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Webinar Report

The Future of Urban Finance: The Way Forward

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Panellists:

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Moderator:

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Opening Remarks by SCUS Head

Ideas and intrigues – for urban India, nudge me to think and understand the design/framework. What comes to mind is ***'Spaghetti in a bowl'***[1]**,** a phrase coined by Professor Jagdish Bhagwati in 1995, often used in international trade to describe the complexities with respect to Regional Trade Agreements (RTAs), which were on the rise. Taking that conceptual framework into lateral understanding and application to Urban India- ***Spaghetti in a bowl*** depicts a challenge as India moves onwards to becoming the third largest economy by 2031. This phenomenon relates to the multiple agencies/parastatals responsible for urban development. Consensus building among all institutions and stakeholders is difficult, which stalls the development process. For example- we have Central Government, State Governments, Urban Local Bodies, and Regulatory Bodies that have stakes in the urban development of India.

As we move onwards from Amrut Mahotsav to Amrit Kaal, from 75 to 100 years of Independence, with the help of technology – digital, Artificial Intelligence (AI), and other emerging technologies - this will help us leapfrog into finding the solutions in the haystack-like framework, as we proceed to become a data-driven economy, throwing up a plethora of opportunities for Urban Development and Transformation in India.

The discourse is also changing positively, as resource persons delivering urban services speak the language of localising SDGs, and mitigation strategies for climate change and becoming increasingly conscious of the urban environment and its challenges. Further, as democratisation gets more vitalised, the participation of the marginalised stakeholders in decision-making will enhance liveability and address the challenges faced by urban India.

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[1] Spaghetti in a bowl**- The Spaghetti Bowl Effect** is an interesting phenomenon in trade economics where the increasing number of Free Trade Agreements (FTAs) between countries slows down trade relations between them.

- When it comes to urban finance - the 14th Finance Commission (FC) had earmarked INR 70,400 crores for urban development, while the 15th FC increased this by almost three times to Rs.1,21,250 crores. This is an outcome of the introduction of the Goods and Service Tax (GST) that has rendered Indian cities even more dependent on the centre and state for finances.
- With respect to city budgets, it can be observed that Brihan Mumbai Municipal Corporation (BMCC) has the highest budget of approximately INR 45000 crores. At the same time, Jaipur Municipal Corporation, the tenth largest city in India, has just a 2% budget - INR 895 crores compared with BMCC, and Thane Municipal Corporation, the 14th largest city of India, has a budget - INR 3300 crores 7.3% of what BMCC has.
- Navi Mumbai, a planned city since the 1970s, has emerged as a great city 40 years later and now has a budget of INR 4285 crores as on February 2022.
- There are 7935 census and statutory towns, with nearly 50% being governed by the former governance structures as rural entities.
- The 2011 definition of urban does not appropriately capture the extent of urbanisation in India as per various reports. The 2015 United Nations and World Bank report highlights India's urbanisation at over 50%.
- The European Union – GHSL (Global Human Settlement Layer) – uses open and free data and tools for assessing the human presence on this planet and has classified urban areas as urban centres, urban clusters, and rural grid cells.[2] The study reveals - 54% of India's population are already living in Urban centres in 2015, accounting for 53% of the built-up area and only 2.3% of the land. The urban cluster comprises 23.5% of the population in 25.7% of the built-up area occupying 3.1% of the land. While the rural grid has 23% of the population in 21% of the built-up area occupying 94% of the land – this will help us monetise land and plan and create new cities.

[2] Retrieved from https://ghsl.jrc.ec.europa.eu/documents/cfs01/V3/CFS_India.pdf

Professor O. P. Mathur
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Key Takeaways

The importance of urban finance will increase exponentially with more than 500 million people living in urban areas. Between the present and 2047, India will roughly add 330 million people to its urban population. But incidentally, we will be the largest country to register these many people as a part of the Urban population. China will only add 180 million people in this duration. India will have over a billion people as urban residents by 2047.

i. The importance of urban finance has to be linked with service provisioning for the ever-increasing million people with respect to urban housing infrastructure, urban services, etc.

ii. The bare minimum required is the doubling of stock infrastructure and services by 2047. This raises a vital question, how do we finance the doubling of infrastructure and housing stock? Where does the money come from? If we do not find the money, all these goals we have set for ourselves, like achieving a Gross Domestic Product (GDP) of $5 trillion by 2026 or being a developed nation by 2047, will all disintegrate.

iii. It is imperative to understand the fiscal framework, given that the 74th Constitution Amendment was enacted in 1992 – three decades ago, introducing three path-breaking amendments.

- Constitutional-led changes
- Statutory led changes and
- Project-led changes

iv. **Constitutional-led** changes mean the inclusion/incorporation of Article 243 (I) into the constitution, which deals with the establishment of state finance commissions. The insertion of sub-clause 3(c) in Article 280, deals with the Central finance commission and the measures needed to augment the consolidated fund of the state.

v. **Statutory-led changes**- The amendment of the Income Tax Act - Article 10.15 allows municipalities to raise tax-free bonds in the open market. Second is the recent change by the Securities and Exchange Board of India (SEBI), where the Corporate and municipal entities will be set up as Special Purpose Vehicles (SPVs) under the Companies Act 2013, bringing some commercial frame for Municipalities in India and making Municipal bonds a tradable commodity in the stock market in India and other foreign exchange markets.

vi. **Project-led changes in the form of** Centrally Sponsored Schemes (CSS) have changed the whole face of Urban Finance and Governance in the sense of how local bodies ought to be functioning. After the centrally sponsored schemes started increasing, two things happened as a result:

- Changes in the whole Framework of property tax from- rental based to unit based to Capital based; Grant system changing from open-ended grant to pooled grant.
- The outcome-based approach came into being.

vii. Post the 74th CAA, the municipal revenue and expenditure have not changed and remain at 1% of the GDP when we talk about the outcome. **This raises the question of how municipal revenues can become more viable to meet future requirements.**

ix. State transfers fall under four categories:

- State conditional grants
- State Finance Commission recommended grants
- Centrally Sponsored Schemes
- Central Finance Commission recommends grants in the form of multilevel responsibilities, which is what it ought to be anyway.

x. **Freebies** are the biggest deterrent to having viable finance. We do know from the existing literature that fiscal laziness exists, and that is because of the freebies. Hence, making it difficult to find sources for increasing finance. This has become a Universal phenomenon.

xi. **The willingness to pay but the unwillingness to charge phenomenon has emerged**. As a result, the business of recovering taxes has been utterly disregarded and ignored and hasn't been employed properly to raise municipal funds.

xii. There are other **fundamental issues like autonomy versus performance**. We had hoped that the 15th FC would recognise/acknowledge the autonomy of municipalities and they did so in the open paragraphs of the report. But when we look into the finer details, the word 'autonomy' has been given up by the commission giving **more weightage to the performance grants system instead of the traditional devolution.**

xiii. **Performance grants system:**
Appropriation of local public goods - while the Central Finance Commission (CFC) calls them the deliverable priority under the new fiscal agenda, under the new development priority (NITI Aayog Correspondence) - the local public goods like sewerage, solid waste management, and water supply have been occupied by this new development agenda. This is because the bare necessities have not been fulfilled by the cities or the states, putting tremendous pressure on the Central Government.

xiv. Urban Local Bodies' (ULB) have therefore witnessed a regressive stance based on the recommendations of the 15th FC, which imposes conditionality[3] - that is unlikely to be met. At

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[3] 15th Finance Commission has recommended INR 38,196 Cr in the form of Million Plus Challenge Fund (MCF) out of which INR 12,139 Cr is for ambient air quality and INR 26,057 Cr is for meeting service level benchmarks. Grants to MPCs is linked to the performance of these cities in improving their air quality and meeting the service level benchmarks for urban drinking water supply, sanitation and solid waste management. Source: https://cityfinance.in/assets/files/FC-XV%20recommended%20Urban%20Local%20Body%20Final%20Operational%20Guidelines%20for%202021-26.pdf

the same time, property taxes must be increased based on the state's GDP performance in the last five years. This makes a mockery of the autonomy system. However, there is no way to keep track of the state's GDP and wait for the FC's recommendation.

xv. Divisible pool- the 13th Finance Commission recommended that ULBs be made a part of the divisible pool, but that has been reversed by saying that municipalities will continue to be grants-in institutions. From a state where ULBs were moving forward to becoming self-reliant, it has now become a completely different scenario, and thus Article 280 3(c) does not hold with respect to the 15thFC.

xvi. Asset Monetization:

- Some of the municipality's assets are maintained in the asset registers as the notional value of Re.1.
- The second issue is to check whether these assets are mortgageable or not.
- And then other issues that have got added – like how do you finance the impacts of Climate Change? Do we need to come up with a climate change cess? How do we finance the SDGs? How are these to be levied by ULBs, the states, or the central government?

xvii. Land:

The land is the only resource being exploited by all three levels of the government. The central government levies capital gains taxes and stamp duty is levied by the state government. Barring some municipalities, which also levy a surcharge apart from these stamp duties, others lose in this regard. Therefore, they are only left with property taxes, a form of direct taxation in India. There are many examples worldwide from where we can learn and raise revenues.

xviii. The key takeaways include:

- Removal of fiscal laziness and appeasement
- Remove the unwillingness to charge
- Debate/Deliberate about the autonomy v/s performance

Dr Ravikant Joshi
World Bank Consultant,
Senior Fellow at Symbiosis Centre for Urban Studies

i. The 1994 renaissance witnessed in the field of Urban finance was short-lived.

ii. From 1994 to 2004, the fund transfers to ULBs were very low and stood at only INR 350 crores by the Central Government on account of urban development. During the same period, revenue grants were absent, like Family Planning and others, with the grants being scheme-based.

iii. Up to 50-60% of the Capital Expenditure was carried out with Municipal Bodies' revenue surplus. Capital Grants were merely 10% by state and central government assistance.

iv. It was therefore referred to as *Renaissance;* because every ULB was looking for sources of revenue.

v. However, over the years, the Central and State Finance Commission's grants increased from 2005 till today. This was particularly on account of the introduction of the Jawaharlal National Urban Renewal Mission –(JNNURM) in December 2005, wherein grants were the freebies provided to the ULBs.

vi. Post-2005, some municipal corporations did not depend on the Central Government for their day-to-day operative budget (Example - Vadodara Municipal Corporation).In Patna, Hyderabad, and Ahmedabad, area-based property tax reforms were introduced to raise the Municipal Corporations' revenues.

vii. Municipal bonds were short-lived and were halted post-2005 – after the implementation of the Jawaharlal Nehru National Urban Renewal Mission (JNNURM). The central government funding provided is usually in the form of tied aid. 85% of urban investment is through Central and State Government grants- with only 15% coming from municipal revenues or other sources.

viii. With the scrapping of Octroi and the introduction of GST – there has been a further decrease in the municipal corporations' revenue. For example - own revenue for Mumbai Municipal Corporation's revenue is just 50-55%, and for Ahmedabad, Surat's stood at 55% of the ULBs total budget.

ix. Further, about 45-50% of the city's budget comes in the form of tied grants under CSS and compensatory grants for GST, while capital investment is through State and Central Governments in the form of schemes.

x. The flow of funds has increased from INR 350 to INR 30,000 crores after Central Finance Commission's recommendations.

Challenges

- **Resource mobilisation has been absent at the local level.**
- The **Compound Annual Growth Rate (CAGR)** of municipal finance has been half that of the State Government. As a result, the **share of municipal finance has declined.**
- It is also observed that **fiscal discipline is absent.** Earlier municipal bodies' operative costs were lower than their expenditure; hence there was a scope for capital expenditure.
- Further, most ULBs depend on the Central and State Govt for a large part of their finances.
  - 50-60% of ULBs operative/revenue accounts are managed by the State and Central government.
  - 70-80% of the capital accounts requirements are being taken care of by the Central and State govt.
  - Hence, this **fiscal deterioration** is going unnoticed.
- Funds are coming in the form of central and state-sponsored schemes that ULBs are unable to utilise. ICRIER Report 2018 states that INR 38,000 crores closing balance of 23% of municipal expenditure is not being utilised, and about INR 60,000 crore

remains unutilised under JNNURM. Approximately INR 100,000 crore has already been spent in the urban sector till 2022. The cities are still witnessing several unaddressed issues like water logging, traffic jams after incessant rains in Bengaluru, and rising air pollution levels in cities like Delhi and Pune.

- The **role of borrowings** in a city's budget has been completely side-lined.
- CRISIL report says that the top 30 cities could have borrowed approximately INR 70,000 crores, but the present-day reality is that their borrowings are less than INR 5000 crores (7 %). Therefore a case of an opportunity lost.
- **Accounting and budgeting practices** have remained rudimentary. Financial management is also conventional and outdated.
- Audits are rarely conducted, and **transparency is negligible**.
- More than 59% of the ULBs are not putting their balance sheets/annual accounts online; hence, **accountability is missing**.

Next 25 years (2022-2047):

- The municipal bodies must become professional entities by improving the accounting and financial management systems, bringing the component of outcome budget. Lastly, service level benchmarks need to be specified. This would improve the value for money aspect.
- Auditing needs to be changed from rudimentary/proprietary audits to performance audits. Amendment in Municipal Act is needed to change the way of accounting and auditing to the 'Double Entry' method.
- Budgeting techniques need to be changed to outcome budgeting techniques and performance budgeting.
- We need to see whether municipalities can apply the growth rate of the State's GDP in the past 5 years and keep that as a target for revising their growth rate targets, not to lose the grants, which the finance commissions have recommended.
- In this regard, the Kelkar Committee had suggested introducing property tax boards. However, the 14^{th} Finance Commission did not suggest the establishment of property tax boards. Discontinuity of recommendations by the finance commission has been a deterrent for Municipalities.

Prof. Jyoti Chandiramani:

- The existing structures of governance are ever evolving – for example, Delhi had five municipal corporations before, but now they have merged three into one - changing the governance structure.
- While Navi Mumbai Municipal Corporation (NMMC) - in its budget for 2022-23, has decided not to increase the property tax rates and also waive the same for houses under 500 sq feet, the corporation has planned to use Light Detection and Ranging Survey (LiDAR) technology to survey properties in the city. The NMMC expects an increase in tax collections as the survey will highlight many existing properties that have added floors and areas, which will be recorded in the new survey conducted.
- It's been 11 years since the last Census was conducted, and new Census Towns are likely to emerge, a natural phenomenon of urbanisation. The governance of the existing and new Census Towns will also need earmarking of funds for their service delivery and other basic functions that must be addressed.

Question and Answers:

Prof. Sandhya Iyer, TISS Mumbai

While decentralization provided the emphasis on local-level development in the planning process, has our idea of urbanization failed?

74th CAA talked about cities, urban agglomerations, multiple municipal corporations, and interconnected economic spaces. During COVID-19, cities forego revenues by reducing property taxes and giving rebates. How would cities function? Under the smart cities mission, tier II cities' ranking is better than traditional cities. Have we created a duality in phenomenon?

Answer: There have been many transitions over the years since 1992. From the time when India was living in rural areas, now everywhere we see and hear that transition into urbanised societies – there is a need to emphasise small cities – which led to the creation of the Integrated Development of Small Towns and Medium Towns[4].

Globalisation has a positive correlation with urbanisation. In India, unfortunately, the 1990s was a dramatic decade not only because of globalisation but also because of the introduction of municipal bonds, then JNNURM, the repeal of the Land-ceiling Act, and the amendment in the Income Tax Act. All this happened over a period of one and a half decades.

Further, the impact of FDI was greater on the GDP – when compared to any of the other indicators for Urbanization. There is a direct correlation with Urbanisation and the FDI coming to the cities. Prof. Mathur mentioned in his paper in 2002 that 7 cities had 70% of the total FDI to India, which has resulted in the phenomenon of Urbanisation like malls, high-rise buildings, and development of cities like Gurgaon, NOIDA.

Prof. Amar Maloda (MIT, Pune)

Apart from population and proximity to the cities, what other criteria should be kept in mind to merge fringe areas into a greater municipal corporation? Because mergers will lead to an increase in service provisioning and ULBs lack finance.

Answer: The merger of fringe areas is a natural process. Peri-urban area in this case, these villages do not look like rural areas and seem more urban-like. But it's the discretion of the State government whether to create them like Panvel Municipal Corporation, Vasai- Virar Municipal Corporation, Mira- Bhayandar Municipal Corporation or merge it with the central city's municipal corporation.

If the government merges fringe areas into the city's municipal corporation, it will bring a financial burden on the ULB, but at the same time, they are likely to help the city prosper. These areas may often be manufacturing hubs, and the people migrate to the cities. In the absence of mergers, these areas would remain underdeveloped.

A study conducted by Symbiosis School of Economics (SSE) - in the 23 merged villages of Pune under the Pune Municipal Corporation (PMC) found that the merger was necessary and

[4] The Centrally sponsored scheme of Integrated Development of Small & Medium Towns (IDSMT) was initiated in the year 1979-80 and is continued with timely amendments and modifications upto2004-2005 and in December 2005 it was subsumed in UIDSSMT Scheme. Investment in the development of small urban centres would help in reducing migration to large cities and support the growth of surrounding rural areas as well. (https://mohua.gov.in/upload/uploadfiles/files/integrateddevelopment.pdf)

could not have been avoided. But at the same time, town planning (regional planning) should have been carried out earlier so that the full potential of these areas could have been realised. While challenges with this merger also exist, placing pressure on PMC, in the long run, this may translate into creating two separate municipal corporations in Pune – the East and West Pune Municipal Corporation.

Rudra Murthy (IIT Kharagpur)

What are the other sources of tax and non-tax revenue to enhance municipal revenues? What Urban Governance model should Indian cities follow?

Answer*:* We have tried different governance models. But, the Mayor-in-council model system functions well (personal opinion of Prof. Mathur). The powers that Mayor in the council had with respect to the urban development minister (West Bengal Government) defined how municipal corporations would function.

For example, JNNURM required repealing the Land Ceiling Act, which was one of the conditions for releasing the funds. Ministries had given some states to NIPFP, NIUA, and some administrative staff in order to monitor how State Governments were implementing the JNNURM agenda.

Repealing the Land Ceiling Act was against the Communist Party's agenda. Nonetheless, taxing households that possess more than 500sq.ft would deter people from coming and ask for rebates (Kolkata Municipal Corporation).

For example- Urban Governance in Delhi.

There is Union Government, State Government, and Municipal Corporation in Delhi. Political Economy plays an important role in such situations. Delhi Government was blaming Punjab till last year for the rise in air pollution post-Diwali and harvest season-stubble burning cases. Because the governments in Delhi and Punjab are from the same political party, Delhi Government is actively saying that air pollution is a national problem and not a local problem anymore, as Faridabad (Haryana), NOIDA (Uttar Pradesh) are also facing similar impact of air pollution.

Ranjit Gadgil (Parisar)

Urban Governance reforms are happening at a global level. What conditions would apply to Urban Governance reforms in India? What will trigger the changes? Can industries play the role of Civil Society Organisations as well as academia is not enough to bring about changes?

Answer: Work on Articles 243 (W) and 243 (X)[5] is needed. A process has to be initiated to repeal and amend these two articles, as they have done tremendous damage to the autonomy

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[5] Article 243 (w)- Subject to the provisions of this Constitution, the Legislature of a State may, by law, endow- (a) the Municipalities with such powers and authority as may be necessary to enable them to function as institutions of self-government and such law may contain provisions for the devolution of powers and responsibilities upon Municipalities, subject to such conditions as may be specified therein, with respect to-(i) the preparation of plans for economic development and social justice;(ii) the performance of functions and the implementation of schemes as may be entrusted to them including those in relation to the matters listed in the Twelfth Schedule;(b) the Committees with such powers and authority as may be necessary to enable them to carry out the responsibilities conferred upon them including those in relation to the matters listed in the Twelfth Schedule.

of the Urban Local Bodies. A book/set of best practices need not be the best solution, as what works for one city might not work for other. The macro picture has to change to see the real changes. Working on Articles 243 (W) and 243 (X) might help in changing the overall framework of Urban Local Governments.

Article 243 (x)- The Legislature of a State may, by law,-(a) authorise a Municipality to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedure and subject to such limits; (b) assign to a Municipality such taxes, duties, tolls and fees levied and collected by the State Government for such purposes and subject to such conditions and limits; (c) provide for making such grants-in-aid to the Municipalities from the Consolidated Fund of the State; and (d) provide for constitution of such Funds for crediting all moneys received, respectively, by or on behalf of the Municipalities and also for the withdrawal of such moneys therefrom, as may be specified in the law.