3. Fiscal Empowerment of ULB - Polity

Urban India contributes nearly two-thirds of the national GDP, but its municipalities control less than 1% of tax revenue, creating a severe fiscal imbalance. Strengthening the fiscal autonomy, own-source revenue, and predictable transfers to Urban Local Bodies (ULBs) is crucial for efficient service delivery, accountability, and sustainable urban growth.

1. Context

Urban India contributes nearly two-thirds of national GDP. Municipalities control less than 1% of the country's tax revenue, creating a stark fiscal imbalance. This imbalance cripples local governance and service delivery, limiting the ability of cities to provide basic services and invest in urban development.

2. Constitutional and Legal Basis of Urban Local Bodies (ULBs)

74th Constitutional Amendment Act, 1992 (Articles 243Q to 243ZG) established ULBs to promote democratic decentralisation in urban governance.

Three-tier classification of ULBs -

1. Nagar Panchayats - Transitional areas (Article 243Q (1)(a))
2. Municipal Councils/Municipalities - Smaller urban areas (Article 243Q (1)(b))
3. Municipal Corporations (MCs) - Large urban areas (Article 243Q (1)(c))

3. Governance Structure of ULBs

Municipal Corporations (MCs) - Led by an elected Mayor and administered by a Municipal Commissioner.

Municipalities/Nagar Panchayats - Headed by a Chairperson or President.

Functional Mandate - Responsible for 18 functions under the 12th Schedule, including -

1. Urban planning
2. Water supply
3. Waste management
4. Public health
5. Roads and street lighting

Scale - India has 4,979 ULBs, including -

1. ~253 Municipal Corporations
2. ~2,187 Municipal Councils
3. ~2,107 Nagar Panchayats

4. Metropolitan Areas

Defined under Article 243P(c); require Metropolitan Planning Committees (MPCs) to coordinate multiple ULBs. Criteria - Population ≥ 10 lakh, spanning one or more districts with multiple municipalities/panchayats.

5. Constitutional Provisions for Municipal Finance

Article 243X - State legislatures may empower municipalities to levy, collect, and appropriate taxes, duties, tolls, and fees.

Article 243Y - Mandates State Finance Commissions (SFCs) to recommend revenue distribution and review municipal finances.

Article 280(3)(c) - Central Finance Commission (CFC) can recommend measures to augment state funds for municipalities based on SFC recommendations.

6. Revenue Sources of ULBs

A. Own Sources -

Tax Revenue - Property tax, advertisement tax, water benefit tax, electricity tax, education tax, and other local taxes.

Non-Tax Revenue - User charges, license fees, development charges, etc.

B. Assigned (Shared) Revenue - Entertainment tax (subsumed under GST, except local levies), professional tax.

C. Grants-in-aid - Devolution from SFCs and CFCs.Programmes like Swachh Bharat Mission (SBM) and AMRUT.

D. Borrowings - Loans from state/central governments, banks, etc.

7. Benefits of Robust ULBs

Efficient Urban Service Delivery - E.g., Indore's Swachh Survekshan ranking due to stable municipal funding.

Economic Competitiveness - Investment in logistics, transit, and digital infrastructure boosts GDP.

Climate Resilience & Sustainability - Example - Kochi's climate-resilient urban project co-financed via local revenues and AMRUT grants.

Citizen Accountability - Transparent fiscal management improves tax compliance and trust. Example - PCMC participatory budget initiative.

8. Reform Initiatives & Policy Framework

74th Amendment - Empowered municipalities with 18 functions, mandated SFCs every 5 years.

AMRUT 2.0 (2021–26) - ₹2.99 lakh crore outlay for universal water supply, sewerage coverage, and urban resilience.

Municipal Bonds - Enable cities to access capital markets for socio-economic development projects.

Own Source Revenue (OSR) Training - Ministry of Panchayati Raj & IIM-A training for financial self-reliance of Gram Panchayats.

NIPFP Financial Models - Frameworks for replicable OSR strategies.

Samarth Portal - Digital dashboard for real-time OSR collection.

Model OSR Rules - Standardised rulebook for PRIs to mobilise own revenue.

9. Challenges in Fiscal Architecture of ULBs

Low Revenue Generation - Municipalities generate only 0.6% of GDP (FY24).

Revenue-Responsibility Mismatch - Cities perform 18 functions but control <1% of taxes.

Weak Implementation - 74th Amendment provisions partially implemented; GST subsumed octroi/entry tax → ~19% municipal revenue loss.

Weak Fiscal Autonomy - Municipalities cannot revise taxes without state approval.

Irregular SFCs - Only 10–12 states comply with five-year cycles.

Tied/Unpredictable Grants - Over 70% of Smart Cities funds centrally monitored.

Low Fiscal Transparency - Only 28% of states/UTs publish audited statements; mega cities 17%.

10. Comparative Analysis - Scandinavian Model vs. India

Aspect	Scandinavian Countries (Denmark, Sweden, Norway)	India (Current Scenario)
Local Tax Powers	Municipalities levy income tax (20–30%)	No income tax; rely on property/user charges
Share in National Taxes	Defined, formula-based, predictable	Dependent on state/central grants; often discretionary
Fiscal Autonomy	High; cities decide rates, budgets, priorities	Limited; require state approval
Revenue Predictability	Stable via income and shared taxes	Fluctuates with tied grants; low predictability
Citizen Accountability	Residents see tax usage; trust & participation high	Weak link between taxes & service delivery
Governance Outcomes	Transparent budgets, strong services, equitable welfare	Chronic underfunding, service deficits, weak accountability

11. Reform Roadmap - Strengthening Municipal Fiscal Architecture

A. Constitutional & Institutional Reforms - Enforce time-bound SFCs; digital dashboard to track devolution.

Direct fiscal transfers - Formula-based, untied grants from 16th Finance Commission. Introduce Municipal Fiscal Responsibility Laws (MFRL) - deficit limits, disclosure norms, debt ceilings.

B. Strengthening Own Revenues -
Property Tax Modernisation **-** GIS-based mapping, digital valuation, automated billing.
Diversify local taxes/fees - congestion fees, advertisement tax, tourism cesses.
C. Rationalising Grants & Transfers - Formula-based, untied transfers via Municipal Finance Authority.
Performance-linked incentives - reward cities with better audits, OSR, transparency.
D. Capital Finance & Market Reforms - Expand Pooled Finance Development Fund (PFDF) for joint borrowing. Recognise transfers as collateral for debt. Scale up green & SDG municipal bonds - e.g., Vadodara's ₹100 crore green bond for wastewater treatment.
E. Pitfalls of Municipal Bonds - Creditworthiness constraints, weak financial management, legal obstacles, market risk, moral hazard, small-scale/illiquidity. Municipal bonds cannot substitute for structural fiscal reforms.

12. Conclusion

Fiscal empowerment of municipalities is critical for urban transformation and cooperative federalism. Predictable devolution, credible revenue powers, and transparent governance will enable cities to become engines of sustainable national growth. Focus on structural reforms, capacity building, and fiscal autonomy is essential to bridge the urban service and development gap in India.

Source - [https - //www.thehindu.com/news/national/why-is-the-fiscal-architecture-of-municipalities-flawed-explained/article70168668.ece](https://www.thehindu.com/news/national/why-is-the-fiscal-architecture-of-municipalities-flawed-explained/article70168668.ece)