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**USER CHARGES:  
*A CASE STUDY OF WATER PRICING***

**Centre for Civil  
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K-36, Hauz Khas Enclave, New Delhi 110 016

Phone: 011-26537456/26521882 Fax: 26512347

Email: [nurm@ccs.in](mailto:nurm@ccs.in) Web: [www.ccs.in](http://www.ccs.in)

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# User Charges Reforms

## *A Case Study of Water Pricing*

Susanne Cassell and Ali Mehdi<sup>1</sup>

***JNNURM Reform:*** *Levy of reasonable user charges by ULBs/ Parastatals with the objective that full cost of operation and maintenance or recurring cost is collected within next seven years. However, cities/towns in North East and other special category States may recover at least 50% of operation & maintenance charges initially. These cities/towns should graduate to full O&M cost recovery in a phased manner.*

User charges are fees for use of services, like tuition at colleges and universities, tolls and transportation charges, parks and recreation fees, solid waste charges, etc. Some of the common goals of user charges are: good governance, financial sustainability, distributive justice, economic efficiency, and fair pricing. In the context of JNNURM reforms, they refer to charges levied for services delivered by the municipalities or the parastatals. Four categories have been identified in the checklist of reforms: 1) water supply & sewerage, 2) solid waste management, 3) public transport agencies, 4) others. And the relevant city municipal corporations have been asked to report on their current status, furnish the total and per unit costs for providing these services against the charges collected, including leakage / theft and free supply.

In the timeline for action on reforms, the States / ULBs are supposed to formulate and adopt a policy on user charges which should include proper targeting of subsidies, if any, for all services; ensuring the full realization of O&M cost by the end of the Mission period; establish proper accounting system for each service so as to determine the O&M cost separately; define service standards and user charge structure and the timelines for achieving these; quantify / study the impact of subsidies for each service on a periodic basis; and a time table to achieve full recovery of O&M costs from user charges.

There is often resistance to policy changes, but then it is only after the implementation of new policies that their benefits become visible to the public.

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<sup>1</sup> Susane interned at CCS and is currently pursuing MPA at Harvard University. Ali is a Research Associate at CCS.

The Durham County Council undertook a field research and generated a road user charge monitoring report. One of their findings was that since the road user charge scheme has been introduced, more people feel that Durham has become a safer place for pedestrians. Before the introduction of this charge, only 49% of people felt that it was a good idea. But since the scheme has been operational, this figure has risen to 70%, which also shows the misplaced anxiety of people before such reforms are introduced and carried out, and their subsequent support looking at the changes brought about in their wake.<sup>2</sup> Carrying out user charges reforms will bring out their benefits in public view and will relax popular anxieties as are sometimes expressed before the policy reforms have been implemented.

*“Water is nature’s gift. The right to water is a natural basic right of all, living beings, and human and fundamental right for human beings. [...] Water cannot be commodified and privatised.”*

(Navdanya 2003)

*“Water has an economic value in all its competing uses and should be recognized as an economic good. [...] Managing water as an economic good is an important way of achieving efficient and equitable use, and of encouraging conservation and protection of water resources.”*

(International Conference on Water and the Environment 1992)

*“The idea of levying user charges for the water supply to households and commercial establishments is quite sensible as well as beneficial for water conservation. Water is a common pool good and water supply has been the most public of all services. Hence, water is most likely to be overused and abused without the levy of user charges. User charges would ensure that unnecessary and superfluous use of water is avoided. People would then like to save than squander water.”*

(Amit Dholakia, Senior Lecturer in Political Science at Maharaja Sayajirao University of Baroda)

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<sup>2</sup> <http://www.durham.gov.uk/durhamcc/usp.nsf/pws/Roads+-Saddler+Street+Road+User+Charge+Monitoring+Report> (Accessed on 09/10/2006 at 12:55)

## **1. PRICING WATER: A CONTENTIOUS ISSUE**

Pricing water is a contentious issue because it is seen by many as anti-poor excluding large parts of the population from a basic need. Although social considerations are a very important part in the debate about water pricing it should not be forgotten that the production and distribution of high quality water is a very expensive undertaking that has to be paid for by someone. The main challenge in the water sector is to find an institutional setup that insures financial sustainability of the utility and at the same time allows access for everybody at affordable prices.

Properly designed water charges serve two purposes: They assure financial sustainability of the utility and regulate demand. Sound finances are an essential prerequisite for sufficient investment in water infrastructure and service delivery. Demand regulation is important to make most efficient use of scarce resources. In the following it is argued that cost-recovering water charges combined with a well-targeted subsidy scheme for the poor will result in expansion of the network, better quality of water and improved services while ensuring that water remains affordable for all.

## **2. THE CURRENT STATE OF WATER PROVISION**

### ***2.1. The demand side: Access, quality and coping costs***

In India alone, 13% of the world's population that is un-served for water resides. According to the 2001 population census 91% of India's urban dwellers have access to drinking water, but only 49.7% of households have tap water on their premises (Asian Development Bank 2004: Part I). Besides access quality of services is a major issue. Connected households usually face intermittence of water supply, low water pressure and poor quality of water.

Both, having no access to piped water as well as having access to unreliable water supply imposes costs on consumers. Households have to resort to alternative sources which include collecting water from public taps or tankers, purchasing it from street vendors or neighbours, building tube wells, investing in storage tanks and filtration systems etc. Apart from usually being of inferior quality these alternative sources are very expensive. Households have to spend money as well as considerable amounts of time (opportunity costs) to collect water.<sup>3</sup>

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<sup>3</sup> The cost of fetching water has been estimated at being almost equivalent to 150 million women days each year or 10 billion rupees per year (Navdanya 2006).

There are many studies that have estimated the cost of coping behaviour.<sup>4</sup> In a study of connected households in Delhi, Zerah finds that the annual average cost of water supply unreliability amounts to Rs. 2000 per household, more than half of which are opportunity costs (Zerah 1997: 15f.). A study on the costs of water supply in Sanjay Colony, an unauthorized slum in Delhi, has come to the following results: Although water is provided free of cost to the inhabitants by tankers from Delhi Jal Board, every household spends on average Rs. 236 per month on water. This is due to the fact that tanker water is not sufficient and therefore households have to buy water from additional sources. 66% of the monthly expenditures on water are opportunity costs. The price of water in Sanjay Colony is Rs. 45 per m<sup>3</sup> which is 6 times the amount that households would have to spend if they were connected to the official water network<sup>5</sup> (Sharma/Dimri 2006).

After the 73rd & 74th amendment of the constitution drinking water supply in rural areas and Urban areas comes under the Panchayat and local bodies respectively. As the cost of O&M, replacement of major component and depreciation will vary scheme to schemes, therefore, Panchayat/local bodies should have freedom to fix water price to consumers considering the above facts. During the initial period the price may be subsidised to an extent of 50% which should be tapered off over a period of five year or longer depending upon the capability of the users to pay the price. (from the speech of Governor Of Bihar in the 51st Meeting of National Development Council, 27th June 2005)

## **2.2. The supply side: Insufficient cost recovery**

In most developing countries revenues from water charges only cover part of the expenses for operating and maintaining the water network and do not

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<sup>4</sup> The Asian Development Bank estimates that the urban poor across Asia are paying 20 to 40 times more per litre than what connected users pay for water. A study on coping behaviour in Kathmandu found that coping costs are around 1% of current Nepalese citizen's income (US\$ 2.94)

(Pattanayak/Yang 2005). In Manila citizens have to pay US \$ 15 a month for non-connected water while connected users only have to pay US \$ 5 per month (Asian Development Bank 2006).

<sup>5</sup> The calculation is based on an average household water consumption of 5,280 litres per month and the current tariff structure of the Delhi Jal Board. For details on the DJB tariff structure see below.

contribute to financing capital costs at all because water user charges are too low.<sup>6</sup> Therefore utilities neither have enough resources to sufficiently invest in maintaining the existing network nor to expand it to new customers. Decisions on water tariffs are highly political. Utilities usually have to get the approval of the state government for tariff changes and therefore cannot act according to economic criteria alone but are also forced to follow political considerations.

Tariffs for domestic water in Delhi used to be among the lowest in the country ranging from US\$ 0.007 to 0.062/m<sup>3</sup> depending on the amount of water used (Asian Development Bank 2006; Asian Development Bank 2004: Part III).<sup>7</sup> In 2005 the Delhi Jal Board introduced a new tariff scheme under which prices for domestic water range from Rs. 6.7/m<sup>3</sup> (US\$ 0.14) (for 6m<sup>3</sup> of consumption) to Rs. 199/m<sup>3</sup> (US\$ 4.3) (for 40m<sup>3</sup> of consumption).<sup>8</sup> With this tariff structure the Delhi Jal Board achieves approximately 50% cost recovery.<sup>9</sup> Cost recovering connection fees are around Rs. 7,500 (US\$ 150) with only a few cities in India levying this much. Most utilities charge around Rs. 1,000 (US\$ 20) for a connection to the water network (Raghupati/Foster 2002).

In addition, revenue of the utilities is squeezed due to large amounts of non revenue water. In Delhi 53% of the annual water use is estimated to be non revenue water (Asian Development Bank 2004: Part I). Most water is lost

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<sup>6</sup> The Delhi Jal Board has yearly operational expenses of Rs. 500 crores and capital costs of Rs. 800 crores, (information provided by Ashish Kundra, Additional Chief Executive Officer, DJB).

<sup>7</sup> In Asia, the average tariff for domestic water is US\$ 0.18/m<sup>3</sup>; see Asian Development Bank (2004).

<sup>8</sup> Calculations are based on the following tariff structure: consumption charge: Rs. 0 for consumption between 0 and 6m<sup>3</sup>; Rs. 2 for consumption between 7 and 20 m; Rs. 7 for consumption between 21 and 30 m<sup>3</sup> and Rs. 10 for consumption over 30 m<sup>3</sup>. In addition fixed service charge of Rs. 40 (sewerage maintenance charge not considered), see Delhi Jal Board (2004-2005). Empirical studies have estimated that a reasonable benchmark of O&M costs for Indian metropolitan cities is around Rs. 15 (US\$ 0.30) per m<sup>3</sup>, see Raghupati/Foster (2002).

<sup>9</sup> Based on a study of water charging practices in 23 Indian metropolitan cities Raghupati and Foster conclude that “the charges levied on residential users – both for connection and onsumption, with or without meters and irrespective of the tariff structure chosen – are less than a 10<sup>th</sup> of the likely full economic cost. Hence, Indian water tariffs essentially fail to make any significant contribution to recovering the costs of service provision”, Raghupati/Foster (2002).

due to leakages in the pipelines. In Delhi leakage losses amount to 35-40% of the total water supply. In addition, water metering is insufficient or nonexistent and therefore consumers can't be charged according to their consumption.<sup>10</sup> Moreover, no revenue can be collected for water taken from public taps and illegal connections. Finally, revenues are lost because of unsatisfactory collection of user charges.

### **3. WATER AS A HUMAN RIGHT OR AS AN ECONOMIC GOOD?**

The main argument put forward by the proponents of subsidized water is that water is a human right and therefore shouldn't be treated like an ordinary good. Water provision should, it is argued, be in the hands of the government and paid for by taxpayer's money because otherwise water prices would be unaffordable for the poor. The main flaw of the "water as a human rights"-approach is that it overlooks the economic dimension of water. Water that is supplied at a highly subsidized rate is perceived as "free" by consumers. Consequently, it is wasted and not used in its most productive way. If the price of water is too low, supply will fall short whereas demand will increase leading to a water shortage. Water suppliers will fail to recover their costs and therefore will not have enough resources to invest. Consumers by contrast will demand water excessively (Segerfeldt 2005: chapter 6). Pricing water at a rate that covers costs contributes to collect sufficient revenue to deliver water services over the long run, maintain and extend the network and improve the service over time. In addition, it is an important incentive mechanism for customers to use scarce water resources carefully and improve the development of renewable water sources.

By relying on taxes rather than user charges as a mode of financing water related expenses, water utilities not only forgo the advantages of the price system but they are also left at the mercy of the government.<sup>11</sup> In times of sustained budget deficits public funds for infrastructure are in short supply. The system slowly deteriorates and service quality worsens.

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<sup>10</sup> In Delhi only 32.7% of the population have meters to control water usage; see Asian Development Bank (2004: Part I).

<sup>11</sup> It has been estimated that drinking water subsidies in India amount to Rs. 5,470.8 crore (US \$ 1.1 bn) per year which is equivalent to 0.5% of GDP, see Srivastava/Sen (1997).

#### **4. SUPPORTING THE POOR: THE NEED FOR AN EFFECTIVE SUBSIDY SCHEME**

The current system of subsidizing water for all connected households is not only inefficient but also inequitable because of its regressive effects.<sup>12</sup> As better-off households are disproportionately more connected than poorer households they benefit much more from subsidized charges than the poor do. In fact, 40% of the urban poor don't have a water connection and are therefore excluded from the subsidies build into the water tariff (Raghupati/Foster 2002). Unconnected households not only forego the subsidies but moreover usually have to pay a lot more money to buy water of relatively poor quality.

A more targeted subsidy scheme will bring about more equity and more efficiency at the same time. The least distorting way of targeting subsidies consists in means-tested income support measures. Water providers would levy a uniform volumetric tariff for every user according to marginal costs of producing water. Needy households would receive transfers in order to pay their water bill and the connection fee. Such a scheme leaves the price mechanism untouched so that it can exert its allocative and signalling functions.<sup>13</sup> Means-tested subsidy schemes can also be built into the water tariff itself. The uniform price with rebate tariff for example is a mixed tariff that consists of a uniform volumetric tariff and a fixed charge that becomes negative for poor households. The lump sum transfer to poor households is paid for by the fixed charge levied from better-off households (Boland/Whittington 2004).

However for income support measures to work properly different income groups need to be identified so as to target the subsidy to the needy. This requires an elaborate administrative system which is not in place everywhere. In addition, reliably identifying poor households in countries where large parts of income are gained in the informal sector is a major challenge.

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<sup>12</sup> For an analysis of water and electricity subsidies see Komives et.al. (2005).

<sup>13</sup> An example of a means-tested subsidy scheme for water consumption is the water stamps-program in Chile. After the privatization of the water sector the Chilean Government introduced a subsidy scheme targeted to poor households. The subsidies are paid by the Federal Government and distributed by the municipalities. Poor households receive between 25% and 85% of their fixed and variable water costs as a subsidy; see República de Chile (1989).

In many developing countries increasing-block tariffs (IBTs) that consist of a free or very low-price first block and increasing charges in higher consumption brackets are used to address distributional concerns within the tariff structure.<sup>14</sup> Such a scheme introduces cross-subsidies from customers with high water consumption to customers with low water consumption on the assumption that richer households consume more water than poorer households. It is however questionable whether IBTs best serve the purpose of redistribution. Firstly, consumption patterns between rich and poor households don't seem to be very different (Foster/Pattanayak/Stalker Prokopy 2003). Secondly, there often is a lot of political pressure on the utilities to extend the size of the subsidized block so that middle-income households also benefit from the subsidized charges (Boland/Whittington 2004). And thirdly ITBs have a regressive effect in cases where several poor families share water connections because they will end up in the highest price bracket (Water and Sanitation for All 2006).

In many cases it is not so much the monthly charge but the connection fee that constitutes the major financial obstacle to getting connected. If this is in fact the case subsidizing connection fees is a more suitable measure to help poor households. As most better-off households are already connected, the subsidy can be targeted relatively easily to poor households without further information on income levels etc. (Foster/Pattanayak/Stalker Prokopy 2003).

## **5. INTRODUCING DRINKING WATER USER CHARGES: TECHNICAL AND POLITICAL-ECONOMIC OBSTACLES**

The biggest technical challenge to introducing volumetric user charges is the installation and maintenance of meters for every household.<sup>15</sup> Utilities also need to be able to calculate the cost of producing water in order to charge cost-based water prices. Therefore, they need appropriate data and accounting mechanisms.

From a political-economic standpoint the main challenge is to overcome public opposition against user charges. Especially more affluent households will oppose reforms because they will be most hurt compared to the status quo. Yet they have most access to political decision makers and therefore can prevent or at

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<sup>14</sup> For a critical assessment of increasing-block tariffs see Boland/Whittington (2004).

<sup>15</sup> The case of Bangalore where all connected customers are metered and a very large percentage of meters work could be used as a role-model.

least retard reforms. To successfully implement reforms political decision makers have to make their plans transparent, be open to discussion and involve stakeholders. Political debates and hearings should be held, citizen's concerns taken seriously and addressed with adequate information. Special emphasis should be put on explaining the subsidy scheme for the poor. Furthermore, acceptance for reforms can be improved by increasing user charges only to the degree that the service of the utility has improved. This would imply government subsidies during the transition period. Once the service quality has markedly improved, service provision is transparent and providers can be held accountable, higher charges are more legitimate and customers will be more likely to accept them.<sup>16</sup>

ULBs/utilities need the right incentives to be willing to implement the reforms required under JNNURM. In the case of water reforms utilities should be given the responsibility of being in charge of drinking water provision. This requires that discretionary political interference from the state and municipal levels is eliminated and replaced by clear regulatory rules. In addition, public funding should – after the transition phase – be reduced to covering investment costs and costs for servicing the debt. As long as the utilities can expect to get public funding for O&M costs they will have no incentive to establish a cost recovering price system and increase efficiency.

## **6. WHAT NEEDS TO BE DONE: A REFORM AGENDA**

- Consumers should be charged for the water they consume so that O&M costs are recovered. Meters for all connected households have to be installed and maintained. From an economic point of view fixed volumetric charges are preferable. Price increases should be delayed so that consumers can experience the improvement in service, water quality and coverage before they have to pay higher charges.
- A well-targeted subsidy-scheme should be worked out so that needy households receive sufficient financial support to pay their water bills and the connection fee.
- Fixing the leaks should be given highest priority because the leaks constitute a major source of water and revenue loss.

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<sup>16</sup> The concept of delayed increases of water charges has successfully worked in an urban water project in Africa; See Briscoe (2005)

- The billing system should be improved in order to increase the amount of revenue collected for water.
- Illegal as well as free water sources (public standposts etc.) should be eliminated step-by-step as soon as more households get (legally) connected.
- Utilities should be made more accountable to citizens and run as independent parastatal agencies that are free from discretionary intervention from the State government.

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## CCS PUBLICATIONS

### **The Voluntary City**

Markets, Communities and Urban Planning



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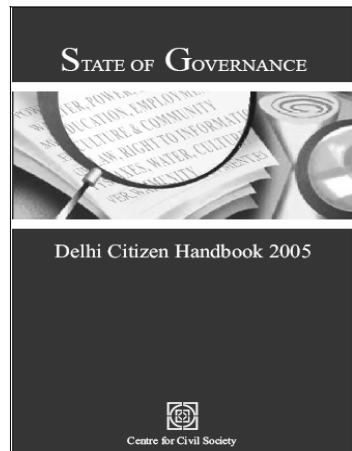
### **The Voluntary City**

*David T Beito, Peter Gordon and  
Alexander Tabarrok*

The book assembles a rich history and analysis of large-scale, private and voluntary, community-based provision of social services, urban infrastructure, and community governance to restore the vitality of city life. Such systems provide education, transportation, housing, crime control, parks and recreation, health care, employment, and more, by being more effective, innovative, and responsive than those provided through special-interest politics-as-usual and bureaucracy. The Voluntary City reveals how the process of providing local public goods through the dynamism of freely competitive, market-based entrepreneurship is unmatched in renewing communities and strengthening the bonds of civil society.

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# CENTRE FOR CIVIL SOCIETY

## *The Power of Ideas*

**The Centre for Civil Society is an independent, non-profit, research and educational organisation devoted to improving the quality of life for all citizens of India by reviving and reinvigorating civil society.**

India got her political independence in 1947 from the British state, but we still do not have complete social, cultural and economic independence from the Indian state. We aim to limit the domain of the state and make more space for civil society.

We champion limited government, rule of law, free trade, and individual rights. We are an ideas organisation, a think tank that develops ideas to better the world. We want to usher in an intellectual revolution that encourages people to look beyond the obvious, think beyond good intentions, and act beyond activism.

We are driven by the dream of a free society, where political, social, and economic freedom reigns. We are soldiers for a Second Freedom Movement.

The Centre's *Livelihood Freedom Test* calls to test all existing and new rules and regulations for their impact on the freedom to earn an honest living. Does any law of the city restrict opportunities of any person to earn an honest living, particularly the one that requires little capital or skills? If so, then Review, Revise, or Remove.

The *School Choice Campaign* is aimed at policy change in order to give education subsidies directly to the students, who would be able to choose the school they would like to attend. This will increase competition among schools and lead to better educational services. Fund Students, Not Schools. Join the Education Choice Campaign at <http://schoolchoice.in>!

CCS is creating awareness about *Ward Level Management*, where many of the current services, provided by the state and the Municipal Corporation, can be more effectively delivered by Ward Committees to their respective Ward. Decentralisation of services would bring transparency and accountability into the system.

*(continued from back cover)*

**Optional Reforms (Common to state and local bodies)**

1. Revision of bye-laws to streamline the approval process for construction of buildings, development of sites, etc
2. Simplification of legal and procedural frameworks for conversion of agricultural land for non-agricultural purposes
3. Introduction of Property Title Certification System in ULBs
4. Earmarking at least 20-25% of developed land in all housing projects (both Public and Private Agencies) for EWS/LIG category with a system of cross subsidization
5. Introduction of computerized process of registration of land and property
6. Revision of bye-laws to make rain water harvesting mandatory in all buildings to come up in future and for adoption of water conservation measures
7. Bye-laws on reuse of recycled water
8. Administrative reforms, i.e., reduction in establishment by bringing out voluntary retirement schemes, non-filling up of posts falling vacant due to retirement etc., and achieving specified milestones in this regard\*
9. Structural reforms
10. Encouraging public-private partnership\*

**The National Urban Renewal Mission (NURM)** is a project of the central government. Through this project, the central government will fund 63 cities for developing urban infrastructure and services. The cities will have to carry out mandated reforms in return. The mission will last for a period of seven years starting December 2005. The total central government funding will be Rs. 50,000 crores. Adding the contribution of states and municipalities, the amount will go upto Rs. 1,25,000 crores over the seven year period.

### **REFORMS UNDER NURM**

CCS research papers are available for the starred reforms.

#### **State Level Mandatory Reforms**

1. Effective implementation of decentralization initiatives as envisaged in the Constitution (Seventy-fourth) Amendment Act, 1992 \*
2. Repeal of Urban Land (Ceiling and Regulation) Act, 1976 \*
3. Reform of Rent Control laws, by balancing the interests of landlords and tenants \*
4. Rationalisation of stamp duty to bring it down to no more than 5 per cent within seven years
5. Enactment of public disclosure law \*
6. Enactment of a community participation law, so as to institutionalise citizens' participation in local decision making \*
7. Association of elected municipalities with the city planning function

#### **Municipal Level Mandatory Reforms**

1. Adoption of a modern, accrual-based, double entry system of accounting\*
2. Introduction of a system of e-governance using IT applications, GIS and MIS for various urban services
3. Reform of property with GIS, and arrangements for its effective implementation so as raise collection efficiency to 85 per cent
4. Levy of reasonable user charges, with the objective that full cost of operation and maintenance is collected within seven years \*
5. Internal earmarking of budgets for basic services to the urban poor
6. Provision of basic services to the urban poor, including security of tenure at affordable prices

*(continued on back page)*



**Centre for Civil Society**

K-36, Hauz Khas Enclave, New Delhi 110016.

Tel: 011-26537456/26521882 Fax: 011-26512347

Website: [www.ccs.in](http://www.ccs.in) E-mail: [nurm@ccs.in](mailto:nurm@ccs.in)