CHAPTER 6

URBAN FINANCE

6.1 Introduction to Urban Finance ................................................................. 299
   6.1.1 Legal Provisions ........................................................................... 300
   6.1.2 Part IXA – The Municipalities ...................................................... 301
   6.1.3 243Y Finance Commission .......................................................... 302

6.2 Conventional and Unconventional Methods ...................................... 303
   6.2.1 Percentage of Own Revenue to Total Revenue ......................... 305

6.3 Financing the Urban Services, User Charges .................................. 306

6.4 Mismatch between Resources and Responsibilities ....................... 311
   6.4.1 Financing of Cities; Constitutional Sources of Finance ............ 312

6.5 Financing the Urban Infrastructure, HPEC, McKinsey ................... 312

6.6 National Finance Commission ............................................................. 314

6.7 Innovative Methods of Urban Finance, PPP ................................... 318

6.8 Proposed Municipal List .................................................................... 322
6.1 Introduction to Urban Finance

Over period of time the functions and responsibilities of ULB’s have increased considerately without commensurate enhancement of their resources base. This chapter examines the constitutional provisions with regard to functions and resources allocated and consequences. The Municipal finances are left to the State Governments and this third tier of Government, without any independent allocated financial resource base. A sound financial base is required to meet out the constitutional responsibilities enshrined by the Constitution upon the ULB’s. This chapter deals with the alternative strengthening mechanisms or Innovative Urban Finance.

Financing the Urban Infrastructure background Census Data 2011 reveals that about 31% (377 million) of Indian population lives in the urban areas. The rate of growth of urban sector is much faster the rate of growth from 1991 to 2001 was 2.10 which have increased to 3.35 % in the decade of 2001 to 2011. This shows that Urbanization is picking up and shall further increase posing new challenges as well as opportunities. It is interesting to note that many similar towns are growing faster than mega cities and tier to cities (Gupta 2013). Urban areas have emerged as huge areas of job creation adding workforce at 44% as compared to 12 % in the rural areas. Urbanization in India is almost synchronized with the National Economic Growth and poverty reduction. Urbanization and Economic Growth are two-way linked organization is an outcome or fast economic growth as well as Urbanization needs to fast economic growth. The States with high (Gross State Domestic Product) GSDP have high levels of Urbanization. These states are the ones which have empowered their Urban Local Bodies and dispensed resources. The urban sector contribution to GDP has risen from 38% at present the top thousands cities produce around half the GDP comprising of 16% of the population and just 0.2% of the land areas. Urban sector will play an increasing critical role in transformation of the Indian economy and achieving high rates of Economic Growth.
6.1.1 Legal Provisions

The Constitutional Provisions for Municipalities are enumerated below:

Article 243

243P. Definitions.
243Q. Constitution of Municipalities.
243R. Composition of Municipalities.
243S. Constitution and Composition of Wards Committees, etc.
243T. Reservation of Seats.
243U. Duration of Municipalities, etc.
243V. Disqualifications for Membership.
243W. Powers Authority and Responsibilities of Municipalities etc.
243X. Power to Impose Taxes by, and funds of, the Municipalities.
243Y. Finance Commission
243Z. Audit of Accounts of Municipalities.
243ZA. Elections to the Municipalities.
243ZB. Application to Union Territories.
243ZC. Part not to apply to certain areas.
243ZD. Committee for District Planning.
243ZE. Committee for Metropolitan Planning.
243ZF. Continuance of Existing Laws and Municipalities.
243ZG. Bar to interference by Courts in Electoral Matters.

A close look at the Constitutional Provisions shows that 24x is about the power to impose taxes by, and funds of, Municipalities. The entire power of the Municipalities is subject to the Legislation of a State which may by law "authorize a Municipality to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedure and subject to such limits, 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". Provide for making such grants-in-aid to the Municipalities from the Consolidated Fund of the State; and 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 there from.

A close look at the Constitutional Provisions shows that the entire dependency of the Municipal Corporations is on the State Government. This is the root cause of the present poor financial condition of the Urban Local Government.

6.1.2 Part- IXA - The Municipalities

243W. Powers, Authority and Responsibilities of Municipalities etc.-
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.

Since the Municipal Corporations have been recognized as an independent third tier of Government, there should be a separate list along with the list of Union List or list one which has got 100 items as given in the 7th Schedule of the Constitution. The Union List consists of 100 items, the State List consists of 61 items and Concurrent List consists up of 52 items as given in the 7th schedule of the Constitution. Since in the Article 243W as stated above, the Powers, Authority and Responsibility of Municipal Corporations have been defined but there is no separate list. The HPEC has suggested sub-section A (2 in the article 243-w should be amended) so that the ULBs should be accountable for the provision of core services in the 12th Schedule.
Table 6.1: "Twelfth Schedule" (Article 243W)

1. Urban Planning including Town Planning.
2. Regulation of Land-use and Construction of Buildings.
3. Planning for Economic and Social Development.
4. Roads and Bridges.
7. Fire Services.
9. Safeguarding the interests of weaker sections of society, including the Handicapped and Mentally Retarded.
10. Slum Improvement and Up-gradation.
12. Provision of Urban Amenities and facilities such as Parks, Gardens, and Playgrounds.
14. Burials and Burial grounds; Cremations, Cremation grounds and Electric Crematoriums.
15. Cattle pounds; Prevention of Cruelty to Animals.
17. Public Amenities including Street Lighting, Parking lots, Bus stops and Public Conveniences.
18. Regulation of Slaughter Houses and Tanneries.

The word 'may' in the sub-section should be replaced “shall” for the core finance. The services mentioned in the 12th Schedule of Article 243w should be the sole domain responsibilities of ULBs. All the parastatals put under the jurisdiction of ULBs. The Article 280 deals with Central Finance Commissions (CFC) the sub-section 3(C). In this article should be amended so that CPCs provide ULBs a share of the taxes. All the provisions relating to the State Finance Commission should be made clear and the financial structure, financial resource of the ULBs should be in commensurate of their responsibilities.

6.1.3 243Y Finance Commission

(1) The Finance Commission constituted under article 243-1 shall also review the financial position of the Municipalities and make recommendations to the Governor as to-

(a) The principles which should govern-
(i) The distribution between the State and the Municipalities of the net proceeds of the taxes, duties, tolls and fees leviable by the State, which may be divided between them under this part and the allocation between the Municipalities at all levels of their respective shares of such proceeds;

(ii) The determination of the taxes, duties, tools and fees which may be assigned to, or appropriated by, the Municipalities;

(iii) The grants-in-aid to the Municipalities from the Consolidated Fund of the State;

(b) The measures needed to improve the financial position of the Municipalities;

(c) Any other matter referred to the Finance Commission by the Governor in the interests of sound finance of the Municipalities.

(2) The Governor shall cause every recommendation made by the Commission under this article together with an explanatory memorandum as to the action taken thereon to be laid before the Legislature of the State.

6.2 Conventional and Unconventional Methods

Figure 6.1 Conventional Sources of ULB Revenue
User Charges:
At present, urban fees are not significant in India, with the proceeds from Non-Tax Revenues from all Urban Local Bodies amounting to a mere 0.13% of GDP. Mohanty et. al (2007) studied that in 10 large Municipal Corporations less than 10% of the cost of providing services was recovered through fees; in another six, cost recovery was between 10 to 20%. Only in two of the 25 Municipal Corporations examined was cost recovery greater than 75%.

Local Taxation:
Reliable and effective local taxation is essential to ensure hard-budget constraints in financing local public goods (Oates, 2005). In particular, it is important that Local Governments have adequate tax powers to ensure a strong linkage between revenue and expenditure decision at the margin (Bird and Smart, 2009).

Which taxes are best suited at local levels? On the whole, the fiscal federalism literature suggests that no: only should Governments (at all levels) bear clear public responsibility at the margin for financing expenditures for which they are politically responsible but that, ideally, local own-source revenues should be sufficient to enable at least the Richest Local Government to finance from its own resources at least those services that they provide which primarily benefit their residents.

Rao and Bird (2011) find that the Collection Efficiency of Property Tax is low in Indian cities, which is one of the reasons for low collection of Property Tax. The Average Collection Rate was only 37%. The Collection Efficacies differ from cities within a State Corporation of Gujarat and Maharashtra though have High Per-Capita Collection for Low Collection Efficiency, the problem with valuations and exemptions are high.

<table>
<thead>
<tr>
<th>S. N.</th>
<th>Service Revenue Sources</th>
<th>Conventional Source</th>
<th>Non-Conventional Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Property Related</td>
<td>Composite Property Tax</td>
<td>Vacant Land Tax, Service Taxes, Surcharge on Land Registration Duty</td>
</tr>
<tr>
<td>3.</td>
<td>Sewerage Related</td>
<td>Sewerage Charges</td>
<td>Sewerage Donations, Sewerage Connection Charges, Sewerage Benefit Tax, Sewerage</td>
</tr>
</tbody>
</table>

Table 6.2 Conventional and Non-Conventional Revenue Sources
6.2.1 Percentage of Own Revenue to Total Revenue

Own revenues of which the property tax is a major source has consistently declined as per the 12th five year plan from 63% to 53%. This means that the nearly half of the Municipal revenues comes by way of grants from State Government, Central Government and Finance Commission. Rao and Bird (2010-2011) have shown various ways of augmenting the resources of Municipal bodies including essential reforms in the property tax system and user charges for services delivered. User charges and new innovative method of finance are the need to meet the gigantic urban financiers required. Municipal Finance to begin with is totally at the discretion of States. There is an urgent need to create a Municipal List.

The present resource based of Urban Taxes include property taxes as shown by a survey of 36 ULB's where collection has been shown at – percentage 486/1229 the own source revenue is just 28.5 percentage and the Municipal Revenue and property tax constitutes around 1/3 of the total Municipal Revenue.

The own revenue as a percent of the GSDP is high in the Urbanized Develop State as 0.61 in AP, 0.79 in Gujarat, 2.14 in Maharashtra and low in the lesser Developed States M.P. 0.17, Rajasthan 0.34 and Uttar Pradesh 0.12. Similarly the total revenue of ULB's as a percentage of the GSDP are 1.5, 1.05 for A.P., 1.28 for Gujarat, 2.81 for Maharashtra and 1.5 for M.P. (the overall spending by grants mix it high), 1.8 for Rajasthan and 0.84 of U.P.

Similarly the State Expenditure on Urban Finance as a percentage of their total outlay is high for Developed States and low for Lesser Develop States.

6.3 Financing the Urban Services, User Charges

As emphasized earlier, an important rule of sound fiscal decentralization is that finances should follow functions (Bahl, 2002). Local Governments need access to adequate revenue sources to finance the public services they are mandated to provide. In India, however, under funding of Municipal services is a common feature. Although all States have devolved the Municipal functions listed in the Twelfth Schedule to a greater or a lesser degree, in the absence of adequate resources, Municipal Bodies have not been able to provide satisfactory levels of the assigned public services. One reason is simply because the revenue handles assigned to them to carry out these functions are clearly inadequate. At the same time, however, until now Municipal Bodies have neither taken the task of delivering public services sufficiently serious nor made adequate efforts to mobilize revenues efficiently from the sources assigned to them. Similarly, there are also not yet in place properly designed systems of inter-governmental transfers to sufficiently offset the fiscal disabilities of the Municipal bodies to ensure minimum standards of important Municipal services. In total, the net result of assigning the constitutionally mandated functions to Municipal Bodies has thus been to impose unfunded mandates on them, as we discuss further in the next section.

The consequence is that Municipal services in India are significantly underfunded as mentioned above section. The serious under-spending documented by Mohanty et.al. (2007) has resulted in such inadequate infrastructure and poor public service delivery by Municipal Bodies that it has seriously constrained the potential role of cities as centers of Economic Growth (India, 1996; Ramanathan and Dasgupta, 2009; Bandypodhyay and Rao, 2009).

In 2005, the poor state of Urban Infrastructure and Services was a major motivation for initiating a central programme, the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) with the objective of improving developmental incentives by linking grants for urban renewal to reforms at both State and Local levels aimed at improving fiscal efficiency of the Urban Local Bodies, freeing urban land and housing markets and preventing the Municipal Bodies and the States from adopting protectionist policies. The first phase of the programme is for the period 2005-12. Although in the first two
years the progress was slow, the resource transfer from the centre has picked up. Nevertheless, much more remains to be done to augment Urban Infrastructure and Services. Furthermore, the global financial crisis and the slowdown in the Indian Economy as a consequence have recently led the Central Government to dilute the reform requirements in order to provide more immediate fiscal stimulus. In particular, a considerable portion of JNNURM funds have recently been spent in purchasing buses for Urban Transport in order to revive the commercial automobile sector as a component of fiscal stimulus strategy. Despite such shortcomings, as discussed further in the next section, the JNNURM approach may both foster urban renewal and motivate the States and Local Governments to undertake some of the reforms needed to generate significant own resources through the reform of property taxes and the liberalization of land and housing markets.

(i) **User Charges:** In many respects, the most important source of finance at local levels should be from user charges imposed for services provided. To a considerable extent a Local Government is like a business providing direct services in the form of 'private goods' (like water) to its customers - local residents. Financing such services through user fees or charges not only provides funds with which to supply such services but also provides invaluable information on which services should be provided, in what quantity and quality, and to whom. Given the proximity to the population and the predominance of private good characteristics of many local services, levying user charges is feasible. Often, however, it is complained that it is not possible to levy user charges when the quality of the services rendered is poor. The result is that a vicious circle is set up, with low quality public services leading to an inability to collect user charges leading to further deterioration in the service levels.

This circle needs to be broken, not only to get more revenues but also to improve standards of principal services. User charges are especially important as for providing signals to consumers of the scarcity value of the services and to providers about the demands that need to be met through service provision. Establishing this strong link between demand and supply both helps to generate resources and ensures efficiency in production and accountability in service delivery. User Charges are particularly relevant for services such as Water, Sewers, Electricity, Garbage Disposal, Public Transit, and Recreation. User Charges are more
important in large metropolitan areas. Marginal cost pricing will improve efficiency by imposing higher charges on far away consumers.

Other important sources of Non-tax Revenues are License fees for shops and establishments and parking fees. A common feature seen virtually in every Urban Local Body, particularly in large corporations is the poor implementation of regulations relating to land use and commercial space occupation. Both the present system of issuing licenses and the common flouting of regulations by shops and establishments provide enormous rent seeking opportunities. Public interest litigation relating to the construction and running of businesses in residential areas against the regulations led to the demolition of several shops and establishments in Delhi in 2005. In some cities, from time to time, the poor implementation of the regulations has been accompanied by periodic amnesties that legalize them after the fact, favouring in particular the politically well-connected and powerful. For instance, recently the State government of Karnataka attempted to pass an ordinance regularizing 70,00,000 illegal constructions within the Bangalore Municipal Corporation area on the eve of an election to the Municipal body.

(ii) **Local Taxation:** Reliable and effective local taxation is essential to ensure hard-budget constraints in financing local public goods (Oates, 2005). In particular, it is important that Local Governments have adequate tax powers to ensure a strong linkage between revenue and expenditure decision at the margin (Bird and Smart, 2009).

Which taxes are best suited at local levels? On the whole, the fiscal federalism literature suggests that not only should Governments (at all levels) bear clear public responsibility at the margin for financing expenditures for which they are politically responsible but that, ideally, local own-source revenues should be sufficient to enable at least the Richest Local Government to finance from its own resources at least those services that they provide which primarily benefit their residents. Indeed, to avoid distorting the allocation of resources, to the extent possible local taxes should burden only local residents, preferably in relation to the benefits they receive from the services provided. For this reason, in general immobile tax bases are best suited at the local level because taxes on mobile bases may result in their migration from higher to lower taxed localities and even result in a “race to the bottom”. However, in many cases, particularly in larger cities, taxing immobile bases alone will not
yield the revenues required to provide local public goods and services, some of which benefit mobile factors.

A local tax designed to satisfy these requirements should in principle have the following characteristics (Bird 2006):

- The base should be relatively immobile to allow the local authorities to vary the rates without losing the base.
- The tax should yield adequate revenues to meet local needs and should be sufficiently buoyant overtime.
- The tax should be stable and predictable overtime.
- It should not be possible to export the tax burden to non-residents except to the extent that such burdens capture benefits non-residents obtain from local services.
- The tax base should be visible to ensure accountability.
- The taxpayers should perceive the tax to be reasonably fair.
- The tax should be relatively easy to administer.

Based on the above considerations, Bird and Slack (2007) review the various possible candidates for local taxes. The most appropriate tax at the local level is clearly the tax on real properties not only because real property is immobile but also because to a considerable extent differences in service levels are reflected in property values so that the tax on real property is like a benefit tax. In addition, income taxes generate significant revenues for Local Governments in many OECD countries, and a good case can be made for a supplemental local income tax to supplement property taxes particularly in metropolitan areas in which Local Governments provide substantial services to people (health, welfare) that are not significantly capitalized into property values; in effect, the local income tax might serve as a kind of (very rough) benefit tax with respect to such services. The best way to levy an income tax at the local level is to 'piggyback' it on higher level income taxes so that, although some flexibility with respect to the tax rate can be given to Local Governments, the determination of the base and tax administration will remain at the higher level. Another tax often used at the local level is some form of sales or consumption tax, including selective taxes on (for example) entertainment services and hotels. Finally, a number of countries have local business taxes that take such forms as corporate income tax, differentially heavy non-residential property tax, transit taxes such as Octroi and Entry Tax, and
various forms of gross receipts and crude sales or 'industry and commerce' taxes (Bird, 2003).

In India, Municipal Bodies can levy and collect only those taxes that are specified by the State Governments from the State List in the Seventh Schedule to the Constitution. Although the taxing powers assigned are non-uniform across States, on the whole the most important tax bases assigned to Municipal Governments include:

(i) Taxes on Lands and Buildings,
(ii) The tax on the Entry of Goods into a local area for consumption, use or sale which is known as Octroi,
(iii) Taxes on luxuries including those on Entertainment, Amusement, Betting and Gambling,
(iv) Taxes on Advertisements other than Advertisements published in Newspapers, or broadcast in Radio or Television,
(v) Taxes on Non-motorized Vehicles,
(vi) Taxes on Animals and Boats,
(vii) Tolls, and;
(viii) Taxes on Professions, Trades, Callings and Employment.

In actual practice, however, most of these taxes are simply not levied. The most important tax actually levied at the local level is undoubtedly that on land and buildings (real properties). Octroi was an important source of Municipal revenue in some States until recently, but as the tax was considered obnoxious, distorting, iniquitous, and a major source of corruption, it is not surprising that all States except Maharashtra have abolished the tax and even in Maharashtra, the tax is levied only in Municipal Corporations. Some States replaced Octroi with Entry Tax which is not much better in economic terms and is also an impediment to internal trade. In most cases, even when the States replaced Octroi by Entry Tax, they did not compensate Municipal Governments for the loss of revenue. Generally, when States abolished Octroi, they provided no alternative source of revenue and simply increased the size of the unfunded mandates confronting Municipal Governments. In a few States, however, Municipal Governments have some access to consumption taxes. In Kerala, for instance, the power to levy entertainment tax is given to the Urban Local Governments. In Andhra Pradesh, Local Governments receive a fixed share of the revenue from entertainment tax. In a few States, Urban Local Bodies collect
some revenue from Advertisement tax. Although the property tax is the most important source of own revenues of Municipal Bodies, it suffers from several infirmities as evidenced by the generally poor collections and low buoyancy of this tax. However, initiatives in some Municipal Corporations in recent years have shown that revenues from this tax can be substantially increased with proper reform of the tax system. Bruhat Bangalore Mahanagara Palike (Greater Bangalore Municipal Corporation), for example, reformed its property tax by revising the area-based values, introducing a self-assessment system and improving the technology of the payments system with the result that revenue increased from Rs. 4,400 million in 2007-08 to Rs. 7,800 million in 2008-09 and is expected to further increase to Rs. 10,000 million in 2009-10.

HPEC has estimated massive requirement for the urban sector, the size of Municipal Finance is in India is about very small as compared to the developing and developed country. The total Municipal Revenue is about 0.75% of the country’s GDP as compared to nearly 5% of most of the countries. The Urban Local Bodies can for only above 2 to 3% of the combined expenditure of Central and State Governments. It is pertinent to mentioned that, urban areas accommodated 30% of the population in context in developed countries local bodies accounts for 25 to 35% of the total government expenditure.

6.4 Mismatch between Resources and Responsibilities

The finances of ULBs form an important element of the larger fiscal scenario of the country as ULBs are the Constitutional entities engaged in providing a variety of civic amenities and infrastructure. The 74th Amendment assigned enormous responsibilities to Municipalities, which include the preparation of plans for Economic Development and social justice as well as the implementation of schemes as may be entrusted to them including those in relation to the 18 items listed in the Twelfth Schedule to the Constitution. In addition to the items of responsibilities referred to in the Constitution, the Legislature of a State, by law, can assign responsibilities to Urban Local Bodies relating to the two items mentioned above. To perform these tasks, Local Bodies have to be financially sound with commensurate amount of powers for raising resources. However, while the Constitution has specified and listed the expenditure responsibilities, it does not provide a clear regime of taxes and revenue sources of ULBs. The expenditure liability of a Municipality depends
on the service cost, service norms and population parameters. This applies to all categories of services.

Revenues raised depend on the size of revenue base, extent of access to the base, the rates and the Collection Efficiency. This is true for all collectible resources. The fiscal gap can be redressed in the following broad ways:

(a) Reducing Municipal Responsibilities,
(b) Scaling down Municipal Service Norms,
(c) Cutting Costs and Unnecessary Expenditures,
(d) Enhancing Municipal Power to raise Revenues,
(e) Increasing transfers from higher levels of Government, and
(f) Stepping up local effort to raise Revenues. Reforms to correct the Municipal Fiscal Gap will need to address all of these factors in a comprehensive manner.

6.4.1 Financing of Indian Cities; Constitutional Sources of Municipal Finance:

There are two sources of Municipal Revenue namely Assigned or Devolved. Municipal own revenues are revenues generated by the Municipality through taxes and fees levied, such as Property Tax and Water Charges. Assigned revenues are those revenues assigned to Local Government by higher tiers of Government such as State Finance Commission, recommended funding assignment. Local Governance also gets funding for execution of programmes by Central Government like JNNRUM (now AMRUT) and USSIDMT. Indian current Urban Infrastructure investment mandate and income passes to district requirements to ensure that the current backlogs in infrastructure provisions and serve delivery are made sufficiently in the next 50 years and to meet of additional infrastructure requirements on account of growth of population and economic activities.

6.5 Financing the Urban Infrastructure, HPEC, McKinsey

HPEC has estimated massive requirement for the urban sector, the size of Municipal Finance is in India is about very small as compared to the developing and developed country. The total Municipal Revenue is about 0.75% of the country's GDF as compared to nearly 5% of most of the countries. The Urban Local Bodies can for only above 2 to 3% of the combined expenditure of Central and State Governments. It is pertinent to mentioned
that, Urban areas accommodated 30% of the population in context in developed countries local bodies accounts for 25 to 35% of the total Government expenditure.

The Isher Ahluwalia Committee on Urban Infrastructure and Services (2011) estimated the total capita investments in Urban Infrastructure at about 39 lakh crores over the next 20 years. To meet this requirement, ULBs will need to identify robust revenue streams. In addition, both Central and State Governments will also have to increase their commitment to the urban sector.

According to HPEC, States should share 25% of the GST equivalent with Urban and Rural Local Bodies, and this should be enforced through an appropriate constitutional mechanism.

**McKINSEY Estimate (2010)**

India spends around US$ 17 per capita, China US$ 116 per capita, UK US$ 391 per capita. McKINSEY study (2010) HPEC report Chairperson Isher Judge Ahluwalia, 2011 on Indian Urban Infrastructure Services Projects Investment over a period of 20 years from 2010 to 2031. The investment on Urban Infrastructure from the ground 0.7% of the GDP has to go to 1.14% of the GDP to meet out such huge financial allocations. The new approach to Municipal funding will be required PPP (Private Public Partnership), Pooled Finance, Institutional Finance and External Commercial Borrowing from Urban Infrastructure Financing Institutions like HUDCO, LIC, IIFCL, IDFC, IL&FS. The Capital Bond Market, Municipal Bond Market, Commercial Urban Services as Metro Multi Plan Strategy of the institutions, agencies and stakeholders need to the activated involving the private sector strengthening the ULBs financial so as to the creditworthy at attract private investment. Municipal creditworthiness is very important factor for Municipal finance.

The most striking feature of urban finance is that merely 80% of the revenue comes from two sources (i) Property Tax (ii) Inter Governmental Transfers and nearly 80% of the Municipal expenditure goes to establishment Roads, SWM and Water. This shows the narrow tax base and narrow working area of the Municipal Corporation.

Unlocking the land value, monetizing land, vacant land tax, micro finance institutions, MMI, multilateral and bilateral loans, Indian Urban Sector shall see increasing activity in the form of Urban Infrastructure asset maintained creation and expansion. When most of the developed and developing countries
as China and Japan shall be pegging, India will be a young potential demographic giant dash the country of great opportunity. The Indian Urban Sector shall be the census of good urban civic living, center of learning center of technology creation, designation centers of economic researchers, employments opportunities centers and creating alternative opportunities for the rural sector.

### 6.6 National Finance Commission

During the Twelfth Plan period, the finances of ULBs should be strengthened with a three pronged approach as 1. Create Robust Tax and Non-tax based Revenue Streams for ULBs 2. Attract Private Capital to the Urban Sector and 3. Systematically Monetize Land. Broad recommendation may by summarize as follows:

**Institutionalize the Revenue Streams for ULBs:** The Ministry of Urban Development should facilitate the process of making a Constitutional Amendment that clearly outlines the various tax and non-tax revenue streams for ULBs through the incorporation of a Local Bodies Finance List in the Constitution. In addition to property, entertainment, professional, motor vehicle, advertising tax and stamp duty, the amendment should also entitle the ULBs to collect appropriate User Charges, Trade License Fees and use land-based instruments to augment their revenues. It must ensure that all taxes are regularly revised using scientific principles such that they serve as relevant sources of funds for ULBs.

**Ensure Revenue Sharing from States to ULBs:** According to HPEC, States should share 25% of the GST equivalent with Urban and Rural Local Bodies and this should be enforced through an appropriate constitutional mechanism.

**Ensure Generation of Non-budgetary Revenues through Innovative Measures including Monetization of Land:** Additional FSI that is given beyond what is normally prescribed should be charged for adequately. Such charges should be a part of the balanced strategy for expanding the effective supply of prime land going hand-in-hand with the strategy for creating 'virtual land' in the required location by building tall. The charges for additional FSI and land-use conversions should be determined professionally and should be at least 50% of the actual land value in the concerned area. Apart from FSI, ULBs should also use various other land value-based instruments like betterment fee, land use conversion charges, impact fees and development charges that should be
parked in a ring fenced city development fund and used for developing the required Urban Infrastructure in the city.

**Establish a Comprehensive Approach to Facilitate PPPPs:** As much as 13–23% of investments in Urban Infrastructure in the Twelfth FYP can be raised through Public-Private and People Partnerships. This should be done under an extended ‘4P’ framework: “People–Private–Public–Partnerships”. As experience across the world indicates that in urban renewal and management, the role of ‘People’ in design of projects and partnerships is crucial, much more so than in large infrastructure projects such as highways, airports, power, power plants and so on, in which ‘People’ have a relatively limited role in the ongoing governance of the projects and their outcomes. Therefore, best practices and model documents for ‘PPPP’ must be evolved and deployed for India’s urban management agenda to succeed. This would improve the ownership of these projects and would facilitate an effective R&R component of the project. These PPPF projects may become more viable if a subvention from property and other urban taxes is imaginatively used to meet any financial gap in the projects where felt necessary set up a ‘Ring-Fenced’.

**City / State-level Development Fund:** Proceeds accruing to ULBs from innovative sources like land monetization and other land based instruments should be pooled into a ‘ring fenced’ city development fund and then used only for Urban Infrastructure projects and projects for providing shelters to the urban poor in respective cities and not for any other purpose. In view of the capital intensity of transport projects, it is suggested that the fund may have two parts-

(i) Fund marked for urban transport projects and

(ii) Fund for other infrastructure and shelter related projects. To start with, such funds may be created in metropolitan cities.

“To meet the demands of smaller ULBs, each State should set up a State Financial Intermediary, on the lines of Tamil Nadu Urban Development Fund (TNUDF), which can then pool funding requirements of the ULBs in the State and provide economies of scale.”

This Recommendation should be taken seriously by the State Governments.

**Empower ULBs to Leverage Municipal Bonds including Pooled Financing. A handbook should be created.**
Bolster State Finance Commissions: The State Finance Commissions (SFCs) need to be further strengthened for financial devolution and imparting predictability to the Municipal finances. For efficient functioning of the SFCs, there is a need for revamping MIS at Municipal level. Suitable assistance for strengthening of SFCs and creation of Municipal level MIS should be admissible under capacity building component of JNNURM.

Other Recommendation are Capacity Building, Institutionalization and Professionalization of Municipal Cadre, Establish a Reforms and Performance Cell at the Central Level, Launch Five Indian Institutes of Urban Management (IIUMs), Facilitate Information Sharing between Urban Managers, Use ICT and e-Governance, Strengthen Institutions to Cater to Dynamic Urban needs,

XIII Finance Commission
The report of XIII FC is a mark departure from earlier reports and has for the first time recommended share transfer from the divisible pool being a general basic grant amounting to 1.5% and performance grant of 0.5% of the divisible pool of the preceding year and for subsequent years in the award period, 1% of the divisible pool of the preceding year.

Volume of transfers to tune of the Rs.23,110 million which is 4-5 times higher than 50,000 million of “local bodies need to be supported through a predictable and buoyant source of revenue, substantially higher than the present levels, local bodies should also be made more accountable in the discharge of their functions (NIUA, 2011). Amendment of Article 280 (3) (bb) and (c) such that the words on the basis of the recommendation made by the Finance Commission of the State.”

Table 6.3: Reform Agenda of XIII Finance Commission

| i) | Auditing needs to |
| ii) | Appointment of independent local body ombudsman |
| iii) | Grants to be transferred electronically to ensure transparency and timely disbursement. |
| iv) | Property Tax should be levied |
| v) | State should constitute property Tax board |
| vi) | Present service standard |
| vii) | Fire fighting service on their own. |
Table 6.4: Some Issues in Urban Finance

1. Government Funding % of ULB share in the following:
   a. Annual, 5 year Plan
   b. GST
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24. Absence Performance based grants
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**Ways of Innovative Urban Finance:**

6.7.1. **Exploiting Land-Related Revenues in ULBs:** Land-based revenues, which have greater implication to urban growth and development and concomitant problems like slum formation, redevelopment, rehabilitation and resettlement. The funds realized from land-based revenue sources can be effectively deployed for the improvement of urban poor people living in the slum areas. Urban land can be a major resource for urban development and its potential can be explored in many ways through the use of various instruments. In particular, it can be a very useful source to augment the revenue base of Municipalities and other Urban Local Bodies.
6.7.2. **Land Use Conversion Charges:** The concept of betterment due to planning permission is well-grounded in the Town Planning Acts of many countries (in the UK, in particular), and there is a strong case for tapping a part of the unearned increments in land values due to planning gains (also, known as Henry George Tax in the USA) and using the same for improvement works like decongestion programs, acquiring and developing land for conservation purposes, etc. This way funds can be generated for programs such as flyovers, outer and inner ring roads, mass rapid transit, etc. The rates can also be enhanced significantly to bring in some correspondence between the value gains due to planning permissions and the charges paid.

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6.7.10. **Development Impact Fees:** Local Governments in many countries today, including USA, levy nonnegotiable monetary assessments or impact fees on new developers. Impact fees are 'one-time' charges collected by Local Governments to pay for local public infrastructure required by new developments. They are imposed as a condition for approval to proceed with development. The infrastructure facilities that may be financed out of impact fees include on-site and off-site infrastructure such as roads, water supply, sewerage, storm water drainage, flood control measures, open space, solid waste management, fire protection, libraries, schools, police services, public buildings and administration. A referendum on the scheme normally precedes the levy of such fees in the USA.

6.7.11. **Bonds:** General obligation bonds, revenue bonds, taxable bonds, tax increment financing, primary market, revolving loan funds, bonds markets are the methods of Urban Finance in Developed countries need to be explored.

6.7.12. **Additional Development Rights (ADR):** In case of re-development of the area of expected rapid development due to introduction of major infrastructure for example transit corridor, the concept of ADR can be applied. The base FSI of the newly developed area or redeveloped area is fixed based on the zoning or development plan of the city. Premium FSI can then be provided over and above the base FSI through legal provisions / provisions in Development Control Regulations of the local authority. The local body provides basic infrastructure like access, water, drainage, waste collection, etc. for the plot for Gross FSI (Base FSI + Premium FSI) for which betterment charges may be levied. The base FSI is available to the owner of the plot whereas premium FSI has to be purchased from the ULB by the owner or developer at market prices.

6.7.13. **Transfer of Development Rights (TDR):** In case of land acquisition for creation of public infrastructure, the owner of land can be issued development rights in form of FSI which can be used in the predefined destination zone which may or may not be at the same location as the original plot.

6.7.14. **Land Developers Contribution (LDC) towards Development of Infrastructure:** In relation to certain large scale infrastructure
investments e.g. development of a suburb of new area of a city / urban region, some jurisdictions require the landowners and land developers to contribute upfront and in stages, towards the development of or extension of existing infrastructure to make the area attractive to new residents and enable a shift from existing congested areas.

6.7.15. Octroi has been an importance source of revenue in the India. A report of the committee on Octroi (1985) constituted by the MoUD recommend that it should be replaced by the local taxes, the alternative taxes suggested were surcharged on sales tax, entry tax, terminal tax, road tax, motor-vehicle tax, etc. The alternative include surcharge on sales tax, entry tax, terminal tax, road tax, tax on motor vehicles, etc. If the revenue realized on account of these taxes is inadequate, augmentation measures through property tax, entertainment tax, profession tax, etc. might be considered. If the revenue remains inadequate even after the imposition of these taxes, only then special grants-in-aid should be provided. Grants-in-aid should not be considered in isolation without augmentation of the tax base of local bodies as this would take away their initiative and autonomy.

6.8 Proposed Municipal List

Central State and Municipal Revenues Constitutional Provision:

(a) 243-I and Y of 74th CAA made it mandatory for State Government to constitute State Finance Commissions (SFCs) every five year to govern the distribution and allocation of the taxes, duties, tolls and fees levied by the state;

(b) The grants-in-aid to the;

(c) The measures needed to improve the Municipalities.

None implementation of the above Constitutional Provision in spirit has created a situation where, most ULBs find it difficult to match the available resources with the responsibilities assigned to them by the Constitution and the respective States. The taxes, duties, tolls and fees to be levied by the Municipalities and assigned to them as also the grants-in-aid to be given to them have been left at the discretion of State Governments. This has allowed the fiscal mismatches to continue because there is not adequate decentralization of ULB resources to correspond to the decentralization of ULB expenditures.
6.8.1 Municipal List
A National consensus needs to evolve on a ‘Municipal Finance Schedule’ for assignment to the ULBs to match the list of functions included in the 12th Schedule. A separate Municipal Finance List has been recommended by most of the Financial Commissions Department of Economic Analysis and Policy Research Reserve Bank of India and HPEC.

Government of India functions (7th Schedule 100 functions) for example Defense and corresponding authority to collect tax comes from Article 246. The Central Taxes are Income Tax, Wealth Tax, Corporate Tax, Customs Duties and Excise Tax etc.

State Government function (7th Schedule 61 functions) as Law and Order and Corresponding authority to collect tax comes from Article 246. The State Taxes are State Excise, Professional Tax, Sales Tax, Entertainment Tax and Land Revenue Tax etc.

Urban Local Body (12th Schedule 18 functions) as Roads, Solid Waste Management, Water, Sewerage and Corresponding Authority to collect taxes are not mentioned in Article 246. Any taxes can only be collected in accordance with the provisions of Article 246 making the ULBs dependent upon State and Central. They have independent tax works as mentioned in the 7th Schedule but no independent tax base.

Chapter Summary:
We have shown that there is a mismatch between the Responsibilities and Resources. We have shown how the creation of a third list, the Municipal List is vital for strengthening the Urban Local Bodies, so that they can sustain the desired level of Economic Growth.
The Municipal List mentioned below needs to be inserted in the Article 246 as has been recommended by most of the Expert Committees.

**Municipal Finance List (Proposed) Model**

<table>
<thead>
<tr>
<th>Number</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Property tax including vacant land tax and taxation of Central and State Government properties (or service charges in lieu thereof),</td>
</tr>
<tr>
<td>2.</td>
<td>E-Octroi (without any physical barriers),</td>
</tr>
<tr>
<td>3.</td>
<td>Pre specified percentage of revenues from all taxes on goods and services 'Revenue Shared Taxes',</td>
</tr>
<tr>
<td>4.</td>
<td>Divisible pool provide for formula sharing of the divisible pool with the ULBs,</td>
</tr>
<tr>
<td>5.</td>
<td>Stamp duty on city a property transfers,</td>
</tr>
<tr>
<td>6.</td>
<td>Shares and Tangible and Intangible Transfers of assets,</td>
</tr>
<tr>
<td>7.</td>
<td>Fixed percentage on GST (Goods and Services Tax) may be known infrastructure taxes,</td>
</tr>
<tr>
<td>8.</td>
<td>Fixed percentage Share in State Taxes,</td>
</tr>
<tr>
<td>9.</td>
<td>Professional tax,</td>
</tr>
<tr>
<td>10.</td>
<td>Entertainment tax,</td>
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<td>Advertisement tax,</td>
</tr>
<tr>
<td>12.</td>
<td>Business Licensing fee or tax,</td>
</tr>
<tr>
<td>13.</td>
<td>Motor Vehicle tax or a share from the same,</td>
</tr>
<tr>
<td>14.</td>
<td>Planning Permission fee,</td>
</tr>
<tr>
<td>15.</td>
<td>Development Impact fee,</td>
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<td>Betterment levy,</td>
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A surcharge on stamp duty on registration deeds or a share from it and a proportion of the Value Added Tax may be considered as part of the scheme of revenue assignment to UL3s. State Governments need to provide freedom to ULBs in matters relating tax base, tax rate and exemptions. Restrictions, if any, may be only by stipulation of ceilings or maximum rates of levy.

Provide that the devolution in (c) above shall be on the basis of a formula designed by the SFC, taking into account the level of economic activity, population levels, extent of poverty, capacity to mobilize resources and other factors as may be necessary over time.

The HPEC Committee also recommends that State should strengthen SFCs by improving their capacity, following the recommendations of the hereinafter CFC. They must also ensure that the recommendation of SFCs is given the same level of consideration as the recommendations of the CFC to the Government of India.

A research group of Municipal Finance in India, Department of Economic Analysis and Policy Research, Reserve Bank of India has concluded that there is a need for certain lines of reform to restructure the system of Municipal Finances in the country by the study concludes that there is a need for certain lines of reforms to restructure the system of Municipal Finances in the country by revisiting expenditure assignment and revenues on a Municipal Finance Schedule.
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   a. Annual, 5 year Plan
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21. Affordable housing
22. Present chief role player to Facilitator
23. Main reason for poor progress in housing sector is the rent control act which prevents the institutional finance to come up in the housing sector, absence of income exemption, lack of stakeholder participation, lack of inclusive development, lack of reluctance of industry participation in housing sector leaves housing sector at the sole domain of Government.
24. Performance based grants
25. Efficiency in Property Tax, Other Tax and Loan Tax and User Charges
### 6.7 Innovative Methods of Urban Finance, PPP

#### Table 6.5: Innovative Alternative Sources of Urban Finance

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(c) The measures needed to improve the Municipalities.

None implementation of the above Constitutional Provision in spirit has created a situation where, most ULBs find it difficult to match the available resources with the responsibilities assigned to them by the Constitution and the respective States. The taxes, duties, tolls and fees to be levied by the Municipalities and assigned to them as also the grants-in-aid to be given to them have been left at the discretion of State Governments. This has allowed the fiscal mismatches to continue because there is not adequate decentralization of ULB resources to correspond to the decentralization of ULB expenditures.
6.8.1 Municipal List

A National consensus needs to evolve on a 'Municipal Finance Schedule' for assignment to the ULBs to match the list of functions included in the 12th Schedule. A separate Municipal Finance List has been recommended by most of the Financial Commissions Department of Economic Analysis and Policy Research Reserve Bank of India and HPEC.

**Government of India functions** (7th Schedule 100 functions) for example Defense and corresponding authority to collect tax comes from Article 246. The Central Taxes are Income Tax, Wealth Tax, Corporate Tax, Customs Duties and Excise Tax etc.

**State Government function** (7th Schedule 61 functions) as Law and Order and Corresponding authority to collect tax comes from Article 246. The State Taxes are State Excise, Professional Tax, Sales Tax, Entertainment Tax and Land Revenue Tax etc.

**Urban Local Body** (12th Schedule 18 functions) as Roads, Solid Waste Management, Water, Sewerage and Corresponding Authority to collect taxes are not mentioned in Article 246. Any taxes can only be collected in accordance with the provisions of Article 246 making the ULBs dependent upon State and Central. They have independent tax works as mentioned in the 7th Schedule but no independent tax base. The Municipal List mentioned in the Proposed Municipal List Model at page 325 needs to be inserted in the Article 246 as has been recommended by most of the Expert Committees.

**Chapter Summary:**

We have shown that there is a mismatch between the Responsibilities and Resources. We have shown how the creation of a third list, the Municipal List is vital for strengthening the Urban Local Bodies, so that they can sustain the desired level of Economic Growth.
Union and State Governments

7th Schedule

Union List (97 Functions)

for example Defense and Corresponding Authority to collect tax comes from Article 246. The Central Taxes are Income tax, Wealth Tax, Corporate Tax, Customs Duties and Excise Tax etc.

State List (66 Functions)

as Law and Order and corresponding authority to collect tax comes from Article 246. The State Taxes are State Excise, Professional Tax, Sales Tax, Entertainment Tax and Land Revenue Tax etc.

Concurrent List (47 Functions)

where both the Union and State Government have combined the jurisdiction for example Criminal Law, Marriage and Divorce, Transfer of Property etc.

Responsibility to carry out these functions come from the Union and State Governments power of imposition of Taxes under Article 246

A Tax may be defined as a 'Pecuniary burden laid upon individuals or property owners to support the Government, a payment exacted by Legislative Authority.' A Tax is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to Legislative Authority. Whatever tax is being charged has to be backed by the Law passed by the Legislature or the Parliament. Article 246 (7th Schedule) of the Indian Constitution, distributes Legislative Powers including Taxation, between the Parliament and the State Legislature.

Urban Local Governments

12th Schedule

Municipal List (18 Functions)

1. Urban planning including town planning.
2. Regulation of land-use and construction of buildings.
3. Planning for economic and social development.
4. Roads and bridges.
5. Water supply for domestic, industrial and commercial purposes.
6. Public health, sanitation conservancy and solid waste management.
7. Fire services.
8. Urban forestry, protection of the environment and promotion of ecological aspects.
9. Safeguarding the interests of weaker sections of society, including the handicapped and mentally retarded.
10. Slum improvement and upgradation.
11. Urban poverty alleviation.
12. Provision of urban amenities and facilities such as parks, gardens, play grounds.
13. Promotion of cultural, educational and aesthetic aspects.
14. Burials and burial grounds; cremations, cremation grounds; and electric crematoriums.
15. Cattle pounds; prevention of cruelty to animals.
16. Vital statistics including registration of births and deaths.
17. Public amenities including street lighting, parking lots, bus stops and public conveniences.
18. Regulation of slaughter houses and tanneries.

Local Governments are thus Government without any direct authority to impose taxes. Thus Urban Local Bodies are governments without any Resources creating serious Resource-Responsibility gap leaving most of the above functions assigned to them under Schedule 12th all most unattended. Authority to impose taxes is derived from article 246. Article 246 mentions only the Union Govt & State Govt .... Policy makers have to look into this issue.
## Municipal Finance List (Proposed) Model

1. Property Tax including Vacant Land Tax and Taxation of Central and State Government Properties (or Service Charges in lieu thereof),
2. E-Octroi (without any physical barriers),
3. Pre-specified percentage of Revenues from all Taxes on Goods and Services ‘Revenue Shared Taxes’,
4. Divisible Pool provide for formula sharing of the divisible pool with the ULBs,
5. Stamp Duty on City Property Transfers,
6. Shares and Tangible and Intangible Transfers of Assets,
7. Fixed percentage on GST (Goods and Services Tax) may be known as Infrastructure Taxes,
8. Fixed percentage share in State Taxes,
9. Professional Tax,
10. Entertainment Tax,
11. Advertisement Tax,
12. Business Licensing Fee or Tax,
13. Motor Vehicle Tax or a share from the same,
14. Planning Permission Fee,
15. Development Impact Fee,

A surcharge on Stamp Duty on Registration Deeds or a share from it and a Proportion of the Value Added Tax may be considered as part of the scheme of revenue assignment to ULBs. State Governments need to provide freedom to ULBs in matters relating Tax base, Tax Rate and Exemptions. Restrictions, if any, may be only by stipulation of ceilings or maximum rates of levy.

Provide that the devolution in (c) above shall be on the basis of a formula designed by the SFC, taking into account the level of economic activity, population levels, extent of poverty, capacity to mobilize resources and other factors as may be necessary over time.

The HPEC Committee also recommends that State should strengthen SFCs by improving their capacity, following the recommendations of the hereinafter CFC. They must also ensure that the recommendation of SFCs is given the same level of consideration as the recommendations of the CFC to the Government of India.

A research group of Municipal Finance in India, Department of Economic Analysis and Policy Research, Reserve Bank of India has concluded that there is a need for certain lines of reform to restructure the system of Municipal Finances in the country. Study concludes that there is a need to restructure the system of Municipal Finances by revisiting expenditure assignment and revenues on a Municipal Finance Schedule.