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UNLOCKING THE POTENTIAL OF MUNICIPAL FINANCING IN INDIA

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TABLE OF CONTENTS

ABSTRACT

With a substantial section of the population moving to cities in quest of better opportunities and higher living standards, urbanisation is drastically changing the landscape of India. Local governments in India face both opportunities and challenges as a result of this rapid urbanisation. Municipalities are crucial for providing basic services, building infrastructure, and promoting social and economic advancement at the local level. The ability of local governments to raise the necessary funds to meet the changing needs of the people and society in general becomes increasingly important as urbanisation accelerates.

This paper aims to address the issues and challenges of municipal finance while emphasising the importance of fiscal autonomy for the local government. It will explore the need for innovative revenue generation strategies to meet the rising demands of urbanisation and provide basic services and infrastructure.

We have refrained from examining property tax, professional tax, etc., due to the extensive and well-established literature on those subjects. In reiterating the imperative to enhance existing tax collection methods, this paper focuses on exploring new avenues for tax collection.

1.INTRODUCTION

Local government constitutes the third tier of India's three-level governance structure. It comprises Urban Local Bodies (ULBs) and Panchayati Raj Institutions (PRIs). The local governance framework was institutionalised in 1992 by the 73rd and 74th Amendment Acts to promote the grassroots level of democracy. The Act provided an illustrative list of 18 functions that the state government could assign to the municipalities, partly or wholly, through the municipal laws. However, the Act did not provide for a corresponding municipal finance list, and it was completely left to the discretion of the state government. As a result, municipal financing[1] varies widely across states.

Article 243X of the Constitution empowers state governments with the authority to levy taxes, duties, tolls, and fees and grants them the ability to allocate revenues from specific sources to Urban Local Bodies (ULBs). Additionally, Article 243Y designates State Finance Commissions (SFCs) with the responsibility of assessing and proposing the distribution of tax revenues and grants-in-aid to ULBs. However, practical implementation of these provisions, especially concerning effective devolution and the transfer of revenue sources, has been constrained (RBI, 2022).

This constraint becomes evident in the functional devolution to municipalities in India. Schedule XII of the 74th Constitutional Amendment Act (CAA) outlines the functions that may be transferred to municipalities. However, states have the discretion to delegate certain functions to local governments. Consequently, there exists a discrepancy between the legal inclusion of functions and their actual transfer to municipalities, thereby impeding these local bodies from having clear-cut authority over their operations. The overlap of responsibilities between state and municipal entities significantly affects governance and service delivery.

Furthermore, the decentralisation of powers to local governments reveals a noticeable inter-state discrepancy. In some jurisdictions, larger municipal corporations handle a range of functions, whereas smaller municipalities assist state departments and have a more limited role. In general, municipalities lack fundamental powers, and the functional sphere of these bodies remains largely under state supervision.

A critical challenge arising from this situation is the insufficient sources of revenue available to municipalities in India. These local bodies primarily rely on property taxes and funding from state governments, which may prove inadequate to meet the growing demands of urban service delivery and infrastructure development. This overreliance on a limited number of revenue sources results in budget constraints and inadequate funding for essential initiatives.

[1] Municipal financing refers to the process of raising and managing funds by local governments to support their operations, deliver public services, and invest in infrastructure projects within their jurisdictions. It involves the collection of revenue from various sources, such as property taxes, user fees, grants and borrowing, as well as the effective management of these funds to meet the needs of the local community.

Notably, property tax, a prime source of tax revenue, has declined due to various issues like property undervaluation, incomplete registers, insufficient policies, and ineffective administration (Awasthi and Nagaraj, 2020). In essence, the interplay of constitutional provisions, challenges in functional devolution, and limited revenue sources create a complex landscape for municipal governance in India, necessitating a more comprehensive and effective approach to empowering and funding Urban Local Bodies. Other key challenges to the functions of municipal corporations include the following:

- **Weak Fiscal Autonomy**

Due to municipalities' dependence on state governments for financial decisions, approvals, and funding allocations, they often lack financial autonomy. This lack of autonomy hampers their capacity to successfully plan and handle finances. Greater financial autonomy for municipalities is necessary so they can manage their own finances and distribute resources in accordance with local objectives and requirements. Municipalities' financial viability and effectiveness can be improved by fostering fiscal empowerment and strengthening financial decentralisation.

- **Inefficient expenditure management, with expenditure being more than revenue**

Municipalities' ability to deliver services and maintain a healthy financial position can suffer from inefficient expenditure management techniques. The Reserve Bank of India (RBI) released a report that provides insight into the changes in municipal corporations' expenditures and revenue. The research states that in 2017–18, municipal corporations' overall spending as a proportion of GDP was 0.68 percent. But this number jumped to 0.9 percent in 2018–19, and it then increased again to 1.05 percent in 2019–20. This increasing trend shows a general rise in municipal corporations' spending over time.

However, the rise of municipal corporations' revenue receipts as a share of GDP was noticeably slower. The revenue receipts were reported at 0.61 percent of GDP in 2017–18. The amount only marginally rose to 0.72 percent of GDP by 2019–20. This demonstrates that there is a financial imbalance for municipal corporations because the growth in revenue receipts has not kept up with the growth in expenditures.

- **Insufficient cost recovery**

Municipalities in India face a huge issue with retrieving costs for basic services like solid waste management, water delivery, and sanitation. The financial viability of these services depends on collecting sufficient revenue through user fees; however, for a variety of reasons, authorities find it difficult to recover their costs adequately.

The low user fees levied by municipalities are one of the main problems. User costs, like water tariffs or waste management rates, are frequently set at amounts that do not account for the actual cost of providing services. Due to this, there is a discrepancy between the revenue earned and the expenditures exerted, which causes the municipalities to incur losses. Municipalities must examine and amend their user fee structures in order to solve this issue, making sure that fees are set at levels that fully cover the cost of providing the services. This entails carrying out a cost analysis to ascertain the actual expenses incurred and setting user fees appropriately.

Indian cities have been struggling financially, which hinders their ability to provide top-notch infrastructure and services to their people.

As a result, the foundational urban facilities in India are not as advanced as those in wealthier and more developed nations, such as the OECD countries and other major emerging economies like the BRICS nations.

India, with an expected increase of 416 million people in its cities by 2050, faces rising challenges like congestion, pollution, and traffic safety issues due to its rapidly growing urban population. In spite of the establishment of a formal structure for local governance in India, there has been little to no discernible enhancement in the operational efficiency of municipal corporations. As a consequence, the availability and quality of essential services for the urban population in India have continued to remain subpar. The rapid increase in urban population density, however, necessitates an improvement in urban infrastructure, which, in turn, demands a more substantial inflow of financial resources to local governments. According to a 2022 World Bank report titled "Financing India's Urban Infrastructure Needs: Constraints to Commercial Financing and Prospects for Policy Action," the country must invest an estimated $840 billion over the next 15 years to adequately serve its rapidly growing urban population.

The ability of municipal corporations to generate revenue on their own has been on the decline over time, leading to an increased reliance on the transfer of taxes and grants from higher levels of government. The overall municipal revenue income in India has proven inadequate to cover the rising expenditure levels, leading to a widening disparity in municipal finances. This shift underscores the need for innovative financing mechanisms to address the evolving financial challenges faced by local governments.

2. HOW TO AUGMENT MUNICIPAL FINANCE?

Municipalities operate within a challenging financial landscape where they must continually seek ways to bolster their revenue streams and explore fresh opportunities. This is essential to securing sustainable financing for providing essential services and supporting infrastructure development within their jurisdictions. To achieve this, municipalities can employ a two-fold strategy: optimising their existing revenue sources and identifying new, untapped revenue-generating avenues. These strategies can enhance the municipality's financial stability and resource allocation, thus strengthening its capacity to cater to the needs of the local community.

This paper focuses on exploring innovative revenue sources for municipalities. By recognising areas where additional revenue can be generated, municipalities can reduce their dependence on a limited set of funding sources, making them more resilient and adaptable in addressing the evolving demands of their communities. While we outline various methods for revenue generation, each approach must undergo meticulous evaluation, taking into account both its advantages and disadvantages within the specific context. Additionally, the assessment should consider the capacity of the local authorities to implement and sustain the chosen revenue-generating strategies effectively.

2.1 NEW AVENUES OF MUNICIPAL FINANCE

To support operations and finance public projects, local governments and municipalities can experiment with new and alternative sources of municipal financing. Some avenues to consider include the following

2.1.1. Road Usage Charges (RUC)

Taxi aggregators, e-commerce delivery agents, etc. use city infrastructure such as roads, bridges, street lights, traffic signals and public parking spaces for their operations, which makes them a prime candidate for generating revenue for the ULBs. One way to do that is by collecting a minimal road usage charge. RUCs are fees that are charged to road users based on the distance travelled or the time spent on the road.

- They can be charged a minimal fee based on the time spent by their vehicles on state-owned roads. This fee can be calculated using a GPS-based system that tracks the time spent by each vehicle on the road.

For example:
If there are 30,000 taxis running for 8 hours on average per day, a negligible fee of 10 paise per hour can still raise (0.10*8*30,000*30) ₹ 7,20,000 in a month.

- RUCs can be different for different types of vehicles based on their size, weight and other factors. The charges can be higher for larger vehicles like SUVs as they tend to cause more wear and tear on the roads and contribute more to traffic congestion in comparison to smaller vehicles such as sedans or hatchbacks (they can be charged less).

- Charges can also be differentiated based on the type of fuel used. Vehicles using diesel or petrol contribute more to air pollution than electric or hybrid vehicles.

Road usage charges (RUCs) for taxi aggregators must be implemented carefully in order to minimise concerns about rising user charges and charging drivers more. In this process, open communication is really essential.

The goal and advantages of the RUC system must be made obvious to both users and drivers. Stakeholders will have a better understanding of the charges if it is made clear how the money will be used to upgrade the city's transit and infrastructure. A phased implementation strategy is advised to minimise the immediate effects of higher charges. This enables users and drivers to gradually become used to the new system. RUCs can be introduced slowly to make the transition easier and give people time to change their travel habits.

Rationale: Taxi aggregators gain from using city infrastructure for their operations, such as roads, bridges, and open parking lots. By putting in place RUCs, it is ensured that these businesses make financial contributions to the upkeep and development of the infrastructure they rely on.

RUC implementation can increase municipal corporations' revenue. The revenue collected can be used to maintain and upgrade the current road infrastructure, make investments in public transit systems, improve traffic control systems, and finance additional urban development initiatives. This kind of revenue can supplement current financing sources and lessen the municipal corporation's financial strain, enabling better resource allocation and enhanced service delivery.

Supplementary Remarks: It is critical to address the claim made by taxi and food aggregator companies that they already pay Goods and Services Tax (GST). Even if these businesses do pay 5% GST, it is important to understand that RUCs and GST have different objectives. Throughout the whole supply chain, goods and services are subject to the generalised consumption tax known as GST.

It is not expressly earmarked for the upkeep and development of city infrastructure. General taxes may fund various government functions, while RUC directly benefits road users by ensuring better-maintained and more efficient roadways. They are specifically intended to generate income for maintaining civic infrastructure, such as roads, bridges, street lights, traffic signals, and open parking areas.

In order to run their businesses effectively, taxi/food aggregator companies primarily rely on these assets. These businesses pay their fair contribution towards the upkeep and upgrading of the infrastructure that directly supports their operations by accumulating RUCs.

2.1.2. Green Cess and Eco Tax

In order to promote sustainable practices and lower carbon emissions, some states in India have implemented the Green Cess and Eco Tax as part of their environmental policies. These fees are intended to lessen the harm that automobiles inflict on the environment and to promote cleaner alternatives in regions like Goa and Uttarakhand. While the Eco fee targets automobiles entering certain locations to address traffic and air pollution, the Green Cess levies a fee on activities that contribute to pollution and environmental deterioration.

Urban Local Bodies (ULBs) can use the introduction of the Green Cess and Eco Tax as novel ways to generate income. By implementing these environmental regulations, ULBs can raise money that can be used for improving infrastructure, environmental preservation activities, and sustainable development programmes within their respective jurisdictions. Green Cess revenue can be used to support programmes including waste management systems, pollution control measures, and encouraging the adoption of renewable energy sources.

The Eco Tax, which is levied on vehicles entering certain areas, can also be utilised to improve public transport and create sustainable infrastructure.

Rationale: The introduction of Green Cess and Eco Tax as sources of income for regional ULBs is a progressive and environment-friendly method of supporting local government. Municipalities can make money while also supporting environmental protection and reducing the negative consequences of pollution by imposing these fees. The revenue raised by these actions can then be used to improve public transport, establish efficient waste management systems, encourage the adoption of renewable energy sources, and upgrade infrastructure. The areas under their jurisdiction can look forward to a future that is greener and more sustainable owing to this revenue-generating strategy that balances commercial interests with environmental sustainability.

Supplementary Remarks: In India, Kerala has tested a green tax structure that primarily focuses on vehicles registered within the state, levying taxes based on the age of the vehicle. For vehicles that have been in use for 15 years or more, a green tax ranging from ₹ 200 to ₹ 600 is imposed. This tax is payable once every five years during the registration renewal process. However, the implementation of a Green Cess and Eco Tax, specifically targeting vehicles entering Kerala from other states or designated areas within the state, necessitates a distinct approach.

In order to establish such a tax system effectively, several crucial factors must be considered. Foremost, a comprehensive evaluation of feasibility, simplicity, and legal implications is imperative to guarantee alignment with prevailing laws and regulations.

It is essential to institute explicit guidelines, transparent rate structures, and rigorous enforcement mechanisms to proficiently administer this tax.

2.1.3. Site-permit Fee

By employing two crucial strategies, municipalities can make money from films that come to shoot in their jurisdiction. Firstly, they can charge a fee to film crews who request permission to shoot in public areas like parks, streets, or administrative buildings. The cost may be influenced by the length of the shoot, the number of crew members, or the location's impact. Local authorities can make money from film production operations by setting up clear rules and price structures.

Secondly, municipal authorities can negotiate location fees with production firms for using particular prominent or well-known areas under their control. Historically significant locations, architecturally distinctive buildings, or landmarks make for appealing shooting settings. Local bodies can levy premium fees for the use of these sites, effectively monetising their distinctive assets and generating additional revenue. Similar strategies could be extended to other activities such as concerts, music events, or large-scale sports activities.

Rationale: Films, particularly successful ones, often earn significant profits, sometimes in crores, and the choice of location can have a small contribution to their success. By charging permit fees and negotiating location fees, local bodies recognise the value that their jurisdiction adds to film productions and rightfully share in the revenue generated. This makes sure that local governments are fairly reimbursed for the use of their public areas and popular sites, resulting in a mutually beneficial agreement. In addition, the revenue earned can be reinvested in community development, tourism promotion, and local infrastructure, which will foster economic growth and increase the region's allure for future filming.

Supplementary Remarks: In India, most states presently impose an entertainment tax at a rate of 30%. This is applicable to various forms of entertainment, including movie tickets. Specifically, the Goods and Services Tax (GST) rate for movie tickets stands at 28%. The state government of Kerala suggested adding a 10% local body tax to the already-applied GST rate on movie tickets. Prior to this, the GST Council nationwide lowered the tax rate for cinema tickets above Rs. 100 from 28% to 18% in December 2018. The highest tax bracket still applied to cinema, with tickets costing more than Rs. 100 is subject to 28% GST and those costing less than that are charged 18%.

The focus of this idea is on collecting revenue directly from filmmakers as opposed to burdening theatres. This strategy aims to alleviate the financial strain on cinema owners and instead shifts the tax responsibility to the film industry as a whole. The state government could benefit from the profits made by film production and distribution. This strategy tries to disperse the tax burden across the whole film value chain while also streamlining the taxation procedure and making it more fair.

2.1.4. Unlocking Revenue through Smart City Services

As a multitude of Indian cities transition into smart cities, many opportunities for revenue generation arise. The data generated by smart city systems, encompassing traffic patterns, environmental conditions, and public behaviour, can be monetised by offering insights to businesses, researchers, and policymakers.

To tap into this potential, cities can adopt strategies such as Municipal Data Bonds, where access to anonymised city data is sold to investors, thereby generating revenue earmarked for crucial urban improvements. Additionally, leveraging predictive analytics allows cities to assess risks and returns and attract private capital, especially for complex and ambitious projects. This data-driven approach not only facilitates informed decision-making but also creates novel avenues for revenue through data analytics services.

Rationale: Smart city systems provide real-time data on various aspects of urban life, enabling businesses, researchers, and policymakers to make well-informed decisions. This data-driven approach enhances the efficiency of city operations and services. The data generated by smart city systems holds significant commercial value. By offering insights into traffic patterns, environmental conditions, and public behaviour, cities can monetise this data by providing valuable services to businesses and researchers.

Supplemental Remark: The collection and monetisation of data may raise concerns among the public regarding surveillance and privacy. Anonymising and safeguarding sensitive information is crucial to ensuring that personal data is not misused or compromised. Building and maintaining public trust through transparent communication and stringent privacy policies is necessary.

2.2 OTHER INNOVATIVE APPROACHES

Indian cities can explore various avenues of municipal financing, depending on their capabilities, technological advancements, and evolving needs. Some of the avenues that can be further explored are as follows.

2.2.1 Land Value Capture (LVC)

Land value capture mechanisms are founded on the fundamental principle that improved accessibility resulting from efficient transport systems contributes to the appreciation of land and real estate values. This strategy involves harnessing the increased land value resulting from public infrastructure projects to fund further development. When advancements in transportation systems, parks, or utility improvements are implemented, they often lead to a rise in surrounding property values. LVC mechanisms enable municipalities to capture a portion of this increased land value through tools like land taxation, development impact fees, or land leasing arrangements. Given that value enhancement is a direct outcome of public investments, it is prudent for public authorities to consider capturing this surplus.

Various land value capture mechanisms exist, including a joint development model in the form of a public-private partnership, which entails collaboration between a public entity and private developers on infrastructure projects encompassing real estate development. This collaborative model involves shared responsibilities, risks, costs, and profits between the public and private entities involved. The surplus captured in LVC can be obtained through various means, and the specific methods can vary depending on the chosen mechanism and the policies implemented by the governing authorities.

Some common ways in which the surplus is captured are through Land Taxation, where the value of the land is assessed periodically and property owners are charged a tax based on the assessed value;

Development Impact Fees, where governments may impose development impact fees on property owners or developers when they seek permits for new construction or improvements; Special Assessment Districts, where property owners within a specific district are charged for the cost of improvements that directly benefit that area. This can include infrastructure upgrades, and the charges are proportionate to the benefits received. The entities that get charged or bear the cost of these mechanisms can vary.

In implementing LVC, the introduction of distinct slabs could be considered, guided by specific criteria tied to land use. For instance, commercial spaces may warrant a higher LVC as opposed to residential housing. Additionally, areas with a high Floor Space Index (FSI) and occupancy levels could be subject to increased LVC. The process design should be meticulous, avoiding a one-size-fits-all approach.

2.2.2 Social Impact Bonds (SIBs)

Social Impact Bonds are innovative financing instruments that leverage private capital to fund social programmes and interventions. In a SIB arrangement, private investors provide upfront funding for social service providers to deliver interventions aimed at addressing social challenges, such as educational attainment, sanitation programmes, etc. The investments have to be repaid to investors with their principal plus return, contingent upon achieving predefined social outcomes. SIBs incentivise collaboration between the public, private, and nonprofit sectors, encourage innovation in service delivery, and shift the focus towards outcomes and measurable impact.

2.2.3 Kiosk Deployment for Enhanced Revenue Generation

Installing informational kiosks throughout the city is a potent means to boost revenue. These kiosks can offer comprehensive maps and localised insights on restaurants, attractions, events, and shopping.This initiative holds the promise of generating multiple revenue streams while concurrently gathering valuable data. The installation costs can be mitigated through collaborations with advertisers, who can display their ads on the kiosk exteriors, either covering or offsetting the installation expenses for the city. By leveraging the digital screens on these kiosks, the city can further secure ongoing revenue by selling advertising space to diverse advertisers. These advertisers can showcase ads or provide coupons to users, establishing a sustained source of income. The initiative also has the potential to facilitate valuable data collection on user preferences, behaviours, and trends. This data can be leveraged for targeted marketing efforts and further enhance the effectiveness of public services. The overall trend of digital literacy, online shopping, digital transactions, etc. in India creates a conducive environment for kiosk systems. Users can seamlessly purchase tickets or avail themselves of various services through kiosks, aligning with the preferences of a digitally inclined population.

2.2.4 Waste-to-Energy

Waste-to-Energy Initiatives are innovative solutions that transform municipal waste into a valuable energy resource, thereby addressing waste management challenges and creating an additional revenue stream.

With technologies like incineration, anaerobic digestion, and gasification, there is a substantial opportunity to mitigate the negative impacts of waste disposal while simultaneously tapping into renewable energy sources. Recent studies indicate that the global waste-to-energy market is projected to reach $50 billion by 2026, boasting a compound annual growth rate of 7.2%.

This growth also means significant opportunities for investors, entrepreneurs, and governments. Municipalities, recognising the financial potential, can consider forming partnerships with private entities for the development and operation of waste-to-energy facilities. In such collaborations, private companies can invest in infrastructure and technology, establishing revenue-sharing arrangements that provide municipalities with a portion of the profits generated. This not only promotes sustainable waste management practices but also creates economic avenues for the various stakeholders involved.

3. CONCLUSION

In conclusion, local governments in India deal with both possibilities and challenges in managing municipal finance as urbanisation continues to change the country. As demand for essential services and infrastructure increases, the capacity to raise funding becomes more crucial. However, there are many challenges with India's current municipal finance system, such as differences in how states generate local tax revenue, a lack of adequate revenue sources, a lack of strong fiscal autonomy, ineffective expenditure management, and insufficient cost recovery.

Municipalities can diversify their sources of revenue and ease their financial burdens by using new sources of municipal funding, such as RUCs for taxi aggregators, green cess and eco-taxes, among others. A city's effective functioning relies on diverse and sustainable revenue sources. However, this underscores the importance of having a robust public finance and fiscal institution at the city level. Such institutions play a crucial role in establishing strong financial management practices and controls, ensuring a balance between revenue and expenditure. Additionally, they facilitate the establishment of a reliable revenue collection system, addressing the city's needs over the long term.

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