

## **Financing Urban Infrastructure and Strengthening Municipal Finance**

### **Recommendations for GOI's 2025-26 Budget**

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**Importance of cities:** India has the second largest urban population in the world, with 11 per cent of the global urban population living in Indian cities. Urban growth is expected to contribute to 73 per cent of the total population increase by 2036, further aggravating the pressure on the city's infrastructure. Cities in India occupy just 3.0% of the nation's land and 30% of the population, but their contribution to gross domestic product (GDP) is 60.0%. An analysis of estimated district GDP reveals that each percentage point increase in a district's urban population share is associated with a 2.7% increase in district GDP. To support GDP growth, cities will need to strengthen their infrastructure. Municipal Finance must be strengthened for cities to be the "engines of economic growth".<sup>1</sup>

**High urban infrastructure finance requirements:** India's cities require an estimated capital investment of USD 840 billion in urban infrastructure and municipal services in the 15 years till 2036, —or an average of \$55 billion (INR 45,000 Cr.) per annum.<sup>2</sup>

**Cities as major contributors to Climate Agenda:** Cities will also contribute to India's NDCs for Global Climate Action. This will require attention to several aspects of urban development, ranging from environmental issues to appropriate mobility choices and the management of used water and solid waste. Specific programmes are also needed to make cities climate-resilient – especially from erratic rains leading to flooding and extreme heat.

#### **So what should Union Budget 25-26 focus on for cities?**

- 1. Enhance the urban budgetary allocation:** The government of India has seen urbanisation as an opportunity to bring transformational change in urban infrastructure delivery through GOI budgetary allocation. For this reason, urban sector investment by this government was increased by 10X from 2004-2014 to 2014-2023. However, from 2014-2024, the average share of the urban budget to the total union budget is about 1.65%. To

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<sup>1</sup> [https://cwas.org.in/resources/file\\_manager/Strengthening\\_Municipal\\_Finances%20\\_White\\_paper.pdf](https://cwas.org.in/resources/file_manager/Strengthening_Municipal_Finances%20_White_paper.pdf)

<sup>2</sup> Sohaib Athar, Roland White and Harsh Goyal. 2022. "Financing India's urban infrastructure needs: Constraints to commercial financing and prospects for policy action." Washington, D.C.: World Bank.

**continue this momentum and pace, the Union budget 2025-26 may consider increasing the share of urban allocation.**

2. **Urban infrastructure or service delivery?** For cities to be more effective engines of growth, the urban population also needs access to good urban services – water supply, sanitation, used water and solid waste management, roads and transport. While considerable investments have gone into these over the past decades, little is known about service levels, quality, and service coverage. The lack of reliable and updated information on these services often leads to misallocation of resources. Such information gaps on service performance often result in an undue focus on building new infrastructure without adequate service quality improvement. The PAS-Service level Benchmark has over a decade of information on service delivery<sup>3</sup>. Publicly available information on service delivery should be mandatory. While many urban missions have advocated this, more attention is needed. **Cities should publish Service Level Benchmarks (SLBs) in the local press and on their website and make a “citizen pact’ on the service level that will be provided next year.**
3. **Share of the Third Tier in GST:** Cities have two main sources of financing – their own-source revenues and inter-governmental transfers and grants. Currently, these are insufficient to bridge the large infrastructure financing gap. The 15<sup>th</sup> Finance Commission has addressed the issue of ‘own source of municipal finance’ by making raising property tax revenue in sync with the State Domestic Product a mandatory condition. However, many cities, especially smaller ones, will struggle to meet these conditions. In contrast, some of the more lucrative sources of income, such as octroi, have, over the years, been taken away from urban local governments. The introduction of Goods and Service Tax (GST) in 2018, has further affected some key sources such as Entry tax (octroi), Local Business Tax (LBT), Advertisement tax and Entertainment tax. Both political stalwarts and learned academicians have argued for a share of the GST for the third tier. Ahluwalia et al. (2019) suggested that “the long-term solution to correct for the structural fiscal imbalance”, *which has crept into the system following the GST-related Constitutional*

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<sup>3</sup>[https://cwas.org.in/resources/file\\_manager/performance\\_assessment\\_system\\_for\\_urban\\_water\\_supply\\_and\\_sanitation\\_2018\\_-executive\\_summary.pdf](https://cwas.org.in/resources/file_manager/performance_assessment_system_for_urban_water_supply_and_sanitation_2018_-executive_summary.pdf)

*amendments in 2016, is for the Constitution to be amended again to provide sharing of the revenues from GST among all three levels of government.<sup>4</sup> Prof. Vijay Kelkar also highlighted the vertical imbalance in India's federalist structure and advocated for a share of GST resources for the Third Tier by allocating "1/6th of GST revenues for the Third Tier".*

**The Union budget 2025-26 may consider constituting a High-Level Committee to recommend structural reforms needed for the fiscal empowerment of ULBs in India.<sup>5</sup>**

4. **Support for Municipal Bonds:** Despite the introduction of municipal bonds in India for over 20 years, there has been limited use of this route. Under the MOUHA's AMRUT program, cities receive subsidies for the issuance of municipal bonds. Despite the availability of this subsidy, the low off-take of municipal bonds suggests that the grant funds for urban infrastructure from national and state missions crowd out market borrowings. In addition, cities require considerable initial technical support for this. Explicit funding for this is needed to develop the capacity of municipal authorities and market players.

In the USA, municipal bonds worth \$385.6 billion were issued last year, with a total outstanding of \$4.0 trillion. This has been possible largely due to the tax-free status accorded to municipal bonds. The Government of India 2015 allowed seven PSUs to raise tax-free bonds worth 40,000 crores. A similar approach should be adopted to encourage retail and institutional investment in municipal bonds. ***Initially, Rs 10,000 crore worth of tax-free municipal bonds may be permitted in fiscal 2025-26. This can easily be accommodated under Section 10(15) of the Income Tax Act, 1961.***

5. **Creditworthiness of Cities:** The experience of the past two decades shows that only large ULBs with good technical competencies have been able to meet the necessary requirements of bond issuance. Raising capital through municipal bonds requires an assessment of the creditworthiness of cities. Assessing the creditworthiness of a city is the first step towards accessing capital markets. We have developed a framework for

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<sup>4</sup> Ahluwalia, I., Mohanty, P., Mathur, O., Roy, D., Khare, A., and Mangla, S. (2019). State of Municipal Finances in India: A report prepared for the Fifteenth Finance Commission. Indian Council for Research on International Economic Relations

<sup>5</sup> Kelkar, V. (2019). Towards India's New Fiscal Federalism. NIPFP Working Paper No. 252

assessing the creditworthiness of cities using publicly available data. This framework was tested for 30 Indian cities. It provides an approach and methodology that cities can use in decision-making as a precursor to actual credit rating and market borrowing.<sup>6</sup>

- 6. Green Bonds:** From the Sovereign Green Bonds, a proportion (say 30%) should be earmarked for cities that develop 'green' projects, enabling them to save the cost of raising bonds. The budget should support efforts for project development using the funds from the Sovereign Green Bonds in waste management, efficiency in energy use in urban infrastructure and transition to solar energy for urban infrastructure. Increasing the green cover in our cities, especially through gardens and urban forests, will also help increase the area of carbon sinks that help in carbon sequestration. **Such activities are being demonstrated in many cities, but the specific targets through budgetary provision support is needed for projects for effective scaling up.**
- 7. Urban Property Tax:** For Urban Local Bodies (ULBs) in India, property tax is an important source of own revenue. Its economic rationale is that it makes it possible to capture a part of the 'unearned' increase in property values, as urban property values rise with infrastructure investments by ULBs. Property tax revenues as a share of GDP in India was only 0.15 per cent, which compares rather unfavourably with 0.6 per cent for developing countries and 2.1 per cent for developed countries.<sup>7</sup> International practice is to levy property tax on capital value. Some states in India (Maharashtra, Karnataka) have moved in this direction. However, many states have continued with the archaic "Annual Rateable Value" (ARV), or the Unit Area Method. **The union budget can urge states to move toward "capital value" based property taxation. The union budget may support the programme in adopting digital tools and drone-based surveys to enhance property tax and other non-tax collection efficiency.**<sup>8</sup>
- 8. Making Cities Climate Resilient:** Extreme weather patterns – temperatures rising to 50 C, erratic rains, flooding – now occur more frequently than in the past. The impact of these

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<sup>6</sup> <https://cwas.org.in/cwas-resources/creditworthiness-assessment-an-approach-for-indian-cities>

<sup>7</sup> [https://cwas.org.in/resources/file\\_manager/Strengthening%20Municipal%20Property%20Tax.pdf](https://cwas.org.in/resources/file_manager/Strengthening%20Municipal%20Property%20Tax.pdf)

<sup>8</sup> [https://cwas.org.in/resources/file\\_manager/assessing\\_land-based\\_tax\\_systems\\_in\\_municipal Acts\\_in\\_India\\_\(2020\).pdf](https://cwas.org.in/resources/file_manager/assessing_land-based_tax_systems_in_municipal Acts_in_India_(2020).pdf)

extreme events on people living in cities and their livelihoods is likely to be significant. Understanding and preparing cities to mitigate and adapt to these changes will lead to a more sustainable future. **A dedicated mission for Climate Action in Cities, such as Mission URVEE (Urban Rejuvenation for Environment and Ecology) is needed to incentivize and fund city-level initiatives focused on renewable energy adoption, promoting water security through groundwater recharge, lake rejuvenation and rainwater harvesting, and the creation of urban forests utilizing treated wastewater.**

**9. PPPs for Solar Power Projects in Cities:** Cities spend nearly 30% of their budget on electricity. **We suggest setting up a mission like 'PM Surya Shahar', on the lines of 'PM Suryoday Yojana'.** Under a PPP arrangement, private entities can enter into a solar power purchase agreement with cities. This proposal will help attain sustainability of operations due to reduced energy bills and help India attain reduced carbon emissions as per the National Determined Contributions (NDCs). We have supported a few ULBs in Maharashtra to set up solar projects at their WASH infrastructure, and, to date, through 180 KW of solar that we have set up, it has potentially leveraged 8300 MWH of clean energy over 25 years, leading to a savings of INR 6 crores and carbon emissions reduction of 6800 tons.<sup>9</sup>

**10. Controlling urban flooding and groundwater recharge:** Another impact of climate change is erratic rainfall, which leads to flooding. Floods cause significant loss of economic life and, often, human lives. ULBs need support for identifying flood-prone zones and making percolation wells - like Artificial recharge tubewell (ARTW), percolation pits and Khambhati Kuva. We have demonstrated some of these initiatives in Gujarat for Anjar and Gandhidham in Kutch Region of Gujarat.<sup>10</sup> This initiative has helped reduce flooding and increase groundwater. Recharge zones and potential sites for recharge wells can be identified based on a sound understanding of local hydrogeology and community involvement. **The Union budget can make allocations for these activities and link to the newly launched programme of the honourable PM for 'jansanchay – jan bhagidari'.**

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<sup>9</sup> <https://cwas.org.in/cwas-resources/moving-towards-climate-resilient-wash-services>

<sup>10</sup> <https://cwas.org.in/cwas-resources/water-secure-and-climate-resilient-cities-anjar-and-gandhidham-citywide-assessment>

**11. Engaging women SHGs for service delivery:** GoI's initiatives, such as the DAY-NULM, have helped to form institutions of economically marginalized communities, especially women, into SHGs and provided them with training and credit support to promote self-employment. There is significant potential to explore participation of SHGs in delivery of urban services. These services can include maintaining municipal assets and infrastructure, such as buildings, canteens, gardens, wastewater treatment plants etc. Traditionally, many local governments outsource these services to the private sector. Through initiatives like the SBM-NULM convergence program, the GoI had encouraged the provision of livelihood to SHGs in sanitation-related activities. This can be further leveraged by allocating funds to the ULBs to make regular payments to the SHGs and develop their capacities. Such allocations should include specific guidelines, ensure regular payments to SHGs, and provide them with the necessary training. **The allocations under the AMRUT Mitra initiative of Rs. 150 crores have helped make regular payments to SHGs and conduct their training programs. This can be enhanced further in the budget.**