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Municipal finance in India: An assessment

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Abstract
Urbanization is sine quo non of economic development. Rapid urbanization coupled with increasing population throws up enormous challenges to local governments in India. One of the key concerns for the local governments is providing basic infrastructure facilities and quality services as well as improving living standards for the citizens. This situation requires the Urban Local Bodies (ULBs) to find innovative ideas for solving the infrastructure and service delivery problems and for creating a larger pool of funds for strengthening the ULBs. With the help of the available literature, the paper attempts to assess critically the main problems of municipal finances in India and to bring out the challenges that the municipalities face with respect to revenue generation and expenditure management. The main findings suggest that the urban local bodies in India are confronted with lack of proper decentralization of functions and finances, inadequate revenue generation, expenditure shortfalls leading to poor service delivery. ULBs have become increasingly dependent on transfers from higher levels of government and have shown a persistent decline in their own revenues. GST has been a blow to the fiscal autonomy of the urban local governments since it has subsumed the most local taxes such as octroi, entry tax, advertisement tax and local body tax. The GST Council has to address this challenge to municipal finances urgently. The 15th Finance Commission recommend that state transfers to urban local governments increase at the rate of 25 per cent per annum over the devolution period of the 15th Finance Commission. State transfers to urban local governments are proposed to be increased from 0.33 per cent of GDP in 2017-18 to 0.70 per cent of GDP by 2024-25. It also analyses the suggestions and recommendations that have been offered in the literature to cope with these critical challenges relating to urban finance.

Keywords: municipal finance, urban local bodies, per capita income, per capita expenditure, municipal revenue, municipal expenditure, inter government transfers

1. Introduction
At present, urbanization will be the most significant issue all over the world and the largest agglomerations will be in the developing countries such as India. Several different reasons help explain this structural shift, especially since 1947 with India's independence. The rise of a more diversified economy, combined with a growing reliance on heavy industry, is one major factor. Similarly, important are the 1991 economic reforms, helping to spread greater market activity and investment across country. With a focus on service industries, India has also experienced a notable transition from rural and semi-urban areas to urbanized growth centres. Better infrastructure facilities and economic opportunities are constantly attracting more people into urban areas. In the reverse, rural areas struggle with economic distress, agricultural stagnation, and limited infrastructure development. However, many areas are urbanizing in an unplanned manner, and a large number of unrecognized slum communities have developed around the peripheries of major towns and cities. Urbanisation is taking place at quite a rapid rate in India. Population residing in urban areas in India, according to 1901 census, was 10.84%. This count increased to 28.53% according to 2001 census, and 31.16% (377 million people) in 2011 census. In 2020, the numbers increased to 34%, according to the World Bank. The survey was conducted by UN State of the World Population report in 2007, by 2030, 40.76% of country's population (Approximately 600 million people) is expected to reside in urban areas. When it comes to the rate of urbanization, India ranks far behind other emerging economies such as China (45%), Brazil (87%), and Mexico (78%), but is comparable to Burma (34%) Nigeria (34.3%), Pakistan (33.6%), Indonesia (34.5%) and Guinea (35%). The share of India's urban population has risen steadily during the past few decades.

As per World Bank, India, along with China, Indonesia, Nigeria, and the United States, will lead the world's urban population by 2050. Urbanisation is a trend unique to the past few decades. By 2050 it's projected that two-third of the world population will live in urban areas, (more than 7 billion people) according to the World Bank. People tend to be migrated from rural to urban areas as they become richer and higher standard of living. Rapid urbanization has challenged the Urban Local Bodies (ULBs) or Municipal Councils (MCs) and are failing short of fulfilling expectations of citizens.

The central government of India has planned about developing of '100 smart cities. The development of such cities would entail substantial expenditure for creation of urban infrastructure such as the water supply, sanitation, public health, roads, markets, schools and colleges, transport arrangements, etc. These developments will require substantial number of financial provisions. Rs. 39.2 lakhs crore (at 2009-10 prices) is the estimated requirement of investment for urban infrastructure over the period from 2012 to 2031 (GoI, 2014). Investment in the infrastructure sector in the Fourteenth Plan has been estimated at Rs. 60 lakhs crore. Indian investor has yet not explored the municipal bonds market, which needs to be examined. The Urban Local Bodies (ULBs) have to provide basic services to the citizens and have a vital role in the State's socio-economic transformation. Most of the ULBs are severely stressed in terms of infrastructure and effective service delivery. India's present Urban Population is 48.19 crore (34.93%). The increase in the growth of urban Population and upcoming new ULBs need more resources to meet the requirements of the people. The major challenges of the ULBs are indicated below.

- Migration from Rural to Urban Areas.
- Widening urban infrastructure deficit - Water Supply, Improving, Monitoring and Delivery of Public Services.
- Addressing Regional Imbalances.
- UGD, Sanitation and Solid Waste Management.
- Power supply, shortage and pollution control.

1.1 Urban Finance in India

Own revenues, consisting of tax (of which the property tax is a major source) and non-tax revenues declined to 53 percent of the total revenues of Municipalities in India in 2007-08 from 63 per cent in 2002-03 (Twelfth Five Year Plan). The rest is accounted for by grants, assignment and devolution by State Governments, grants from Central Government and Finance Commissions. Various ways of augmenting the resources of the municipal bodies in the country, including essential reforms in the property tax system and adequate exploitation of user charges and fees for various services delivered as well as ways of strengthening and improving central and state transfers to urban local governments, are explored in Rao and Bird (2010, 2011). With respect to financing urban infrastructure, judicious use of development charges and effective collections from public lands are recommended in general. In addition, development of the municipal bond market is also advocated for financing capital expenditures.

2. Review of literature

A comprehensive literature review was conducted to obtain the information or pursuing the objectives of present study. Information was obtained from books, academic journals, government and institutional reports.

2.1 Sandeep Thakur (2006): Examined the fiscal performance of the municipalities from different states and seeks explanation for differential performance and also examined the fiscal performance of municipalities from the same state and rank of these cities on the basis of their fiscal performance. The major conclusion of this study as follows: - Municipalities cannot be compared merely on the basis of per capita incomes and expenditures. - Municipalities differ because of their Fiscal and Functional Domain. - Across States and within States bigger municipalities have larger functional domain and larger control over their tax and non-tax administration. - State Municipal Acts also differ in allotting tax powers and functions between Municipal Corporations and Municipalities.

2.2 Abhijit Dutta (2007): In his study titled "Municipal Finances", he has given a holistic perspective on the municipal finances, functions and revenues. He tried to find out as to how corporations rising their revenues. He has analysed all the avenues of revenues to the municipal bodies. He has analysed the fiscal and financial management by municipal bodies without forgetting the obligations of such bodies towards the general public. He has given some useful suggestions for the betterment of the financial position of the municipal bodies.

2.3 Mohanty, Mishra *et al*. (2007) [1]: In the book called 'Municipal finance in India: An Assessment', found that on an average for the period 1999- 2000 to 2003-04 actual spending in 30 large municipal corporations in India is only about 24 per cent of the requirements established by the Zakaria Committee. While there was considerable variability in the sample, the extent of 'under spending' on urban services was over 75 per cent in 17 municipal corporations, and indeed over 50 per cent in all of them except for three: Pune (31.6 per cent), Nagpur (30.8 per cent), and Nasik (35.5 per cent). At the other extreme, spending in the Patna Municipal Corporation was estimated to be only 5.6 per cent of the normative requirement, and the shortfall was over 90 per cent in almost all municipal corporations in the poorest States of Uttar Pradesh and Bihar.

2.4 Om Prakash Mathur (2013) [6]: The article addressing the issues before Fourteenth Finance Commission regarding the finances of municipalities, has focused on the finances of municipalities in India and stated that they are in a highly unsatisfactory state, adversely affecting, on the one hand, the productivity of cities and towns and, on the other, the quality of life. Moreover, the fiscal implications of rapid urbanization stare us in the face and failure to take appropriate action on this front will have adverse consequences for India's growth and development trajectory. The Finance Commission's grants-in-aid over the years have not been able to bridge the vertical fiscal gap of municipalities.

2.5 Mehta Ketan J. (2013): In his research works entitled "A Comparative Study on Public Expenditure and Income of Rajkot Municipal Corporation" examined economic and social work of Rajkot Municipal Corporation during 2007-08 to 2011- 12 and found that revenue income, revenue expenditure, capital income and capital expenditure are increased. But in comparison between income and expenditure, expenditure is 1.91% higher to income.

2.6 Ramanathan and Dasgupta (2016): Estimates cumulative capital investment requirements for providing services at 2007 prices for the period 2006-2031 at Rs. 71,251 billion and O&M requirements at Rs. 10,031 billion. This works out to an annual average of Rs. 3,251 billion or about 25 per cent of the consolidated revenue receipts of the Centre and States.

2.7 Bhattacharyya, Anupam Dey and *et al*. (2017): Are of the view that the major portion of grant is usually sent at the end of the year and little scope for utilisation. Therefore, there is a need to use developed e-governance process for timely remittance of grant and related information. Political intervention in decisions making process of the elected body should be avoided to restrict fund diversion and making unfruitful revenue expenditure often found in engaging casual labours or undertaking illegitimate repairing work as these minimise the available amount for infrastructure development. Ideal urban infrastructure development process depends upon timely receipt of grants and subsequent release of grant depends on timely utilisation of earlier instalment. Therefore, ULGs should adopt financial analysis, planning and control process to avoid such delays so that these governments also become a true contributor in the process of urban infrastructure development.

2.8 Isher Judge Ahluwalia (2019) [3]: Examined that the planned urbanization is crucial for the sustainability of rapid growth and for improving the quality of life of the 420 million people living in Indian cities and towns. Though investing in urban infrastructure to bridge the infrastructure investment deficit and upgrading its quality is very important, the analysis clearly suggests that institutional reforms are crucial both for reaching out to the private sector for sharing the financing burden of infrastructure and for ensuring that the expansion of infrastructure results in improved service delivery.

3. Objectives of the Study

1. To understand the trends of Municipal Revenue and Expenditure as per cent of GDP
2. To study the Municipal Tax Revenue, Non-Tax Revenue and Own Revenue of the country.
3. To analyse the Municipal Own Revenue and Intergovernmental Transfers as per centage of total Municipal Revenue.
4. To evaluate the CFC Grants Per Capita and State Transfers Per Capita for the year 2017-18

4. Hypothesis of the study

1. **H_1:** There is no significant difference between the growth rates of Municipal Revenue and Expenditure as per cent of GDP of the country.
2. **H_2:** There is no significant difference between the growth rates of Municipal Tax Revenue, Non-Tax Revenue and Own Revenue of the country.
3. **H_3:** There is no significant difference between the growth rates of Municipal Own Revenue and Intergovernmental Transfers as per centage of total Municipal Revenue.
4. **H_4:** There is no significant difference between the growth rates of CFC Grants Per Capita and State Transfers Per Capita for the year 2017-18

5. Research methodology

In order to examine the financial performance of the municipalities of the country, quantitative research method has been used. Secondary data were collected on Municipal Revenue and Expenditure, Municipal Tax Revenue, Non-Tax Revenue and Own Revenue of the country. Municipal Own Revenue and Intergovernmental Transfers, CFC Grants and state grants. Comparative study of municipal revenue and expenditure for a period from 2007-08 to 2017-18 has taken into consideration. The survey consists of Secondary data have been collected from the published and unpublished sources such as RBI annual reports, government records, Government annual reports, municipal audit reports, books, journals, periodicals, etc.

5.1 Statistical tools used

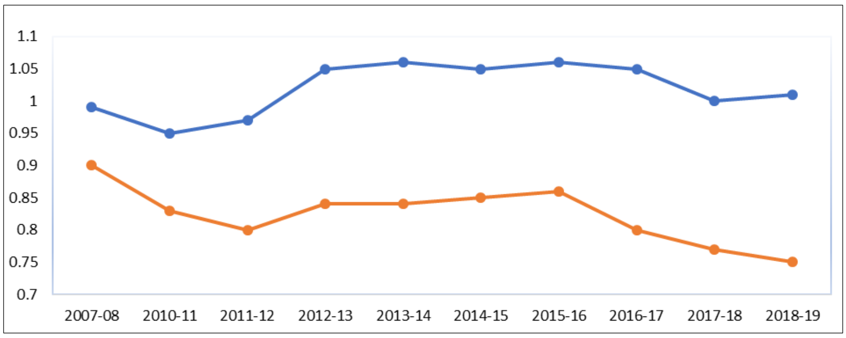
In order to analyse the financial performance of Municipalities in India, the data will be collected and analysed with appropriate statistical tools. Averages, Percentages, ratio analysis have been used.

6. Municipal Finance Trends

Finances of urban local governments in India are in a state of decay. There is a growing mismatch between their responsibilities and revenues. Municipal revenues and expenditures as per cent of GDP are in a state of decline and have not kept pace with the increasing needs of the urban centres. Municipal own revenues lack buoyancy leading to a decline in their financial autonomy and increase in their dependence on transfers from higher levels of government. Property tax, a major source of revenue for metropolitan cities around the world, has remained stagnant in Indian cities. The latest blow has been from the introduction of GST which has subsumed local taxes such as octroi, local body tax, entry tax and advertisement tax, without any provision for compensation at the municipal level.

6.1 Municipal Revenue and Municipal Expenditure (per cent of GDP)

Municipal own revenue as percent of GDP (blueline) rose between 2010-11 and 2012-13 but has declined thereafter. In 2017-18, own revenue stood at 0.43 per cent of GDP, the lowest in the last eight years. Municipal tax revenue forms a major yet declining share of own revenue (Chart 6.2). Null hypothesis (H_1) is rejected and alternative hypothesis (H_{a1}) accepted as there is a difference between the growth rates of Municipal Revenue and Expenditure as per cent of GDP of the country.

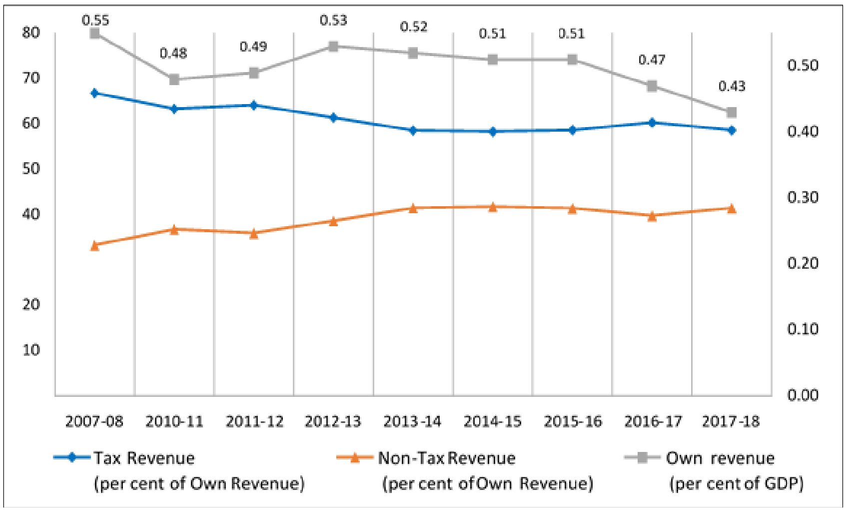


(**Source:** Annual reports of RBI)

Chart 1: Municipal Revenue and Municipal Expenditure (per cent of GDP)

6.2 Municipal Tax Revenue, Non-Tax Revenue and Own Revenue (Chart 6.2)

It includes property tax, profession tax, entertainment tax, and the recently abolished octroi/entry tax and advertisement tax, among others, with the taxes levied varying across states. However, in most states, local taxes other than property tax have been taken over by the states over the years. While combined tax revenues for Centre and States as a percentage of GDP have increased from 16 per cent in 2010-11 to 18 per cent in 2017-18 (RBI 2018), municipal tax revenue to GDP ratio has declined from 0.30 per cent to 0.25 per cent in the same period (Table 6.1)



(**Source:** Annual reports of RBI)

Note: Own Revenue is plotted as per cent of GDP on the right vertical axis. Tax and non-tax revenue are plotted as per cent of own revenue on the left vertical axis.

Chart 2: Municipal Tax Revenue, Non-Tax Revenue and Own Revenue (Per cent)

At present**,** property tax remains the only major tax in the municipal portfolio in India and it contributed about 60 per cent to municipal tax revenue in India in 2017-18. By contrast, municipalities in other parts of the world have access to a much wider basket of taxes. Municipal revenue sources in China include business taxes, real estate tax, resource taxes, urban land use tax, land appreciation tax, urban maintenance and construction tax, farm land occupation tax, deed tax, tax on vehicles etc. Null hypothesis (H_2) is rejected and alternative hypothesis (H_{a2}) accepted as there is a difference between the growth rates of Municipal Tax Revenue, Non-Tax Revenue and Own Revenue of the country.

Table 6.1: Municipal Finance Indicators (per cent of GDP)

Year	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Municipal own Revenue	0.48	0.49	0.53	0.52	0.51	0.51	0.47	0.43
Tax Revenue	0.30	0.31	0.32	0.30	0.30	0.30	0.28	0.25
Non-Tax Revenue	0.18	0.18	0.20	0.21	0.21	0.21	0.19	0.18
General Transfers	0.07	0.07	0.08	0.09	0.08	0.10	0.13	0.12
CFC Grants	0.03	0.03	0.04	0.05	0.04	0.05	0.08	0.07
Other Central Transfers	0.04	0.04	0.04	0.04	0.04	0.04	0.05	0.05
State Transfers	0.28	0.30	0.34	0.35	0.35	0.34	0.34	0.33
Borrowings	0.04	0.03	0.02	0.03	0.03	0.03	0.03	0.02
Other Sources of Revenue	0.07	0.09	0.08	0.08	0.09	0.08	0.08	0.10
Municipal Revenue Total	0.94	0.98	1.05	1.06	1.05	1.06	1.05	1.00
Municipal Expenditure	0.82	0.81	0.83	0.83	0.86	0.86	0.81	0.78

(**Source:** Annual reports of RBI)

Table 6.2: Composition of Municipal Tax Revenues: Selected cities (per cent)

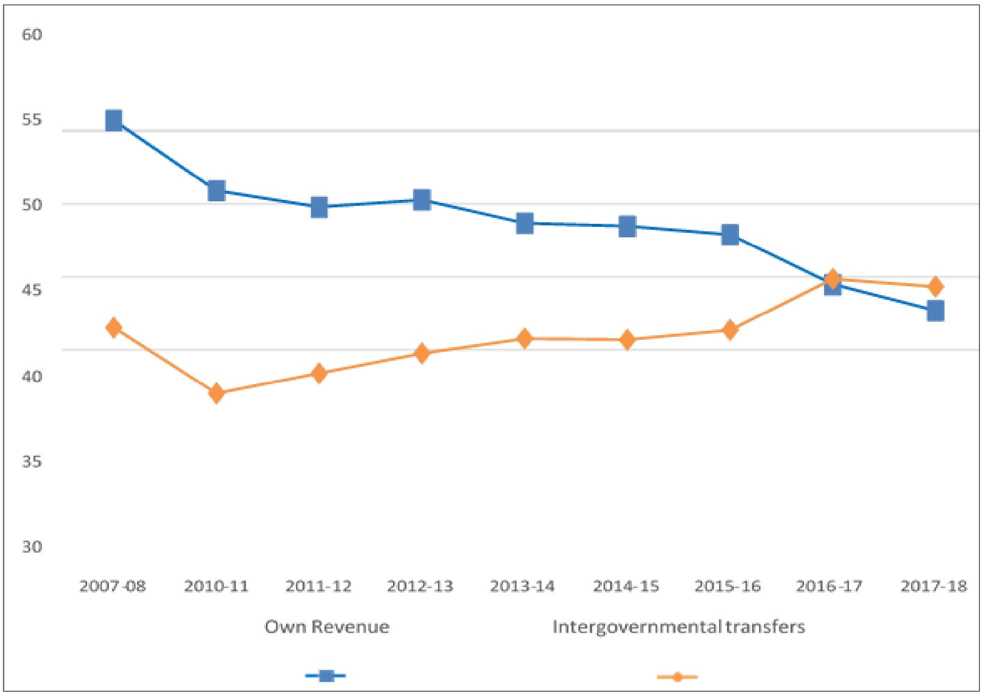
City	Barcelona	Beijing	Buenos Aires	Lima	Sao Paulo	Delhi
Property Tax	64.7	8.1	9.0	58.8	38.2	88.8
Sales Tax	11.8	39.3	×	×	53.9	×
VAT Share	12.0	9.4	78.5	×	×	×
Vehicle Tax	8.6	0.6	8.7	22.6	×	×
Construction Tax	2.9	3.7	×	×	×	×
Individual Income Tax	×	9.3	×	×	6.6	×
Excise Tax	×	×	×	8.3	×	×
Stamp Tax	×	1.7	3.8	×	×	×
Utilities Tax	×	×	×	×	×	11.2
Deed Tax	×	5.4	×	×	×	×
Gambling Tax	×	×	×	7.9	×	×

Table 6.2 presents a comparison of municipal tax basket of some selected cities from across the world with Delhi. While property tax accounted for the bulk of Delhi's tax revenues in 2010, cities around the world had access to other taxes such as sales tax, VAT share, income tax, registration tax/stamp duty, vehicle tax, and construction tax. In 2017-18, property tax revenue as a share of GDP in India was 0.15 per cent which is far below the level of 1 per cent estimated for recurrent taxes on immovable property in OECD countries (OECD Revenue Statistics 2018).

In the Indian context, the potential of property tax is far from realized. State governments have neglected property tax as a source of revenue because of their inability to fix the administrative challenges of coverage, assessment, valuation and the political difficulty of enforcement. The potential of property tax needs to be fully leveraged by broadening the tax base through extending coverage, revising rates from the very low current rates to get closer to international norms in other developing countries, improving the assessments system as in Bengaluru, more frequent property revaluations to reflect the impact of rising prices including through methods such as indexing to inflation, and improving the efficiency in municipal tax administration which is generally very poor across most Indian cities. Non-tax revenues largely comprise user charges (including for water), fees, rentals from municipal property, etc. The share of non-tax revenue in own revenue has increased significantly from 33 per cent in 2007-08 to 41 per cent in 2017-18 (Chart 6.2). User charges, fees inclusive of water charges constituted more than 60 per cent of non-tax revenue in four out of the five years between 2013-14 and 2017-18. There is high potential for raising non-tax revenues further, especially given the record of poor cost recovery of services by urban local governments.

6.3 Municipal Own Revenue and Intergovernmental Transfers

The primary role of central and state transfers to urban local governments is to supplement the own sources of funds of urban local governments and reduce vertical and horizontal imbalances. The dependence of the municipal sector on the higher levels of government has increased as manifest in an increase in transfers as a proportion of total municipal revenue (Chart 6.3). In comparison with 2.1 per cent of GDP in Denmark, 6.0 per cent in Norway, 7.8 per cent in Italy, and 9.9 per cent in United Kingdom, such transfers account for a meagre 0.45 per cent of GDP in India (Mohanty 2016) [4]. By contrast, transfers from central government to state governments as a ratio of GDP in India amounted to 7.23 per cent in 2017-18 (RBI 2018).



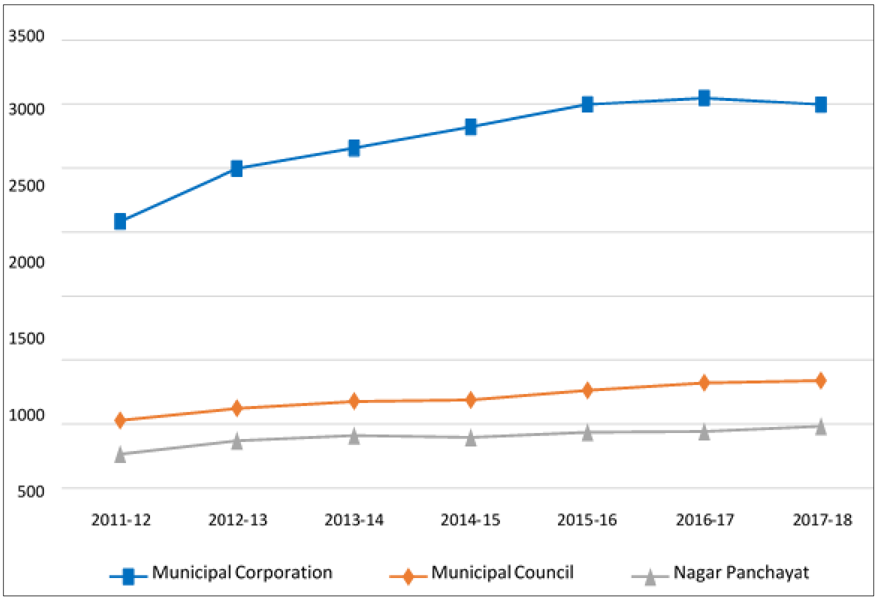
(**Source:** Annual reports of RBI)

Chart 3: Municipal Own Revenue and Intergovernmental Transfers (per cent of Total Municipal Revenue)

As is to be expected, state transfers to urban local governments are much larger (3:1) than central transfers to urban local governments, since urban development is the constitutional responsibility of state governments. However, due to a significant rise in transfers from the center to state governments resulting from the award of the Fourteenth Finance Commission, transfers to urban local governments have increased in 2015-16, 2016-17 and 2017-18. Null hypothesis (H_3) is rejected and alternative hypothesis (H_{a3}) accepted as there is a difference between the growth rates of Municipal Own Revenue and Intergovernmental Transfers as per centage of total Municipal Revenue.

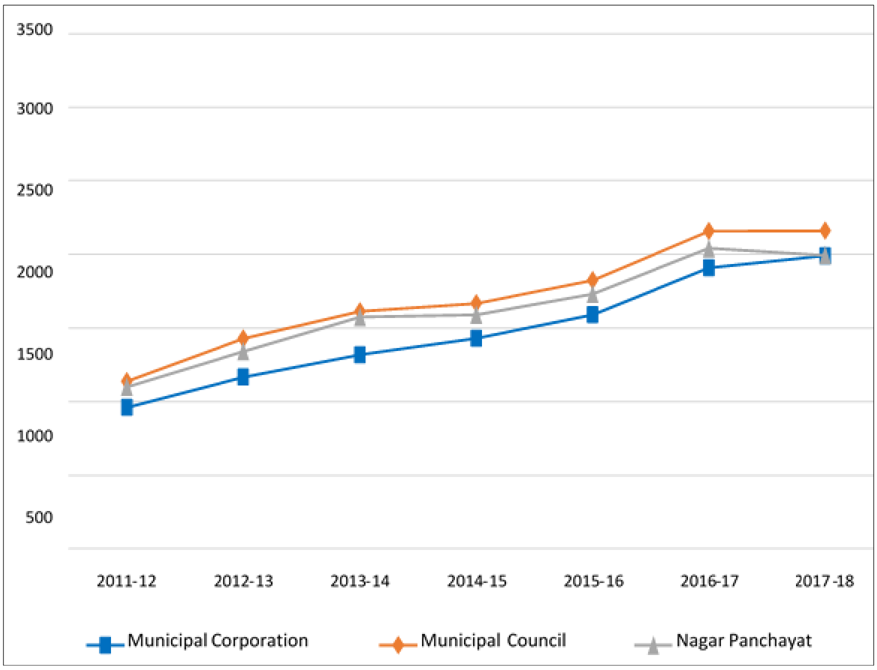
6.4 Own Revenue of Urban Local Governments Per Capita

The ratio of own revenues to total revenues declined across the board in 2017-18 compared to 2012-13. The smaller municipalities i.e. Municipal Councils and *Nagar Panchayats* fare far worse than Municipal Corporations in this respect. The latter contribute nearly 80 per cent to India's municipal own revenue. While own revenue per capita of Municipal Corporations is much higher than of the Municipal Councils and *Nagar Panchayats* (Chart 6.4), per capita transfers are much the same as shown in Chart 6.5. In 2017-18, per capita own revenue of Municipal Corporations was about four times and more than six times that of Municipal Councils and *Nagar Panchayats* respectively. Tax revenue as a share of total municipal revenue was 30 per cent for Municipal Corporations, 15 per cent for Municipal Councils and 8 per cent for *Nagar Panchayats* in 2017-18. However, the share of tax revenues in municipal revenues for Municipal Corporations has also declined over the last five years, suggesting need for improvement



(**Source:** Annual reports of RBI)

Chart 4: Own Revenue of Urban Local Governments Per Capita



(**Source:** Annual reports of RBI)

Chart 5: Total Transfers to Urban Local Governments Per Capita

The current paper deals with the municipal bond as an innovative option of municipal finance. This study explores the satisfactoriness of an important measure taken by the local government i.e. introduction of municipal bonds to create a local funding source to improve the infrastructure facilities at the grass root levels and analyses weather this initiative has been accepted well by the citizens/general public at large. Partial Least Square Structural Equation Model (PLS-SEM) was used to establish the reliability and validity of the scales and to test the hypotheses. The results documented investors' perception to have greater impact in influencing municipal bond investment decision of Indian investors.

6.5 Interstate Disparities

Large disparities exist in different aspects of municipal finances across different states. Chart 6.6 arranges states in order of per capita total municipal revenue. Maharashtra, Gujarat, and Madhya Pradesh have the highest municipal revenue per capita. However, in the case of Madhya Pradesh, this was largely on account of the octroi compensation received. The same three states also have the highest own revenue per capita (Chart 6.7). Punjab's own revenue share in municipal revenue has been high at about 82 per cent on account of tax/surcharge on electricity. The urban consumer cross-subsidizes the farmer for the free electricity provided by the state to farmers. Own revenue in Maharashtra constituted more than 80 per cent of its municipal revenue in the pre-GST years coming down to 65 per cent in 2017-18 after octroi was subsumed under GST. Bihar had the lowest own revenue per capita and an excessive dependence on transfers. Assam spent a disproportionate amount of its budget on administrative and establishment costs.

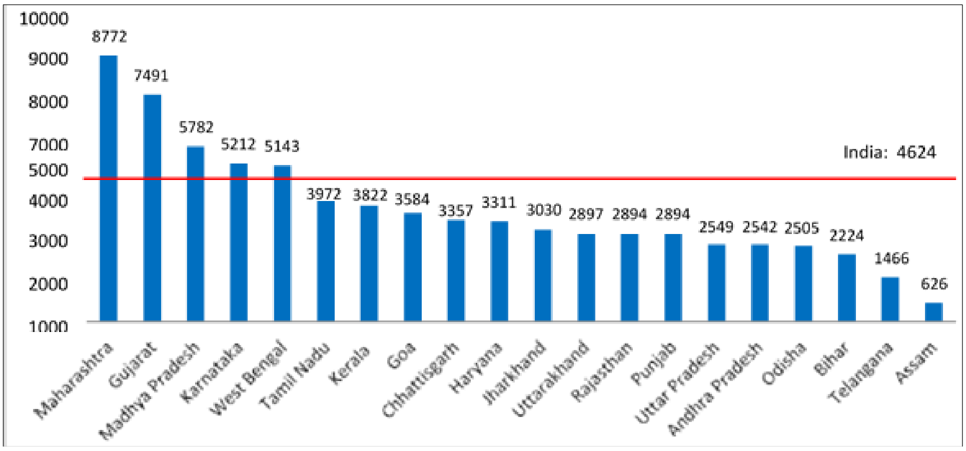


Chart 6: Total Municipal Revenue Per Capita: 2017-18 (Rs.)

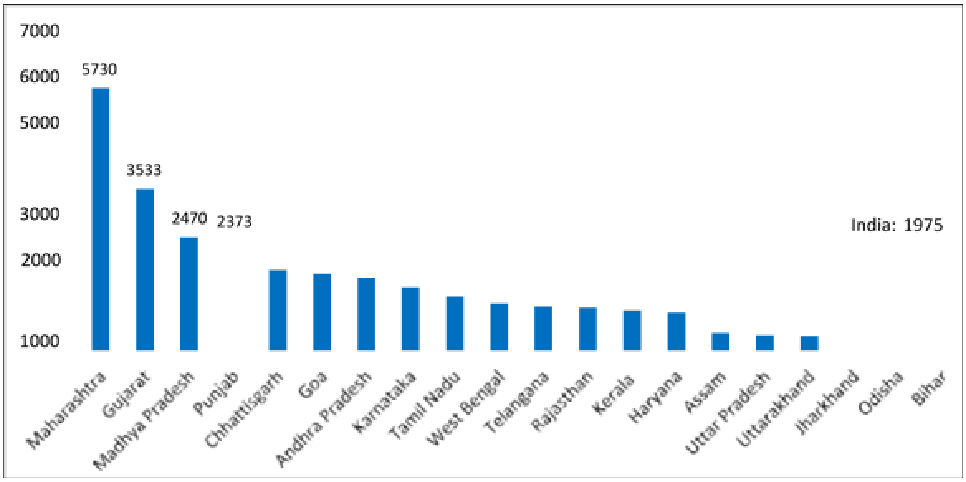
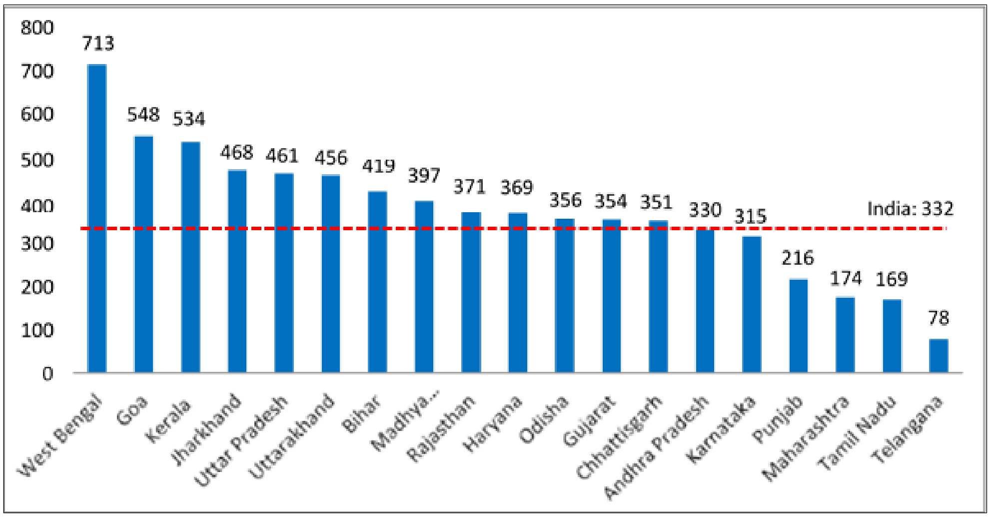


Chart 7: Municipal Own Revenue Per Capita: 2017-18 (Rs.)

Property tax has not only been a major source of municipal revenue in India as in other countries, but going forward it is the only major source of municipal revenue for urban local governments in India. The share of property tax in own revenue in 2017-18 was the highest in Karnataka at 68 per cent and the lowest in Punjab at 9 per cent, among major states. As is to be expected, Municipal Corporations accounted for a large share of the total property tax revenues. The top three states in per capita property tax revenue of Municipal Corporations were Karnataka, Gujarat, and Maharashtra in 2017-18.

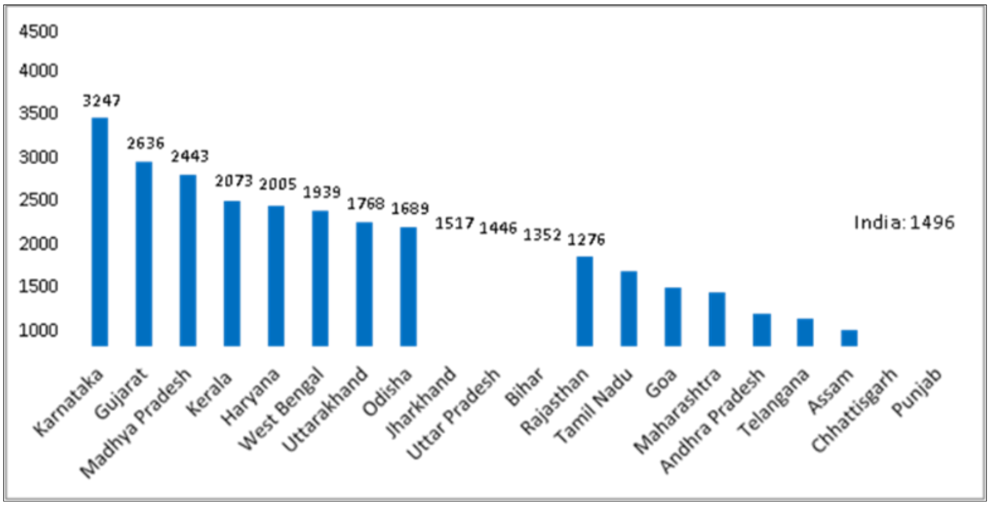
6.6 CFC Grants Per Capita and State Transfers Per Capita: 2017-18 (Rs.)

Per capita grants from Central Finance Commissions increased for all major states between 2011-12 and 2017-18. Comparing the average per capita grants of the last three years of the Thirteenth Finance Commission (2012-13, 2013-14 and 2014-15) with the first three years of the Fourteenth Finance Commission (2015-16, 2016-17 and 2017-18), we find that the per capita CFC grants to urban local governments increased for all major states. Maharashtra, Tamil Nadu and Telangana had the lowest per capita CFC grants to urban local governments among major states in 2017-18 (Chart 6.8). Karnataka, Gujarat and Madhya Pradesh have the highest per capita state transfers to urban local governments (Chart 6.9). State transfers consist of state grants and revenue sharing. Karnataka has the highest per capita revenue sharing and Gujarat the highest per capita state grants-in-aid in 2017-18. Karnataka has a transparent system of state transfers to urban local governments and they also have an efficient property tax collection system. Punjab has the lowest share of state transfers in total municipal revenue in 2017-18. As in Karnataka, significant contribution to state transfers in Tamil Nadu, and Haryana is through revenue sharing while in Maharashtra, Gujarat, West Bengal and Bihar, it is through state grants. Null hypothesis (H_4) is rejected and alternative hypothesis (H_{a4}) accepted as there is a difference between the growth rates of CFC Grants Per Capita and State Transfers Per Capita for the year 2017-18



(**Source:** Annual report of RBI: 2017-18)

Chart 8: CFC Grants Per Capita: 2017-18 (Rs.)



(**Source:** Annual report of RBI: 2017-18)

Chart 9: State Transfers Per Capita: 2017-18 (Rs.)

Gujarat was the only state to access market and institutional sources of finance in a substantial way. On average, between 2010-11 and 2017-18, about 14 per cent of its municipal revenue accrued through borrowing. Madhya Pradesh (8%), West Bengal (4%), Karnataka (2.2%) and Maharashtra (1.2%) were the other four states to tap the capital market, over this period. Telangana also raised Rs 300 crore through the issuance of Greater Hyderabad Municipal Corporation (GHMC) bonds amounting to 6.2 per cent of Telangana's municipal revenue in 2017-18.

7. Conclusion

The data and analysis presented in this study clearly indicates that urban local governments in India are seriously underfunded compared to their counterparts in other countries. They have become increasingly dependent on transfers from higher levels of government and have shown a persistent decline in their own revenues. GST has been a blow to the fiscal autonomy of the urban local governments since it has subsumed the most local taxes such as octroi, entry tax, advertisement tax and local body tax. The GST Council has to address this challenge to municipal finances urgently. The 15th Finance Commission recommend that state transfers to urban local governments increase at the rate of 25 per cent per annum over the devolution period of the 15th Finance Commission. State transfers to urban local governments are proposed to be increased from 0.33 per cent of GDP in 2017-18 to 0.70 per cent of GDP by 2024-25. They include: (i) SFC transfers, (ii) assigned revenues, and (iii) grants in aid. Central Government must increase

CFC grants will partially act as compensation on the center's behalf for taxes subsumed under the GST regime. Similarly, state governments must increase transfers to urban local governments to address the problem of no longer having access to octroi, entry tax, advertisement tax, local body tax and other consumption related taxes in the GST regime.

8. Suggestions for Municipal Revenue Improvement

Profession tax should be assigned to municipalities as a local tax under law. States may assign local body entertainment tax to urban local governments as a local tax by law, enabling them to have access to cable TV and other new forms of entertainment such as internet cafes, pubs, gaming facilities, and amusement parks. States may assign a share of motor vehicles tax to urban local governments - not less than 20 per cent, and more in the case of more urbanized states. All states may consider sharing a suitable percentage of stamp duty with their local bodies – at least 10 per cent. Property tax to GDP ratio of 0.15 per cent is very low by any standard. Property Tax Boards must be set up in each state and create conditions for buoyancy in property tax revenue. User charges of urban local governments for public service delivery must at least recover the operation and maintenance costs from beneficiaries and mobilize 10 per cent of capital costs with dedicated revenue improvement measures such as betterment levy, impact fee, special assessment district, tax increment financing, etc. State governments to share a portion of their income from mining royalties with those local governments from whose jurisdiction such income originates. The 15th Finance Commission should set up an Incentive Fund for municipalities to access the capital market and raise funds, recognizing that improving credit worthiness is intimately linked with governance reforms. Municipal bonds guidelines may cover revenue, general obligation and hybrid bonds.

9. References

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