)			Cost (% of estate)	0
		Cost (% of property value)			Recovery rate (cents on the dollar)	10
Paying Taxes	169	Payments (#)	Trading Across Borders	90	Documents for export (#)	8
		Time (hours)			Time for export (days)	17
		Profit tax (%)			Cost to export (US\$ per container)	945
		Labor tax and contributions (%)			Documents for import (#)	9
		Other taxes (%)			Time for import (days)	20
		Total tax rate (% profit)			Cost to import (US\$ per container)	960
Employing Workers	89	Difficulty of Hiring Index	Getting Credit	28	Legal Rights Index	8
		Rigidity of Hours Index			Credit Information Index	4
		Difficulty of Firing Index			Public registry coverage (% adults)	0
		Rigidity of Employment Index			Private bureau coverage (% adults)	11
		Firing costs (weeks of salary)				

Source: Doing Business 2009: Country profile for India, World Bank, accessed at <http://www.worldbank.org>, November 2008.



## Annex I-2. Mandatory and Optional Reforms under JNNURM

Local government-level mandatory reforms	State government-level mandatory reforms	Optional reforms
Accrual-based, double-entry system of accounting in local governments and parastatal agencies	Implementation of decentralization measures as envisaged in the 74th CAA	Revision of bylaws to streamline local building approvals
Introduce e-governance using IT applications, such as GIS/MIS	Repeal of Urban Land Ceiling and Regulation Act	Simplification of procedure; conversion of land to nonagricultural purposes
Reform of property tax with GIS and collection efficiency to increase to 85%	Reform of rent control laws balancing the interest of landlords and tenants	Introduction of Property Title Certification system in local governments
Levy of reasonable user charges to achieve operation and maintenance cost recovery over 7 years, with special concession to Northeast states	Rationalization of stamp duties: reduce it to less than 5% over 7 years	Earmarking 20%-25% of land for economically weaker section/low-income group category with cross-subsidization
Internal earmarking of funds in local government budgets for basic services for the poor	Enactment of Public Disclosure Law to ensure release of quarterly performance information to all stakeholders	Introduction of computerized process of registration of land and property
Provision of basic services to the poor, including security of tenure at affordable prices, housing, water, sanitation, education, health, and social security	Enactment of community participation law to institutionalize citizen's participation and introduce concept of area <i>sabha</i>	Rainwater harvesting to make mandatory and bylaws for reuse of recycled water
	Associating elected local governments with city planning, transferring special agencies for civic services to local governments and accountability platforms for service providers in transition	Administrative reforms (reduction in establishment costs), structural reforms, and encouraging PPPs

Source: Based on MoUD, n.d.

## Annex I-3. Status of JNNURM Reforms, 2010

	JNNURM reform	Type of reform	Number and name of states/cities initiating this reform
Internal Operations	Shift city planning and service delivery to local government	State mandatory	13 Andhra Pradesh, Assam, Chattisgarh, Gujarat, Himachal Pradesh, Kerala, Madhya Pradesh, Maharashtra, Tamil Nadu, West Bengal, Bihar, Chandigarh, Haryana
	Accrual accounting	Local government mandatory	23 Hyderabad, Vijayawada, Vishakapatnam, Ahmedabad, Rajkot, Surat, Shimla, Kochi, Thiruvananthapuram, Bangalore, Mysore, Bhopal, Indore, Ujjain, Nagpur, Greater Mumbai, Bhubaneshwar, Jaipur, Coimbatore, Madurai, Chennai, Allahabad, Kolkata
	Property tax	Local government mandatory	14 Hyderabad, Vijayawada, Vishakapatnam, Rajkot, Vadodara, Pune, Coimbatore, Madurai, Chennai, Agra, Allahabad, Chandigarh, Lucknow, Asansol
	User charge	Local government mandatory	7 Vishakapatnam, Nashik, Pune, Greater Mumbai, Chennai, Madurai, Vishakapatnam
	e-governance	Local government mandatory	11 Hyderabad, Vijayawada, Vishakapatnam, Ahmedabad, Rajkot, Surat, Greater Mumbai, Coimbatore, Madurai, Chennai, Kolkata
	Internal earmarking for poor	Optional	44 Hyderabad, Vijayawada, Vishakapatnam, Chandigarh, Raipur, Ahmedabad, Rajkot, Surat, Vadodara, Faridabad, Kochi, Thiruvananthapuram, Bangalore, Mysore, Bhopal, Indore, Jabalpur, Ujjain, Nagpur, Nanded, Nashik, Pune, Greater Mumbai, Kohima, Amritsar, Bhubaneshwar, Puri, Jaipur, Ajmer, Coimbatore, Madurai, Chennai, Dehradun, Haridwar, Nainital, Agra, Allahabad, Kanpur, Lucknow, Mathura, Meerut, Varanasi, Asansol, Kolkata
Civil Society	Simplify building bylaws	Optional	21 Hyderabad, Vijayawada, Vishakapatnam, Guahati, Amritsar, Ludhiana, Jaipur, Ajmer, Ahmedabad, Rajkot, Surat, Vadodara, Bhopal, Indore, Nagpur, Nashik, Pune, Asansol, Kolkata, Patna, Delhi
	Property title cert.	Optional	2 Chandigarh, Rajkot
	Simplify land conversion	Optional	23 Hyderabad, Vijayawada, Vishakapatnam, Ahmedabad, Rajkot, Surat, Vadodara, Kochi, Thiruvananthapuram, Bangalore, Mysore, Bhopal, Indore, Jabalpur, Ujjain, Indore, Jaipur, Ajmer, Coimbatore, Madurai, Chennai, Asansol, Kolkata
	Computerize land registration	Optional	17 Hyderabad, Vijayawada, Vishakapatnam, Ahmedabad, Rajkot, Surat, Vadodara, Shimla, Bangalore, Mysore, Nagpur, Nanded, Greater Mumbai, Jaipur, Coimbatore, Madurai, Chennai
Oversight	Public Disclosure Law	State mandatory	3 Andhra Pradesh, Assam, Gujarat
	Community Participation Law	State mandatory	6 Andhra Pradesh, Assam, Gujarat, Maharashtra, Tripura, Uttar Pradesh
	Implement 74th CAA	State mandatory	18 Andhra Pradesh, Bihar, Chattisgarh, Gujarat, Kerala, Madhya Pradesh, Maharashtra, Tamil Nadu, Tripura, West Bengal, Assam, Goa, Haryana, Himachal Pradesh, Karnataka, Orissa, Rajasthan, Uttar Pradesh
	Administrative structure	Optional	5 Nashik, Madurai, Coimbatore, Chennai, Mysore

