

Fiscal Federalism and the Crisis of Municipal Finance in Urban India

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Fiscal Federalism Latest News

- Urban India contributes nearly two-thirds of the national GDP, yet its **municipalities control less than 1% of the country's tax revenue.**
- This mismatch highlights a fundamental flaw in India's fiscal architecture, where **centralisation of taxation powers** has **weakened municipal autonomy.**
- Understanding this issue is crucial, as it touches upon **governance, decentralisation, urbanisation, and fiscal federalism.**

The Fiscal Paradox of Urban India

- **Urban contribution vs fiscal control:**
 - Indian cities are **economic powerhouses** but remain **fiscally handicapped.**
 - **Municipalities depend** heavily on State and Central transfers, loans, and schemes.

- This has **created an inversion of democracy** — power is centralised while responsibilities are decentralised.
- **Post-GST revenue loss:**
 - Introduction of GST (2017) led to the **subsuming** of octroi, entry tax, and local surcharges, resulting in **an average 19% loss of municipal revenues**.
 - **Compensation** mechanisms have **not reached the municipal level effectively**.
 - The result is the **fiscal uncertainty and dependence** on higher governments.

Municipal Bonds - Promise and Pitfalls

- **Policy push:**
 - NITI Aayog and recent urban reforms promote **municipal bonds** as the **next frontier of city finance**.
 - However, **credibility** and **uptake remain low** due to systemic flaws.
- **Challenges in creditworthiness:**
 - Credit rating agencies assess cities narrowly on their **“own revenue,”** ignoring grants and transfers which form a legitimate and recurring income stream.
 - This misjudgment reflects an **ideological bias**, treating cities as dependent entities rather than equal tiers of governance envisaged under the **74th Constitutional Amendment**.
- **The property tax trap:**
 - Property tax reforms, though vital, **contribute only 20-25%** of total revenue potential.
 - **Over-reliance on the “user-pays” model** shifts the burden of urban finance onto citizens, especially the urban poor, turning public goods into private commodities.
 - Services like water, sanitation, public lighting, and mobility are collective entitlements, **not market goods**.

The Constitutional and Ideological Dimensions

- **74th Amendment and fiscal equality:**
 - The 74th Constitutional Amendment (**1992**) envisioned **urban local bodies** (ULBs) as **institutions of self-government**.
 - However, the **absence of fiscal devolution** has reduced them to **dependent implementers** of centrally designed schemes.
- **Need for fiscal justice:**
 - Recognising grants and shared taxes as rights, not favours, **align with the spirit of cooperative federalism**.
 - Urban **fiscal empowerment** is not a technical reform but **a moral and political imperative**.

The Way Forward

- **Democratise the fiscal contract:**
 - Adopt a **Scandinavian model** where cities have the right to levy and collect local taxes, including income taxes in some cases.

- This **promotes accountability, transparency**, and a direct link between citizens and governance.
- **Reimagine fiscal federalism:** Ensure predictable, adequate, and untied transfers to cities. Recognise municipal grants as part of a shared fiscal ecosystem, not as discretionary handouts.
- **Reform the municipal bond framework:**
 - Recognise grants and shared taxes as part of city income.
 - **Include governance indicators** (transparency, audit compliance, citizen participation) in **city credit ratings**.
 - Allow cities to use GST compensation or State tax shares **as collateral for borrowing**.
- **Strengthen local revenue mechanisms:** Improve property tax coverage, **digitise** assessment systems. **Diversify** revenue sources — land value capture, service charges, and urban transport levies.
- **Restructure urban fiscal framework:** Tackling urban challenges — from waste management and housing to climate resilience and infrastructure, and grounded in **cooperative federalism**, predictability, and autonomy.

Conclusion

- **India's urban future depends on fiscal justice.** Municipal finance is not merely a bookkeeping exercise, but a reflection of democratic and moral values.
- **Cities should not be viewed as cost centres but as engines of national prosperity.**
- For India to achieve sustainable urbanisation and inclusive growth, **the fiscal relationship between the Centre, States, and cities must be rebalanced** — restoring trust, autonomy, and resources to the grassroots.

Source: **TH**

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