



MUNICIPAL FINANCE CHALLENGES AND SOLUTIONS IN INDIA - POLITY

NEWS: Over 50 per cent of municipal corporations generate less than half their revenue independently, while government transfers rose by over 20 per cent in 2022–23.

WHAT'S IN THE NEWS?

State of Municipal Finances in India

1. Revenue Dependency:

- Over 50% of municipal corporations generate less than half their revenue independently.
- Reliance on government transfers has increased significantly (20.4% from states and 24.9% from the Centre in 2022–23).

2. Comparison with International Benchmarks:

- Financial transfers to Indian municipalities account for only 0.45% of GDP.
- In countries like Brazil, Indonesia, and Mexico, this ranges from 1.6% to 5.4%, while in Europe, it is between 6% to 10%.

3. Limited Revenue Generation:

- Municipal corporations generate only 0.6% of GDP in revenue, compared to 14.6% by states and 9.2% by the central government.

Challenges in Municipal Revenue Generation

1. Low Revenue Collection:

- Approximately 50% of municipalities generate less than 23% of their total revenue independently.
- Heavy reliance on tax revenue, with some deriving 80% of their revenue from it.

2. Rising Municipal Borrowings:

- Borrowings increased by 363%, from ₹2,886 crore in 2019–20 to ₹13,364 crore in 2023–24.

3. Inefficient Property Tax Mechanisms:

- Property tax, the most significant revenue source, does not adequately reflect appreciating property values.

Key Insights from Municipal Performance Evaluation

1. Evaluation Criteria:



- The study "Municipal Performance of Indian Cities" evaluates 134 municipalities based on five verticals: governance, services, technology, planning, and finance.
- The finance pillar examines revenue management, expenditure management, fiscal responsibility, and fiscal decentralisation.

2. Expenditure Management:

- Average central grant efficiency: 59%; state grant efficiency: 67%.
- Own tax revenue is primarily allocated to salaries, limiting capital expenditure per capita.

3. Fiscal Responsibility:

- Municipalities maintain a budget surplus exceeding 10% over three years, reflecting financial prudence.

4. Fiscal Decentralisation:

- 81% of municipalities lack independent borrowing and investment powers, requiring state approval for financial decisions.

Recommendations for Strengthening Municipal Finances

1. Enhancing Financial Transfers:

- Increase allocations from central and state governments to align with international benchmarks.

2. Diversifying Revenue Streams:

- Adopt Geographic Information System (GIS) mapping, digital payment systems, and modernised property tax mechanisms.
- Introduce user charges for essential services like water supply, sanitation, and waste management.

3. Promoting Financial Autonomy:

- Empower municipalities to make independent financial decisions without state approval.
- Facilitate public-private partnerships and use financial instruments like municipal and green bonds.

4. Improving Non-Tax Revenue:

- Examples from states like Maharashtra and Gujarat highlight the success of user charges for services.

Proposed Structural Reforms

1. Devolving Administrative and Financial Authority:



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- Decentralise governance to provide municipalities with greater autonomy in decision-making and financial management.
2. **Modernising Municipal Operations:**
 - Leverage digital solutions for cost optimisation and efficiency improvement.
 3. **Building Climate Resilience:**
 - Use municipal finance to support sustainable urban infrastructure and climate resilience.
 4. **Establishing a New Institutional Framework:**
 - Design a governance model placing municipalities at the core of developmental strategies with accountability and flexibility.

Conclusion

- Strengthening municipal finances is critical for effective urban governance.
- A dual strategy of increasing financial transfers and empowering municipalities to generate and manage revenue independently can enhance their fiscal foundation.
- By adopting these reforms, municipalities can address urban challenges effectively and support sustainable development efforts.

Source: https://www.business-standard.com/opinion/columns/municipal-fiscal-reforms-crucial-for-addressing-urban-governance-challenges-124121801344_1.html