

Book Review

Financing Cities in India

Municipal Reforms, Fiscal Accountability and Urban Infrastructure

Reviewed by

Pradeepta Kumar Samanta

Associate Professor in Finance, School of General Management (SoGM)

National Institute of Construction Management and Research (NICMAR)

Pune – 411045, Email: pksamanta@nicmar.ac.in

<i>Author</i>	:	<i>Prasanna K. Mohanty</i>
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India is rapidly urbanizing as the urban population increased from 62 million in 1951 to 286 million in 2001 and 377 million in 2011 and is expected to become half a billion by 2020. The level of urbanization rose from 17% in 1951 to 28% in 2001 and 31% in 2011. In 2031, at least 50% of the population will live in urban areas, and their contribution to the GDP will be about 63%. Cities in India face a gross mismatch between their responsibilities and revenues. The lack of adequate revenues with municipalities has resulted in a vicious circle; insufficient investments in infrastructure, poor quality of services, lack of willingness of citizens to pay taxes and charges, the poor state of municipal finances and so on. This vicious circle needs to be broken by addressing the factors responsible for the fiscal gap in cities. These factors include narrow resource base of municipalities, inadequate intergovernmental transfers, inefficient collection of taxes, user charges and benefit charges, lack of capacity to borrow and weak service delivery systems. Serious finance and governance issues plague India's cities, undermining their competitive strength in the globalizing world economy. The haphazard growth of Indian cities is largely due to the haphazard way in which they have been financed.

The Jawaharlal Nehru National Urban Renewal Mission (JNNURM) launched in 2005 was the first major initiative in India to provide reform-linked funding support from the central government to cities for infrastructure and basic services. It emphasized the implementation of 23 state and city-level reforms, including those to strengthen municipal finances. The reforms, however, have met with only partial success. Keeping in mind the experience, the Government of India has recently launched new initiatives such as Smart Cities Mission, and Atal Mission for Rejuvenation and Urban Transformation aimed at transforming urban India. The success of these missions will crucially depend on how the current strategies to finance cities in India are revamped.

Chapter one provides an overview of the worrying municipal finances in the Indian scenario as cities drive growth and productive employment. *Chapter two* presents the dimensions of India's urban fiscal problem and a logical framework to address the same. The author presents a framework for urban public finance reforms rooted in the generalized benefit principle, including golden rules of local public finance and principle of earmarked benefit taxes. This framework is aimed at guiding the levy of user charges, benefit charges, benefit taxes, and

general taxes, and the design of debt instruments to finance regional and urban infrastructure.

Chapter three discusses municipal taxation, including an alternative to octroi. It emphasizes the need to empower cities with a broad-based portfolio of taxes that enable them to exploit agglomeration externalities. The author has suggested a city GST rate within state GST rate or a formula-based share in state GST for municipalities. Also, cities may be enabled to access the divisible pool of central taxes, including central GST through the Central Finance Commission route. It is only logical that cities, which create growth, are enabled to benefit from it to further augment growth.

Chapter four presents a strong case for urban land value tax in India, citing theory and practice. The author has examined the practice of urban land value taxation adopted internationally. Finally, he has advocated linking vacant land tax (VLT) to the capital value of the land. Further, the tax on land may be levied at a rate higher than on built-up property to promote land development, including housing. The land tax component of property tax and VLT may be escrowed to leverage debt from the market to undertake infrastructure projects leading to increased land values and making way for further resource mobilization.

Chapter five addresses the issues of property tax reforms in India. The property-tax GDP ratio in India is very low compared to developed and most developing countries. The author has recommended a split-rate property tax: one rate for land and another for building on the basis of experiments of property tax reform carried out in Hyderabad, Bengaluru, and Mumbai. Efforts may also be initiated to shift property tax base to a capital value of land and buildings in large cities to benefit from the ongoing increase in real estate values due to urbanization, agglomeration externalities, and economic growth. The unit area value (UAV) method, followed by the municipal corporation of Bengaluru with mapping of properties using Geographic Information System

(GIS) offers a promising approach to replicate aiming at a higher property tax-GDP ratio.

Chapter six examines issues of user charges, benefit charges in the light of poor cost recovery record in municipalities and utilities in India. Insufficient cost recovery in services hurt the urban poor with limited access to lifeline services the most. The author has suggested that charges for services should cover operation and maintenance (O&M), capital, environmental and resource opportunity cost along with a component for cross-subsidizing the poor. Further, he has advocated for full cost recovery by combining instruments of 'user pay,' 'beneficiaries pay,' 'polluters pay,' 'exacerbaters pay' and 'congesters pay.'

Chapter seven focuses on the design of intergovernmental transfers to municipalities to correct for vertical and horizontal imbalances and address the huge demands of capital investment in cities. In India, two constitutional channels review the devolution of resources to municipalities: SFC and CFC. However, fiscal transfers to ULBs in the country remain in a highly unsatisfactory state. The recommendations by CFCs and SFCs also bear no relation to the requirements of cities. Unlike many countries, intergovernmental transfers to ULBs in India are also not formula-based, incorporating weights to 'fiscal need,' 'fiscal capacity,' and 'fiscal effort' factors.

Chapter eight deals with key instruments of financing of land and infrastructure development adopted internationally. Development financing instruments promote planned urban expansion and renewal, without burdening local, state and central government exchequers. Development financing including municipal bonds, bond banks, pooled finance bonds, financial intermediation, lease purchase contracting and so on, offer considerable opportunities to undertake urban infrastructure development in India. *Chapter nine* discusses key instruments of value capture financing including land value capture (LVC). These tools enable public authorities to trade

anticipated future revenues for a present infrastructure programme. They aim at appropriating and recycling the values generated by public sector actions and private sector investments in cities.

Chapter ten outlines a roadmap for reforms in India's urban public finance, taking into account principles and practices, as well as the context of India's fiscal federalism. The author has suggested an amendment to the Constitution of India include a 'municipal finance list' corresponding to the 12th Schedule. This list may include: property tax, land value tax, land use conversion tax, entertainment tax, utility user taxes, carbon tax, a statutory share in motor vehicle tax, motor fuel tax, transfer of property tax/stamp duty and mining royalties, a city GST or a statutory city share in state GST, user charges, benefit charges including Floor Space Index (FSI) charges, betterment charges, development charges and impact fees. Cities create value

through externalities, spatial planning, infrastructure, local economic development, and growth. When external economies are vibrant, benefit taxation and value capture financing mechanisms offer unique opportunities for self-financing urban development.

As India embarks on a program of smart cities, urban public finance reforms stand out as a critical area for focused attention. The author with his vast experience in the urban development and city administration refers in the book to the principles of urban public finance and practices of financing urban infrastructure and services in countries drawing lessons from across the globe. This book is undoubtedly a must-read for the policy makers, planners, administrators and research scholars in the area of city/urban development for understanding and brainstorming.