# Municipal Finance: A Case for a Statutory share in State GST to the Municipalities

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## Abstract

Financial health of municipalities needs due cognizance on urban decentralisation to be pursued for India @ 2047.The state of municipal finance in India shows wide gap as compared to its normative base vis-a-vis inter-country data. Goods and services The paper examines the municipal finance in Maharashtra in the context of abolition of octroy and associated compensation which appears to be fairly low as compared to proceeds from GST.As the share of Goods and services Tax (GST) particularly state GST in India has shown rapid increase in its proceeds it need to be shared with local bodies directly .It suggested that 10 percent of proceeds from state GST should be considered for sharing with cities directly.it will improve the delivery of municipal functions in line with schedule XII(,article 243W).

**Keywords:** XII schedule, Funds, Octroi, Property tax, functions and functionaries, GDP, State GST, Finance Commissions

The Seventy-fourth Amendment to the Constitution of India made it a Constitutional requirement for the state governments to set up and empower urban local bodies. In this context, Article 243-W of the Constitution of India reads as under.

**Article 243-X. Powers, authority and responsibilities of Municipalities, etc.-** Subject to the provisions of this Constitution, the Legislature of a State may, by law, ---------------- endow the municipalities such powers and authority as may be necessary to enable them to carry out the responsibilities conferred upon them in relation to the matters listed in the Twelfth Schedule.

The provisions in the Twelfth Schedule to the Constitution are as under.

## Twelfth Schedule

1. (Article 243-W)
2. Urban Planning including town planning.
3. Regulation of land use and construction of buildings.
4. Planning for economic and social development.
5. Roads and bridges.
6. Water Supply for domestic, industrial and commercial purposes.
7. Public health, sanitation conservancy and solid waste management.
8. Fire Services.
9. Urban forestry, protection of the environment and promotion of ecological aspects.
10. Safeguarding the interests of weaker sections of society, including the handicapped and mentally retarded.
11. Slum improvement and up-gradation.
12. Urban poverty alleviation.
13. Provision of urban amenities and facilities such as parks, gardens, playgrounds.
14. Promotion of cultural, educational and aesthetic aspects.
15. Burials and burial grounds; cremations, cremation grounds and electric crematoriums.
16. Cattle pounds; prevention of cruelty to animals.
17. Vital statistics including registration of births and deaths.
18. Public amenities including street lighting, parking lots, bus stops and public conveniences.
19. Regulation of slaughter houses and tanneries.

Exercise of powers and authority require resources. Now the moot question is whether the Indian Municipalities have been given adequate resources or even the fair share of resources of the state governments to enable them to discharge the duties that may be allotted to them.

It is worth noting that the phrase used in the first sentence of Article 243-W is 'the Legislature of a State may, by law'. Thus this gives discretion to the State governments as to what powers, authorities and responsibilities they may pass to the Municipalities. If a State government does not wish to devolve some powers to the Municipalities, there is no compulsion on them to delegate. In Shanti G. Patel v. State of Maharashtra, (2006) 2 SCC 505, the Supreme Court observed, 'Existing provisions of statutes governing the field relating to urban planning and/ or regulation of land use and construction of buildings, etc. would continue to operate in that field unless a statute is enacted by State Legislature in terms of Article 243-W and Twelfth Schedule.' *'Shanti Patel v. State of Maharashtra, (2006) 2 SCC 505.'*

Most states enact separate laws for the Municipal Corporations and the Municipal Councils although the population norms for constituting a Municipal Corporation may be different. Usually more functions from the Twelfth Schedule are devolved by the state governments on the Municipal Corporations than on the Municipal Councils since the Municipal Corporations are expected to be financially stronger and less dependent on government grants.

It is thus up to the State government as to which powers and funds they want to transfer to the local bodies. Shri Mani Shankar Iyer, a former Minister for Panchayati Raj used to describe these as 3 F's; 'funds, functions and functionaries' In a Conference at IGIDR, Mumbai during 2017, he added that Rajiv Gandhi delegated powers to the Panchayats/ Municipalities, which he himself did not have. All the functions enumerated in Twelfth Schedule are from the State List in the Seventh Schedule and thus it is only the State government that can devolve these functions on the Municipalities. On the rural side, a separate Panchayati Raj Ministry was carved out of the Ministry of Rural Development to oversee the implementation of the 73$^{rd}$ Constitutional Amendment. Since most of the funds spent in rural India are grant-in-aid funds from the Central and State governments, this Ministry could play a major role in cajoling the State government to devolve more activities on the Panchayats. However, on the urban side there never was any such Central ministry/ initiative to impel the States for further devolution to the Municipalities.

The functions listed in the Twelfth Schedule are very diverse and it is useful to divide them in nine groups of inter-related subjects to examine the activities of the Municipalities. These groups could be divided as under.

| Group and Broad Area | Functions from the Twelfth Schedule |
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| Sanitation and Health | 3. Public Health, sanitation, Conservancy, Solid Waste<br>14. Burials, crematoriums<br>15. Cattle Pounds<br>16. Vital Statistics, births and deaths. |
| Roads | 4. Roads and Bridges,<br>17. Street-lighting, parking lots |
| Greenery | 8. Urban forestry<br>12. Parks, gardens, playgrounds. |
| Education | 3. Cultural, educational, aesthetics |
| Slums | 10. Slum Improvement, Urban Poverty |
| Welfare State | 3. Planning for economic and social development<br>9. Weaker sections, handicapped, mentally retarded |
| Water Supply | 5.Water supply for domestic, industrial and commercial purposes |
| Land use planning | 1.Urban Planning including town planning |
| Fire Brigade | 6.Fire Services |

It is generally seen that the activities in Groups A to E are performed by the Municipalities in almost all the States. Activities in Group F have come to the Municipalities because of centrally sponsored programmes and there is a general reluctance to devolve the functions in Groups G to I on Municipalities in many States.

It is also seen that more developed States generally devolve more activities on the local bodies. The devolution is thus like giving pocket money to a growing son. Obviously, the poorer parents cannot give much pocket money. Unlike the Central Finance commission, whose recommendations are accepted by the Government of India, the State Finance Commission recommendations are often kept in cold storage and sometimes do not even see the light of the day.

Praja Foundation, an NGO based in Mumbai ranks various States on the Praja Foundation's Urban Governance Index. The Foundation used four themes to evaluate the Index, which are not really part of the Seventy-fourth Amendment and may indicate spirit thereof. The four themes are, first, 'Empowered City Representatives and Legislative structure', secondly, 'Empowered City Administration', thirdly, 'Empowered Citizens' and fourthly, 'fiscal empowerment'. As per their latest report, Odisha ranks first, with a score of (56.86) followed by Maharashtra (55.15) and Chattisgarh (49.68). Meghalaya (14.82), Manipur (14.63) and Nagaland (13.37) are the bottom three states, according to this index. This is understandable since states are very small and comparable to a district in a large state. Thus, there is a limit as to what they can devolve on the local bodies.

Lastly, since most activities require money, even within comparable populations, a richer Municipality is able to give services of higher order. Thus, while Mumbai, Delhi, Ahmedabad and Thane Municipal Corporations have their own medical colleges, the poorer corporations cannot even set up a decent hospital.

## How the Municipalities evolved?

Although Lord Ripon (1882) is credited with the empowerment of elected Municipalities in India and 'Local government' was a subject mentioned in the State List of the Seventh Schedule to the Constitution of India, there was no Constitutional requirement of devolution of specific subjects on the Municipalities. The 74$^{th}$ Amendment of the Constitution during 1993 recommended the eighteen subjects for devolution. These subjects are all from the State List of the Seventh Schedule and as such it was left to the state governments as to whether these subjects should be devolved or not.

Before the Seventy-fourth Amendment, it was the state governments that decided to devolve activities on the municipalities through their respective Municipal Acts. This, Mumbai served as the role model in western India, Kolkata in the eastern India and Chennai in the south India. Delhi Municipal Corporation Act, 1957 is relatively recent. Shri P.R. Nayak, ICS, a former Municipal Commissioner of Mumbai was instrumental in drafting the Delhi Municipal Corporation Act as Joint Secretary in MHA, and he was also appointed as the first Municipal Commissioner of Delhi. However, Delhi, being a Union Territory and a city-state evolved its own system. The creation of Delhi Development Authority at the same time created a somewhat different system. This system of a city Development Authority and the city Municipal Corporation was often looked upon as the model while framing the municipal legislations in Northern and Central India. This area spreads over the large Hindi speaking-states and has somewhat similar culture.

**The 'million-plus' cities:** The Fifteenth Finance Commission has, for the first time, made a special effort to financially support these largest cities of India, that have more than a million population. Forty percent of the urban population lives in these cities and some urban agglomerations. As per 2011 census there were 48 such municipalities. Maharashtra has the highest number with ten, U.P. has seven, Gujarat and Madhya Pradesh four each, Rajasthan, NCT of Delhi and Tamil Nadu three each, Punjab, West Bengal, Jharkhand and Andhra Pradesh two each and Chattisgarh, J and K, Haryana, Bihar, Karnataka and Telangana one each. Thus only sixteen states or Union Territories have these 48 million-plus cities. In the history of Indian planning, it is for the first time that there is a Million-plus Challenge Fund of Rs. 38, 196 cr. that can be accessed by these million plus cities only through adequate improvements in their air quality and meeting service level benchmarks for drinking water supply, sanitation and solid waste management. This focus on metropolitan governance is 100 percent outcome-based grants.

First, the FFC (Fifteenth Finance Commission) has distinguished between the 'million-plus' cities and other cities. Since the Seventy-fourth Amendment this is probably the first time that the special challenges of metropolitan governance have been recognized for the purpose of grants. At the same time, these grants are not untied but specifically linked to the quality of life outcomes. Secondly, the two requirements of the audited annual accounts and bringing the property tax collections in line with the State's GDP, the FFC has given realistic targets to the Municipalities. The third requirement of acting on the State Finance Commission reports would really help in proper devolution to the local bodies.

The 'Million-plus' cities are the engines of growth for a country's economy. Jones Lang LaSalle (JLL) has recently published a JLL's City Momentum Index 2020. Indian Cities feature strongly despite a slowing national economy. Hyderabad emerges as the world's most dynamic city with last years' winner, Bengaluru in the second place. Another five Indian cities make it to the Top 20-Chennai (5th), Delhi (6th), Pune (12th), Kolkata (16th) and Mumbai (20th). Incidentally, all of these are 'million-plus cities' and would be studied in this paper.

Another characteristic of Indian cities is that they are often densest in the world. The famous Indian demographer Dr. Sripati Chandrasekhar has projected as early as 1969 that the Indian cities would be very dense. Dr. Chadrasekhar set up the Indian Institute of Population Studies at Deonar, Mumbai. The Institute was letter renamed as Indian Institute of Population Sciences.

## Municipal Finance:

'Government if finance'. - Lloyd George.

Lloyd' George's observation holds true in the municipal domain also. Effectively, the 'Local government is local finance'. The activities that the municipalities can take depend on the money that comes into the municipal fund. It is true that some infrastructure projects can be financed through borrowing but then the repaying of the loan is always through the municipal fund. India's local tax to GDP ratio was 0.33 percent in the last decade. It was 16.1 percent in Sweden, 12.7 percent in Denmark, 10.4 percent in Finland, 7.2 percent in Japan, 4.2 percent in Korea and 4 percent in the USA. It is true that the total tax to GDP ratio in the low income countries like India is itself much lower than the developed countries. However, the ratio further deteriorates when the local tax to GDP ratios are compared.

Even within the different Indian states, the per capita total municipal revenue varies greatly. During the last decade it varied from about Rs. 10000 per head for Maharashtra, Gujarat and Goa to about Rs. 1000 per head for Assam, Bihar, Mizoram and Sikkim. Within the same state, the larger and more industrialized cities have higher revenue per capita that the smaller cities without much industry.

This large variation in the incomes of the Municipalities is also reflected in the credit ratings for the municipal bonds when they try to raise money from the market.

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| AA+ | Navi Mumbai, Pune |
| AA | Ahmedabad, Hyderabad, Visakhapatnam |
| AA- | Surat, Nashik, Thane, Pimpri-Chinchwad |
| A+ | Indore, Kolkata, Vadodara |
| A- | Jaipur, Bhopal, Jabalpur, Mira-Bhayandar |
| BBB+ | Kota, Ludhiana |
| BBB | Hubbali-Dharwad, Kochi, Thiruvanthapuram, Nagpur, Jodhpur |
| BBB- | Kozhikode, Solapur |
| BB- | |

Property tax has been historically the main source of own revenue for the Municipal Corporations. Property tax is levied on unrealized increases in wealth i.e. the appreciation in property values. The governments are reluctant to increase the rates. The 13th Finance Commission had suggested Property Tax Boards, on the lines of regulators. However, the absence of legal title to property and the significant slum population make it difficult to increase the municipal income from property tax. There is a way to tax this appreciation in property, called 'the unearned increment' by John Stuart Mill. This is to link the property tax to the Ready Reckoner Rate or Circle Rate. Although the Fifteenth Finance Commission has included this in the Agenda of reforms, there is a reluctance of the state governments to implement this reform. Property tax revenues now account for 0.35 percent share of the GDP. This is below the estimated revenue in OECD countries, which is about 1 percent of taxes on immovable properties as a percentage of GDP. There are large inter-city variations in the per capita collection by different cities since the property values vary a great deal between cities. It is interesting to note that more than half of the property tax collection in the country is from the two states of Maharashtra and Gujarat, although these two states contribute only 20 percent of the country's GDP. Under Article 285 of the Constitution of India, properties of the Union Government are exempt from the property tax. However, usually agreements are reached with the Union Government and the state government to pay service charges for the services rendered. Exempted properties in India constitute about 10 percent of the total urban properties and about 11 percent of the assessed properties.

The primary role of Central and state transfers to urban local governments is to reduce horizontal and vertical imbalances. Notwithstanding their increasing importance vis-à-vis own resources in municipal finance, they still constitute a small and declining proportion of GDP in India. These are only 0.45 percent of GDP in India, as against 9.9 percent in the U.K., 7.8 percent in Italy and 6 percent in Norway. This is because the total tax/GDP ratio is quite low in India as compared to the above countries. By way of comparison, transfers from central government to state governments constitute 7.23 percent in India.

The recent Fifteenth Finance Commission (FFC) Report has retained the inter-se distribution of grants for all the local governments with 90 percent weightage on population and 10 percent on area, as was the case with the Fourteenth Finance Commission. This again does not correct the horizontal and vertical imbalance.

The total tax revenues in India are about 17 percent of the GDP. Since the Municipalities are now recognized as the third tier of the government, there is a strong case that at least 2 percent of the GDP is spent through the municipalities. In Maharashtra and Gujarat, the octroi, an indirect tax on the entry of goods into the local area, used to supplement the income of all municipalities. As a part of the tax reforms, octroi was at first abolished for the municipal councils. The compensation to the municipal councils, called LBT grants are now of the order of Rs. 3000 crores, which is about 1.5% of annual State GST collection in Maharashtra. Subsequently, during the tax reforms, octroi was abolished even in the Municipal Corporations and there was an ad hoc decision to compensate them of the final year's octroi collection plus an anuual increase of 8 per cent per annum. Incidentally, the annual increase in GST collection is about 13% per annum.

The grants in lieu of octroi have kept the Municipal Corporations in Maharashtra financially strong. Annual grants of Rs. 23000 crores (about 11 percent of total State GST collection) are paid to the 27 Municipal Corporations in Maharashtra. The Municipal Corporation of Greater Mumbai (MCGM) is the only Municipal Corporation to obtain a AAA rating by Crisil/ Standard and Poor. With an assured grant from the GST income, the MCGM is able to discharge many functions from the Twelfth Schedule to the Constitution.

Since the Property Tax collection for the Municipalities is only 0.35 percent of the GDP and even with reforms it is unlikely to exceed 0.5 percent in near future, there is a strong case to assign 10 percent of the GST collection from each city/ town to the local municipality. This will make the municipalities financially stable and less dependent on the arbitrary release of grants from the state government. The ad hoc decisions taken in Maharashtra after the abolition of the octroi have effectively achieved this. However, a Statutory/ Constitutional guarantee of this income to the Municipalities will enable them to discharge the duties entrusted to them more effectively.