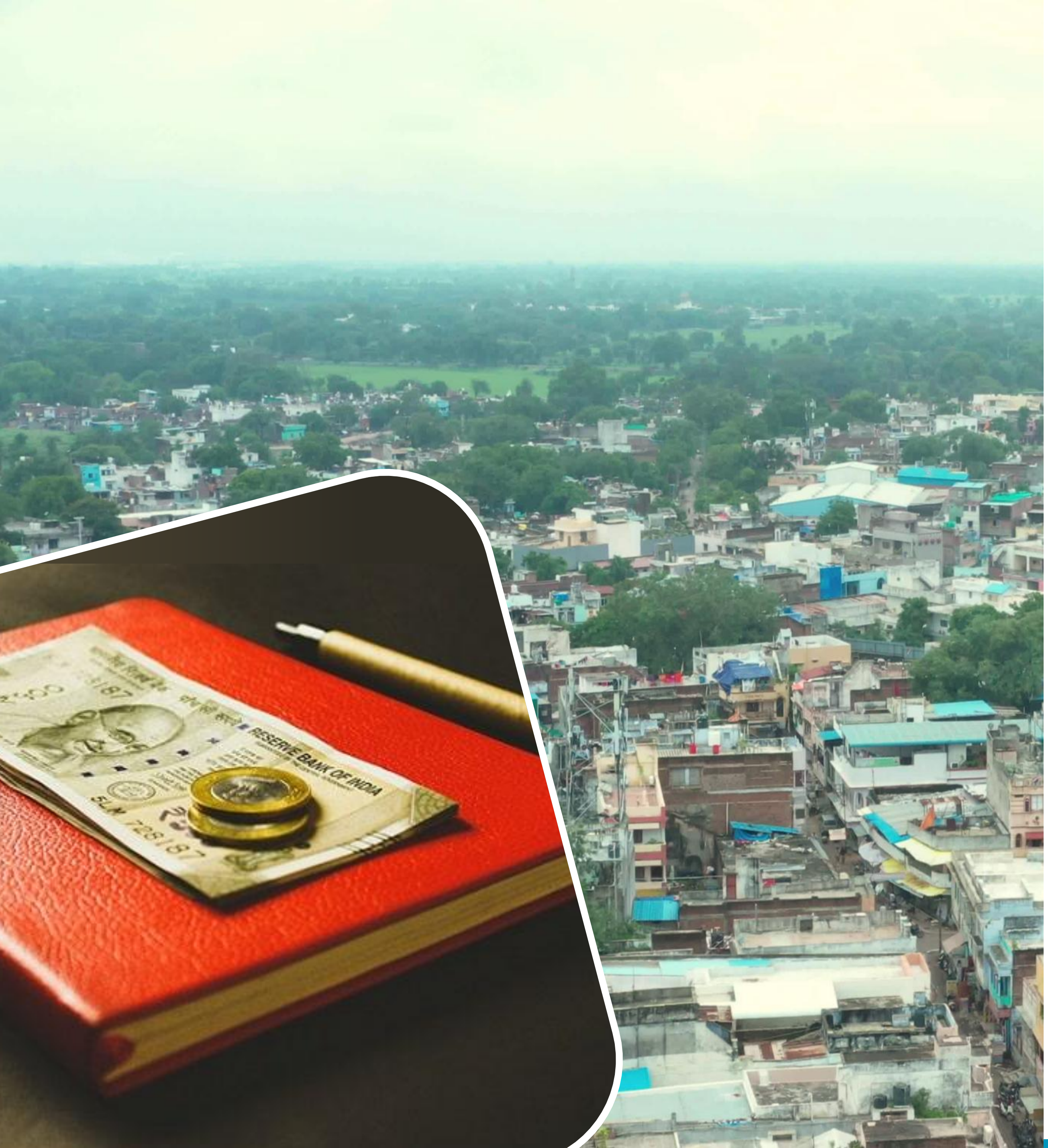

Fiscal Dimensions of Urban Governance in India

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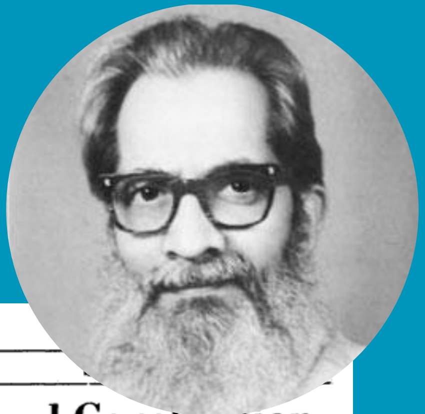
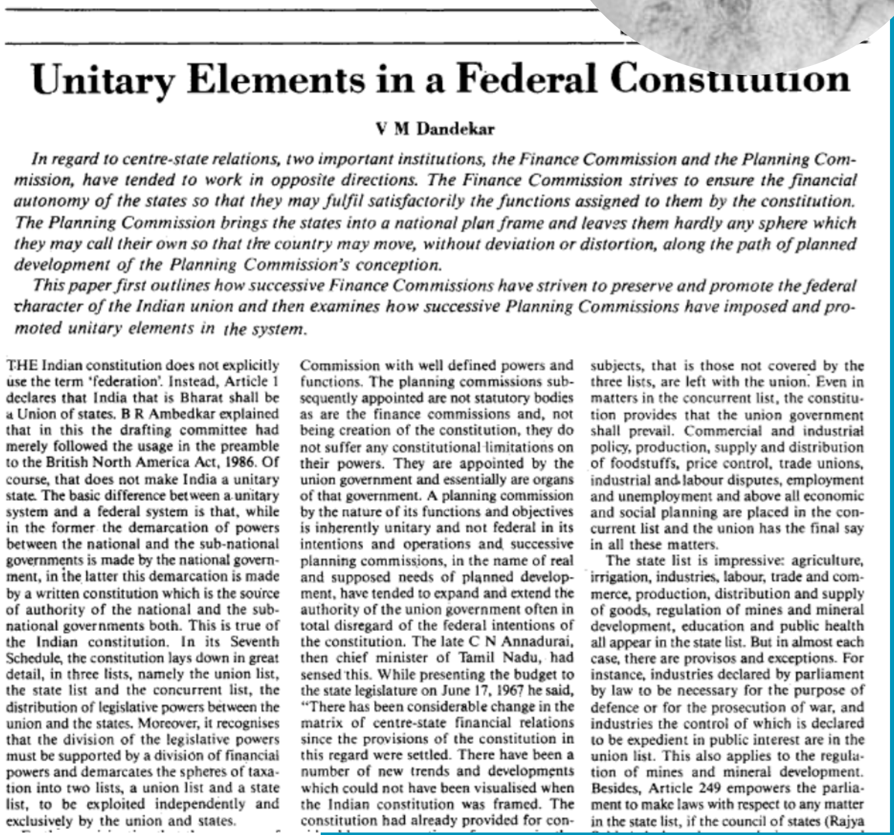
January 2026

Prof Dandekar on Fiscal Decentralisation

- In his 1987 article, "Unitary Elements in a Federal Constitution," Prof. V.M. Dandekar critiques the structural imbalances within the Indian Constitution that favour a strong central government over state autonomy.
- He pointed out that while states are responsible for many public services, the most productive revenue sources (customs, excise, income tax) are vested in the Centre, leading to this inherent financial imbalance.
- A similar situation prevails today regarding local governments. This presentation focuses on systemic 'disempowerment' of local governments in India





Unitary Elements in a Federal Constitution

V M Dandekar

In regard to centre-state relations, two important institutions, the Finance Commission and the Planning Commission, have tended to work in opposite directions. The Finance Commission strives to ensure the financial autonomy of the states so that they may fulfil satisfactorily the functions assigned to them by the constitution. The Planning Commission brings the states into a national plan frame and leaves them hardly any sphere which they may call their own so that the country may move, without deviation or distortion, along the path of planned development of the Planning Commission's conception.

This paper first outlines how successive Finance Commissions have striven to preserve and promote the federal character of the Indian union and then examines how successive Planning Commissions have imposed and promoted unitary elements in the system.

THE Indian constitution does not explicitly use the term 'federation'. Instead, Article 1 declares that India that is Bharat shall be a Union of states. B R Ambedkar explained that in this the drafting committee had merely followed the usage in the preamble to the British North America Act, 1986. Of course, that does not make India a unitary state. The basic difference between a unitary system and a federal system is that, while in the former the demarcation of powers between the national and the sub-national governments is made by the national government, in the latter this demarcation is made by a written constitution which is the source of authority of the national and the sub-national governments both. This is true of the Indian constitution. In its Seventh Schedule, the constitution lays down in great detail, in three lists, namely the union list, the state list and the concurrent list, the distribution of legislative powers between the union and the states. Moreover, it recognises that the division of the legislative powers must be supported by a division of financial powers and demarcates the spheres of taxation into two lists, a union list and a state list, to be exploited independently and exclusively by the union and states.

... Commission with well defined powers and functions. The planning commissions subsequently appointed are not statutory bodies as are the finance commissions and, not being creation of the constitution, they do not suffer any constitutional limitations on their powers. They are appointed by the union government and essentially are organs of that government. A planning commission by the nature of its functions and objectives is inherently unitary and not federal in its intentions and operations and successive planning commissions, in the name of real and supposed needs of planned development, have tended to expand and extend the authority of the union government often in total disregard of the federal intentions of the constitution. The late C N Annadurai, then chief minister of Tamil Nadu, had sensed this. While presenting the budget to the state legislature on June 17, 1967 he said, "There has been considerable change in the matrix of centre-state financial relations since the provisions of the constitution in this regard were settled. There have been a number of new trends and developments which could not have been visualised when the Indian constitution was framed. The constitution had already provided for con-

... subjects, that is those not covered by the three lists, are left with the union. Even in matters in the concurrent list, the constitution provides that the union government shall prevail. Commercial and industrial policy, production, supply and distribution of foodstuffs, price control, trade unions, industrial and labour disputes, employment and unemployment and above all economic and social planning are placed in the concurrent list and the union has the final say in all these matters.

The state list is impressive: agriculture, irrigation, industries, labour, trade and commerce, production, distribution and supply of goods, regulation of mines and mineral development, education and public health all appear in the state list. But in almost each case, there are provisos and exceptions. For instance, industries declared by parliament by law to be necessary for the purpose of defence or for the prosecution of war, and industries the control of which is declared to be expedient in public interest are in the union list. This also applies to the regulation of mines and mineral development. Besides, Article 249 empowers the parliament to make laws with respect to any matter in the state list, if the council of states (Rajya

V M Dandekar (1987), Unitary Elements in a Federal Constitution, Economic and Political Weekly Vol. 22, No. 44 (Oct. 31, 1987), pp. 1865-1867+1869-1870

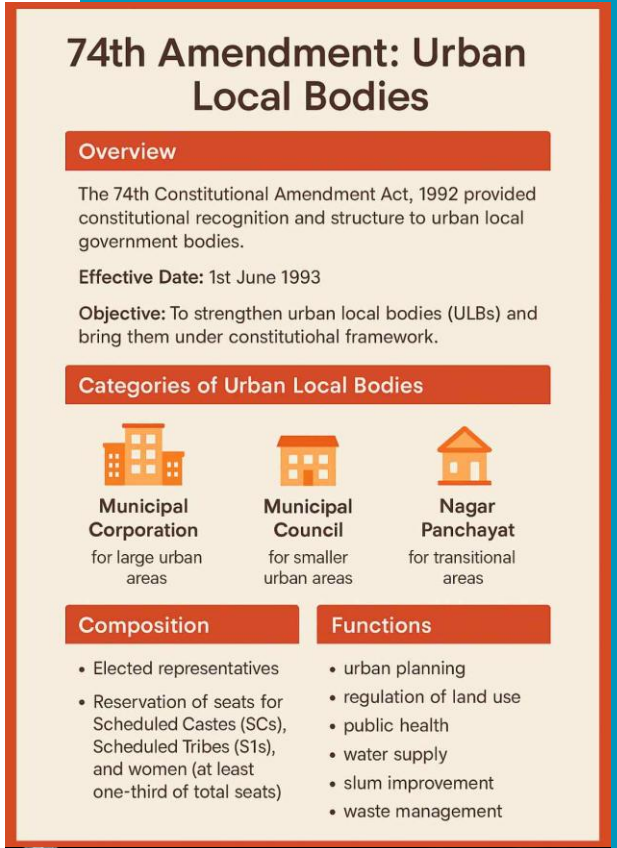
Fiscal Dimension

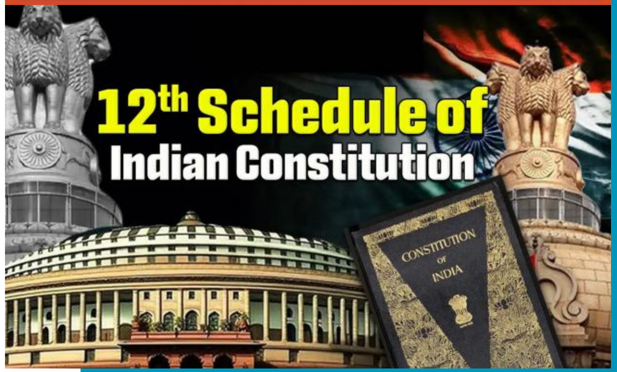
- The fiscal dimension of urban governance refers to the systems, processes, and policies through which urban local bodies (municipalities, corporations, etc.) finance their operations, manage their resources, and make decisions regarding public expenditure and revenue generation
- The fiscal dimension encompasses several essential elements. However, in this presentation, we will focus on revenue generation by the urban local body. More specifically, we will focus on:
    - Own Sources that include local taxes (like property tax) and user charges, fees, etc.
    - Grants and transfers from higher levels of government (state and central),
    - Innovative financing like Blended Finance, Municipal bonds etc.

M. Govinda Rao and Richard M. Bird, 'Urban Governance and Finance in India', NIPFP

74th Amendment – did it empower ULBs?

- Municipalities have been established as 'The third tier of Government' by the 74th CAA
- The Act has incorporated the Twelfth Schedule, containing a list of 18 functions as the functional domain of Urban Local Bodies.
- However, there is no separate list of taxes indicated in the Constitution for assignment to the municipal governments.
- State governments are required to assign the tax powers to local governments from the State List in the Seventh Schedule.
- Assignment of functions and sources of finance to municipal bodies is to be done at the complete discretion of State governments.





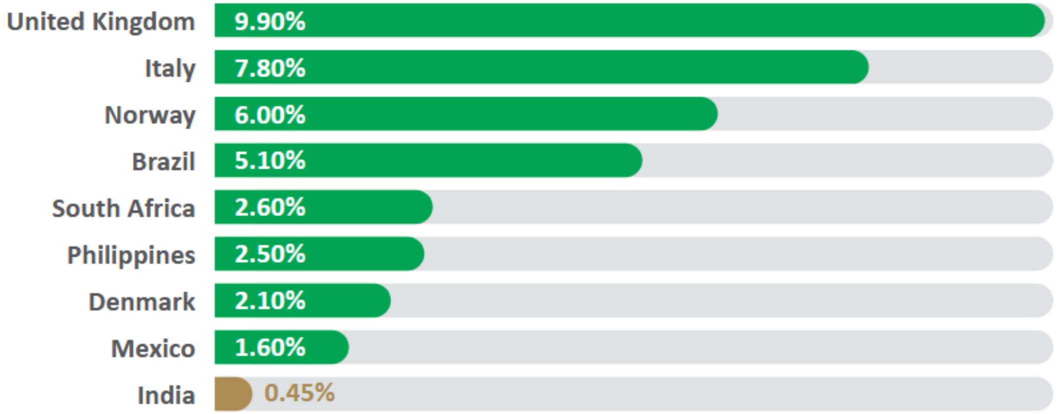
Key facts on municipal finances in India – A poor state of affairs

- Municipal accounts for less than 0.9% of the total GDP, despite cities contributing almost 60% towards GDP
- Municipal tax to GDP ratio is a meagre 0.5%, while Property tax to GDP ratio is only 0.25%
- Municipal own revenue receipts (MORR) as % of state own revenue receipts is around 8.24 per cent.
- Share of municipal expenditure as a percentage of GDP was a mere 1.09%

Figure 16: **Property Tax as a Percentage of GDP in Select Countries**

Sources: For India 2017-18: Ahluwalia et al. (2019), p. 9; for Organisation for Economic Co-operation and Development (OECD) and developing countries in the 2000s: Bahl and Martinez (2007), Table 1, p. 16; and for 18 OECD and 29 developing countries, based on International Monetary Fund Government Finance Statistics, various years.

Figure 10: **IGT to Municipal Governments as a Proportion of GDP**



Sources: UK, Denmark, Norway, Italy and India – Mohanty (2016) as cited in Ahluwalia et al. (2019) p.11; Brazil – Organisation for Economic Co-operation and Development (OECD) (2016a); Mexico – OECD (2016b); South Africa – OECD (2016c); Philippines – Diokno-Sicat, J. (2019) p. 10

Municipal Finance-challenges

- ULBs have weak fiscal capacity, relying heavily on state contributions to finance their budgets. This defeats the whole concept of decentralisation envisaged in 74th amendment
- 74th amendment – weak on financial aspects -mismatch of finance and functions
- In recent years -erosion of municipal fiscal powers by centre and state –e.g. abolition of Octroi
- Larger cities (Municipal Corporations) are better off – more fiscal powers, more capacity to mobilise resources
- Smaller cities (municipal councils, nagar/town panchayats) are largely dependent on grants and hence lack autonomy
- Poor municipal finance related database/ no recent studies on municipal finance

Figure 19: **Per Capita Property Tax by Size of ULB (INR)**

Source: Ahluwalia et al. (2019)

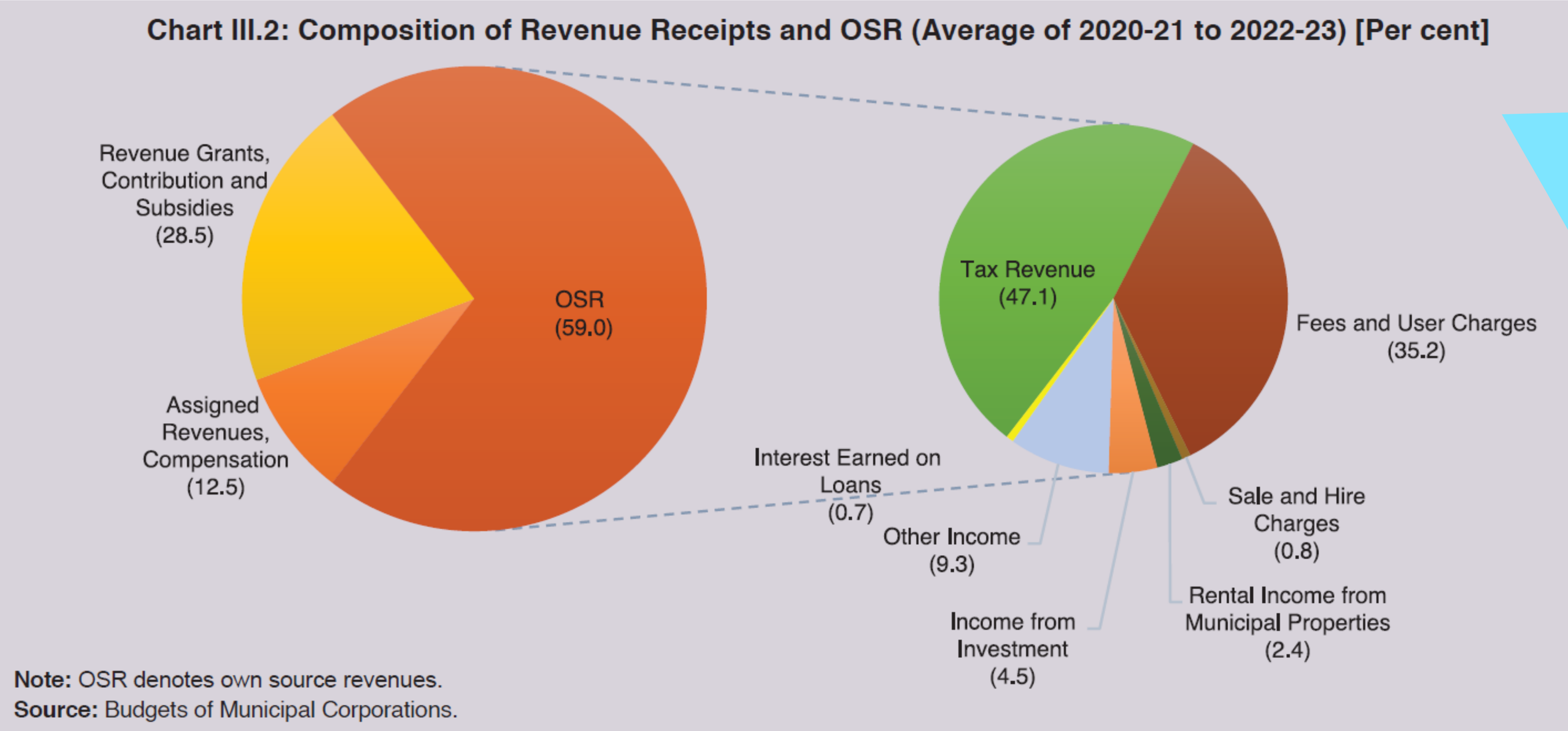
Own Sources of ULB revenues

Revenue sources of ULBs

Table III.1: Revenue Sources of ULBs		
Revenue Head		**Sources of Revenue**
1. Own Resources	A. Tax Revenue	Property tax, vacant land tax, water benefit tax, advertisement tax, sewerage benefit tax, tax on animals, and taxes on carriages and carts.
	B. Non-Tax Revenue	User charges, betterment charges, development charges, sale and hire charges, water supply and sewerage donations, market fees, trade licensing fees, parking fees, layout/building approval fees, slaughterhouse fees, and birth and death registration fees.
	C. Other Receipts	Sale of rubbish, miscellaneous sales, rent on tools and plants, lease rents, law charges and costs recovered, lapsed deposits, fees, fines and forfeitures, and sundry receipts.
2. Assigned (Shared) Revenues		Entertainment tax (subsumed under GST, except when levied by the local bodies), professional tax, surcharge on stamp duty, entry tax, and motor vehicles tax.
3. Grants-in-aid		• Central and State Finance Commission devolution through State governments. • Grants through transfers from Central and State governments under various programmes, schemes and projects, *e.g.*, Housing for All, Smart Cities Mission, *Swachh Bharat Mission, Atal Mission for Rejuvenation and Urban Transformation.* • Grants from States to compensate against the loss of income, *e.g.*, octroi compensation, property tax compensation and specific transfers including salary grants.
4. Borrowings		Loans from the Central and State governments, banks, Housing & Urban Development Corporation (HUDCO), Life Insurance Corporation (LIC); municipal bonds, *etc.*
Source: Mishra and Mohanty, 2018.		

Own source of revenue includes tax revenues, non-tax revenues, and other receipts

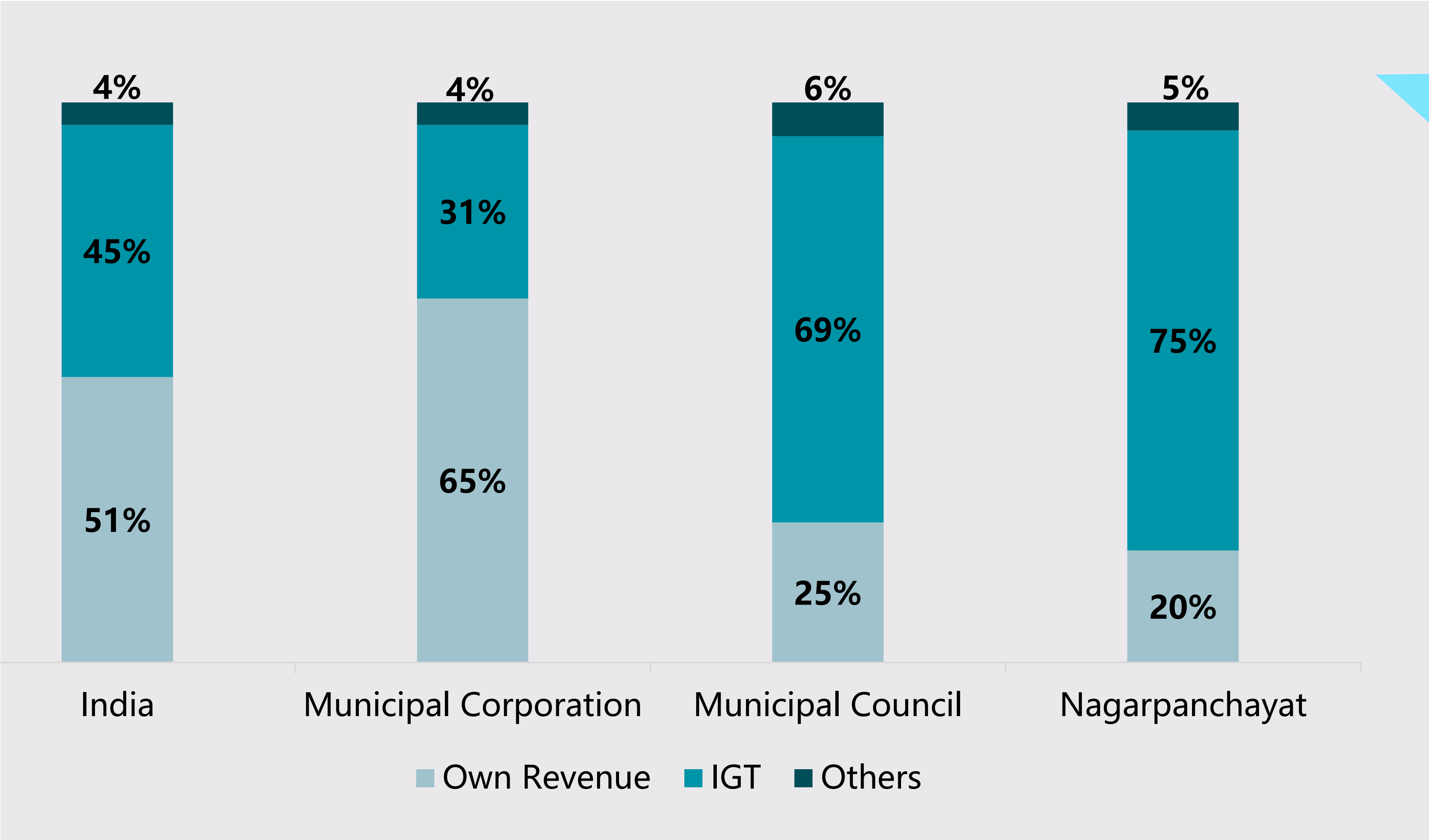
Composition of Revenue Receipts



Own source of revenues accounts for nearly 60% of Municipal Corporations' revenues. Non-tax revenues contribute more that 50% of the OSR

Reserve Bank of India (2024) : Report on Municipal Finance, 2024

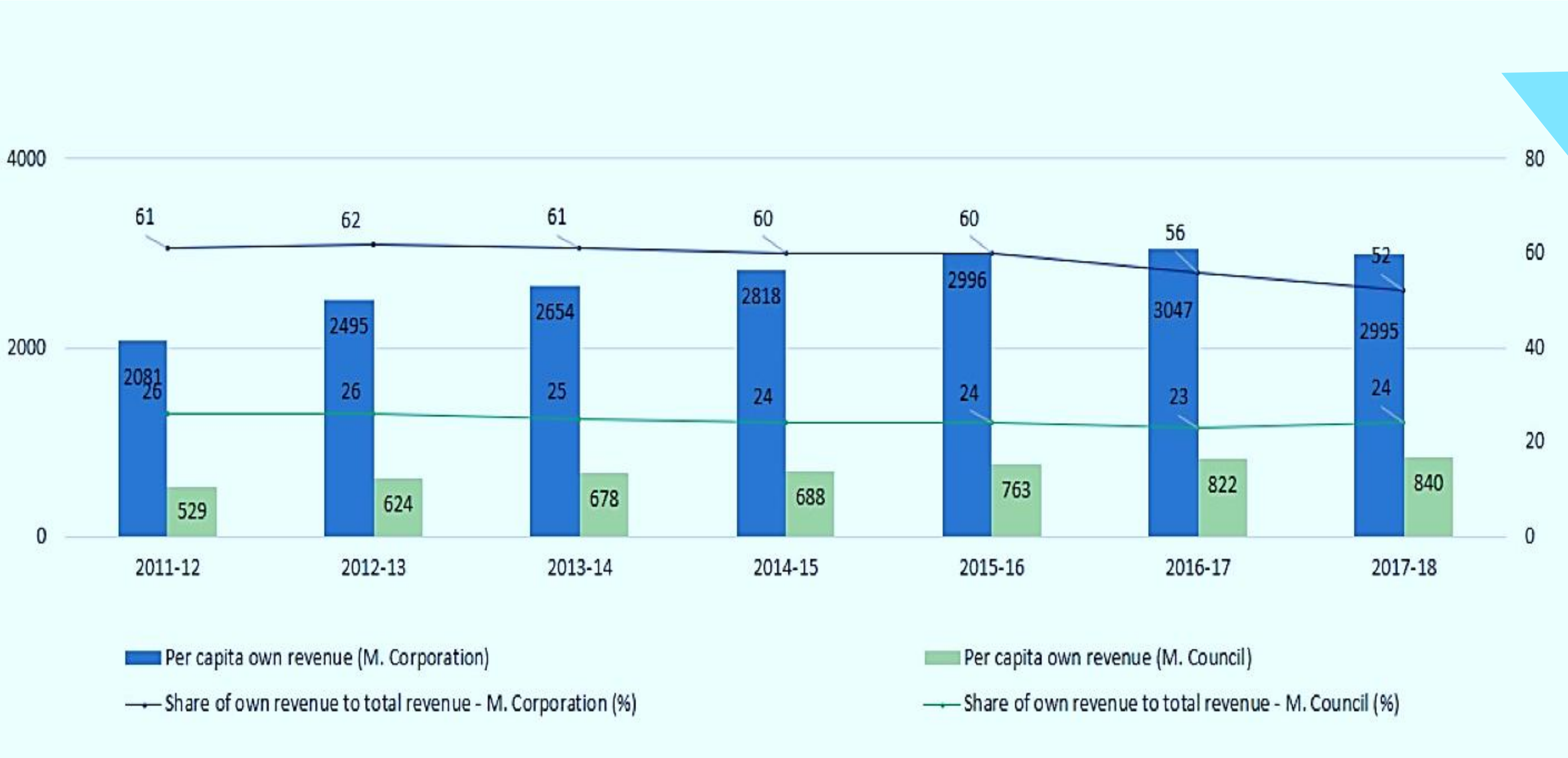
Fiscal dependency of Indian cities



Municipal Corporations can generate significant revenue, whereas the small and medium towns have to depend on grants

Source: ASCI (2015), Municipal finances and service delivery in India, a study for 14th FC

Share of own income and per capita own income



Share of Own Source of Income is declining over time. This implies greater dependence on grants and transfers from the Centre and State Governments

Derived from data available in 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. , pp. 39–47 and pp. 83–90.

Municipal Corporation Finance – Key Ratios

Table II.8: Municipal Corporations' Finances – Key Ratios

(Per cent)

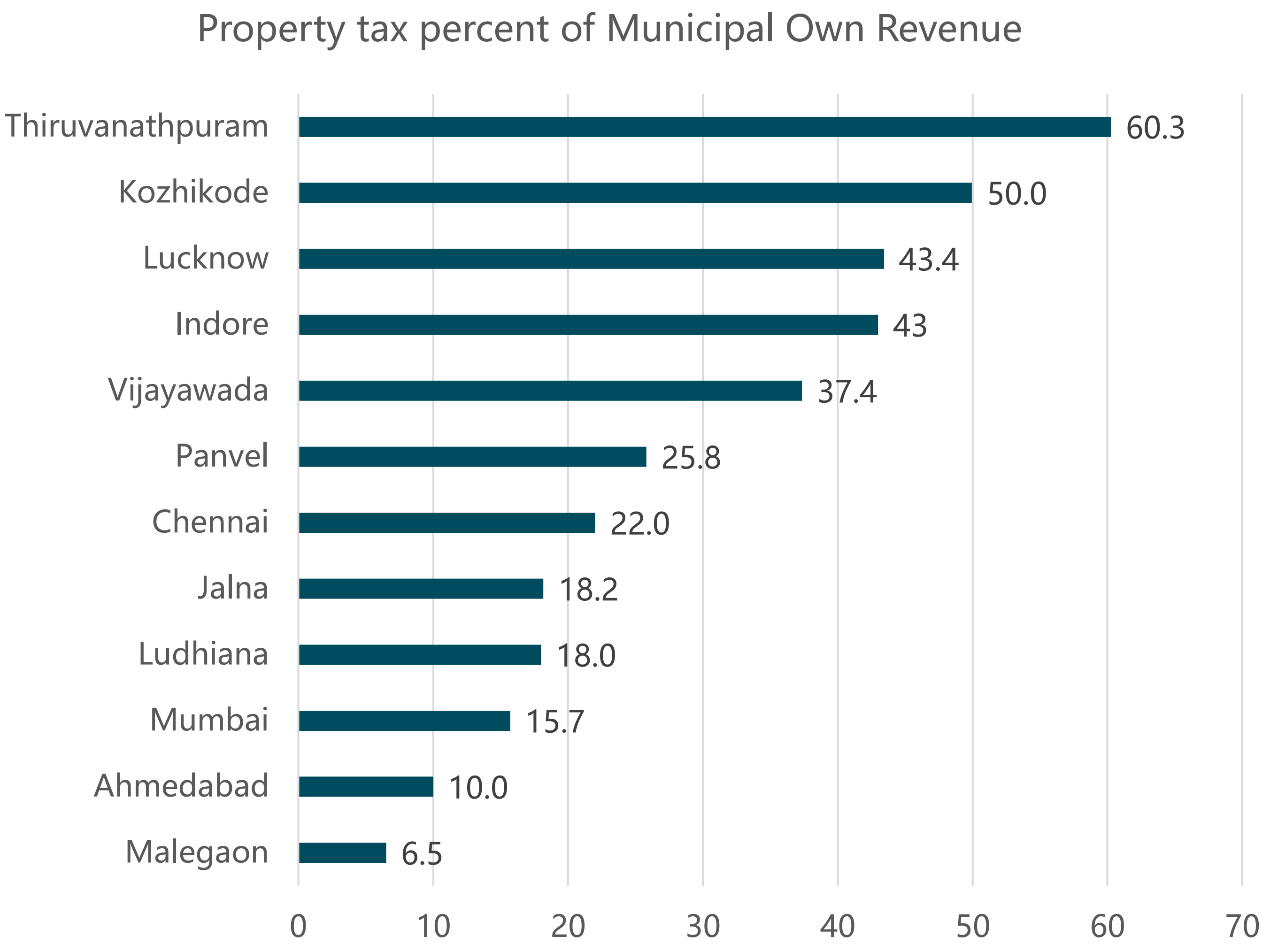
Ratio	2019-20 (Accounts)	2020-21 (Accounts)	2021-22 (Accounts)	2022-23 (RE)	2023-24 (BE)
Own Revenue / Total Revenue Receipts	**59.0**	**55.2**	**61.4**	**59.7**	**61.9**
Tax Revenue / Total Revenue Receipts	27.3	28.9	25.1	29.6	30.0
Property Tax Collection / Total Revenue Receipts	16.5	17.7	13.4	18.3	19.0
States' Transfer / Total Revenue Receipts	30.3	30.2	27.0	30.0	28.7
Central Government's Transfer / Total Revenue Receipts	2.7	3.6	2.7	2.5	2.5
Combined (Centre *plus* States) Transfer / Total Revenue Receipts	33.0	33.8	29.7	32.5	31.3

Note: RE – Revised Estimates; and BE – Budget Estimates.
Source: Municipal Corporations; and RBI staff estimates.

The share of own revenue to total revenue for Municipal corporations has not changed much over the years

Reserve Bank of India (2024) : Report on Municipal Finance, 2024

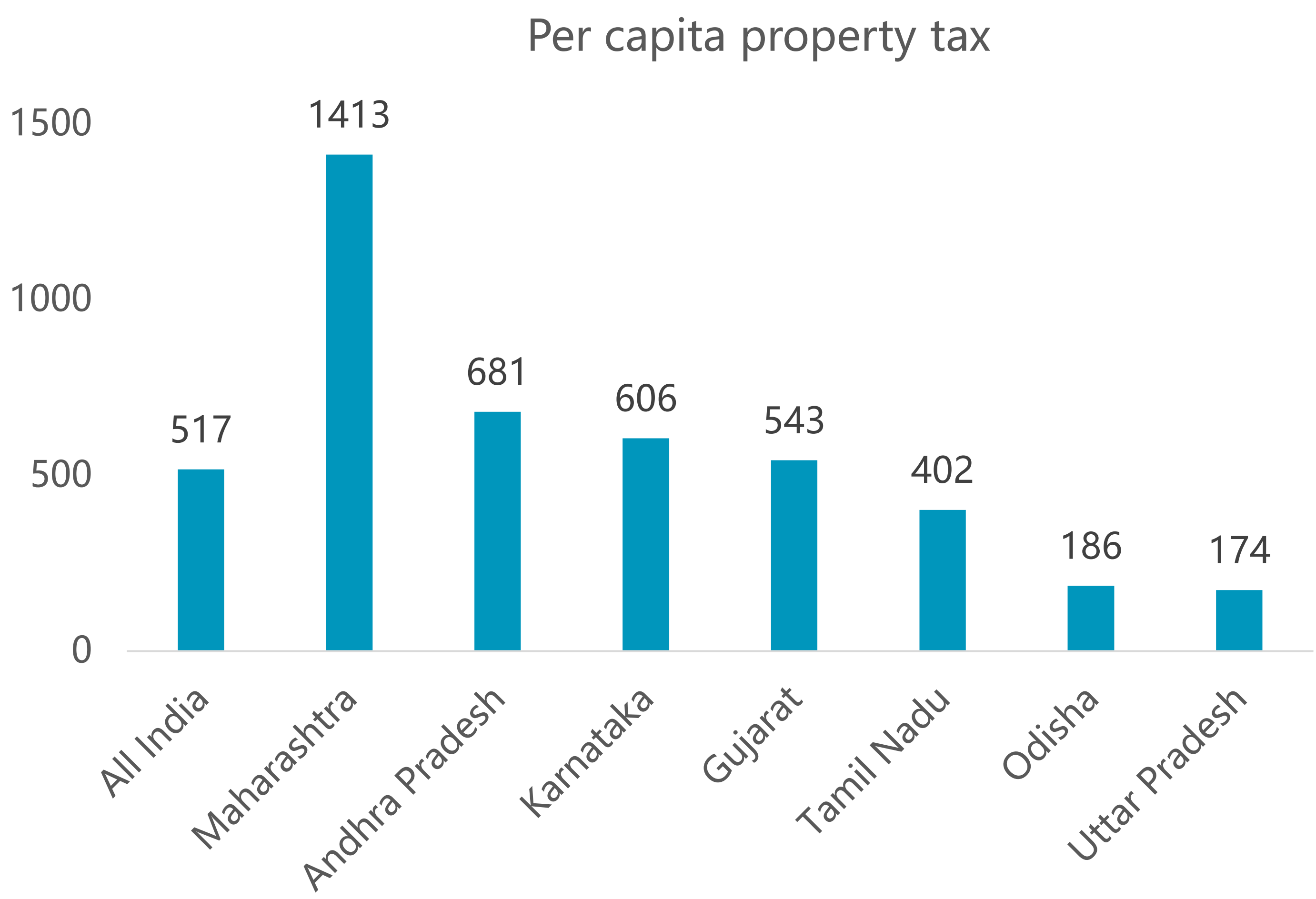
Share of property tax in municipal revenue



- Property tax has significant potential to contribute to own (tax) revenues, but problems of low coverage and low collection efficiency are typical obstacles
- Absence of a formal count of properties in municipalities is one of the major handicaps in exploiting the true potential of property tax in India.
- Assessment of properties is supposed to be done once every four years, but this is often not done.
- In many cities, GIS is used to map all properties; however, its use is beset with problems while using the unit area method of valuation.

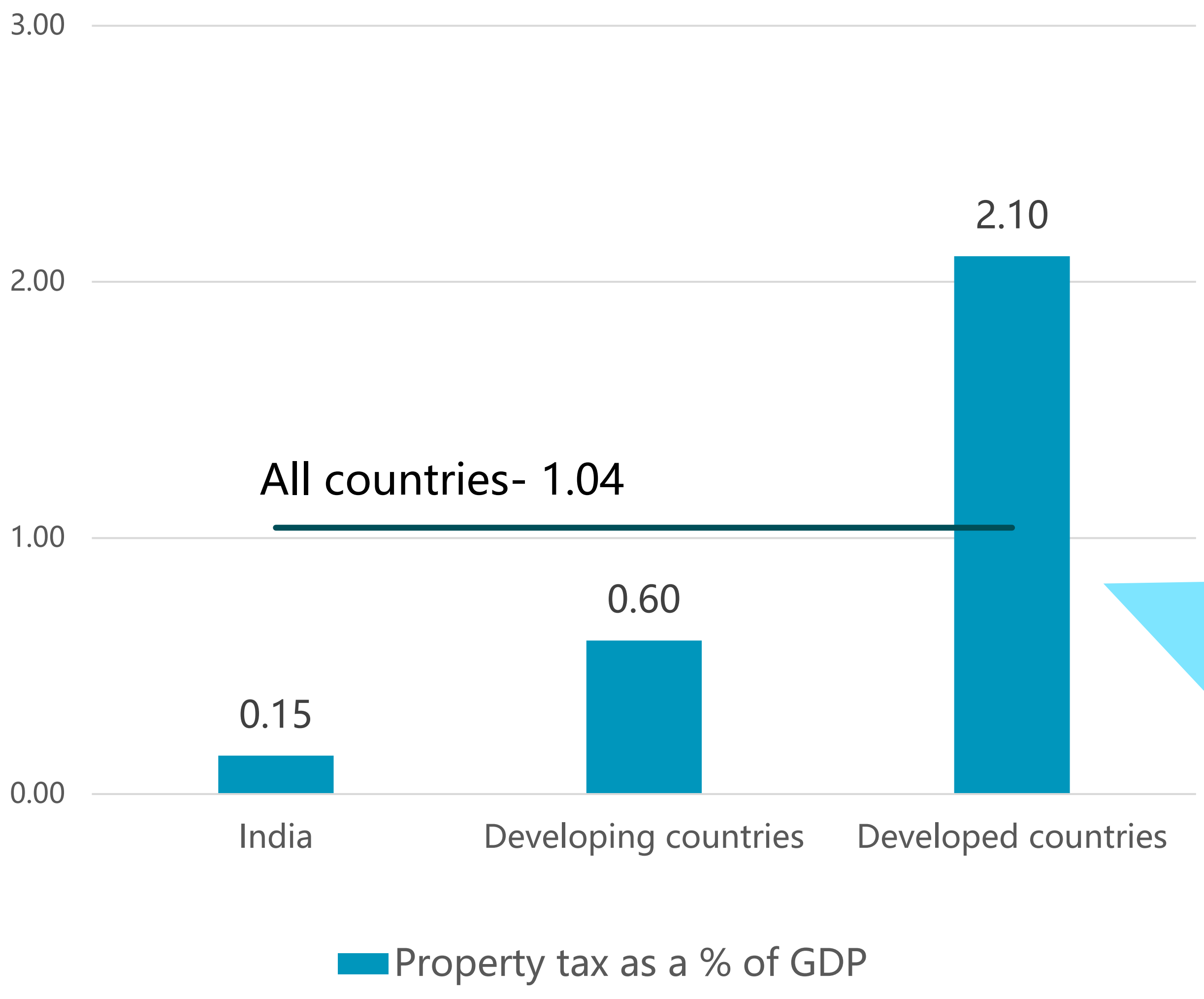
Source: Municipal Finance Matters, IMFR (2011)

Large variation in per capita property tax revenue across states



Source: ASCI (2015), Municipal finances and service delivery in India, a study for 14th FC

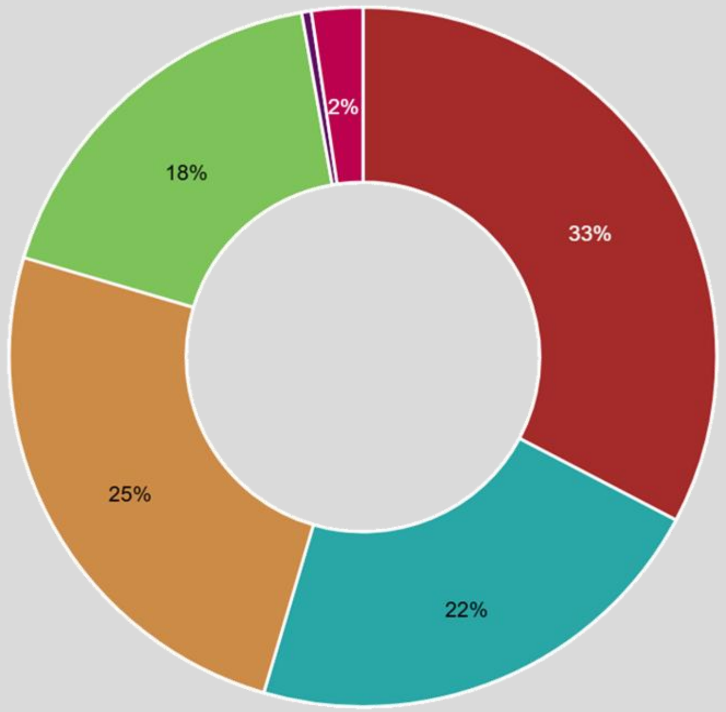
Property tax as a % of GDP across selected countries



There is a potential to increase property tax revenues four to five times when compared with developing countries, and by 15 times when compared with developed countries.

Prakash P (2013): Property taxes across G20 countries: Can India get it right? Oxfam India working papers series, January 2013

Own revenue split

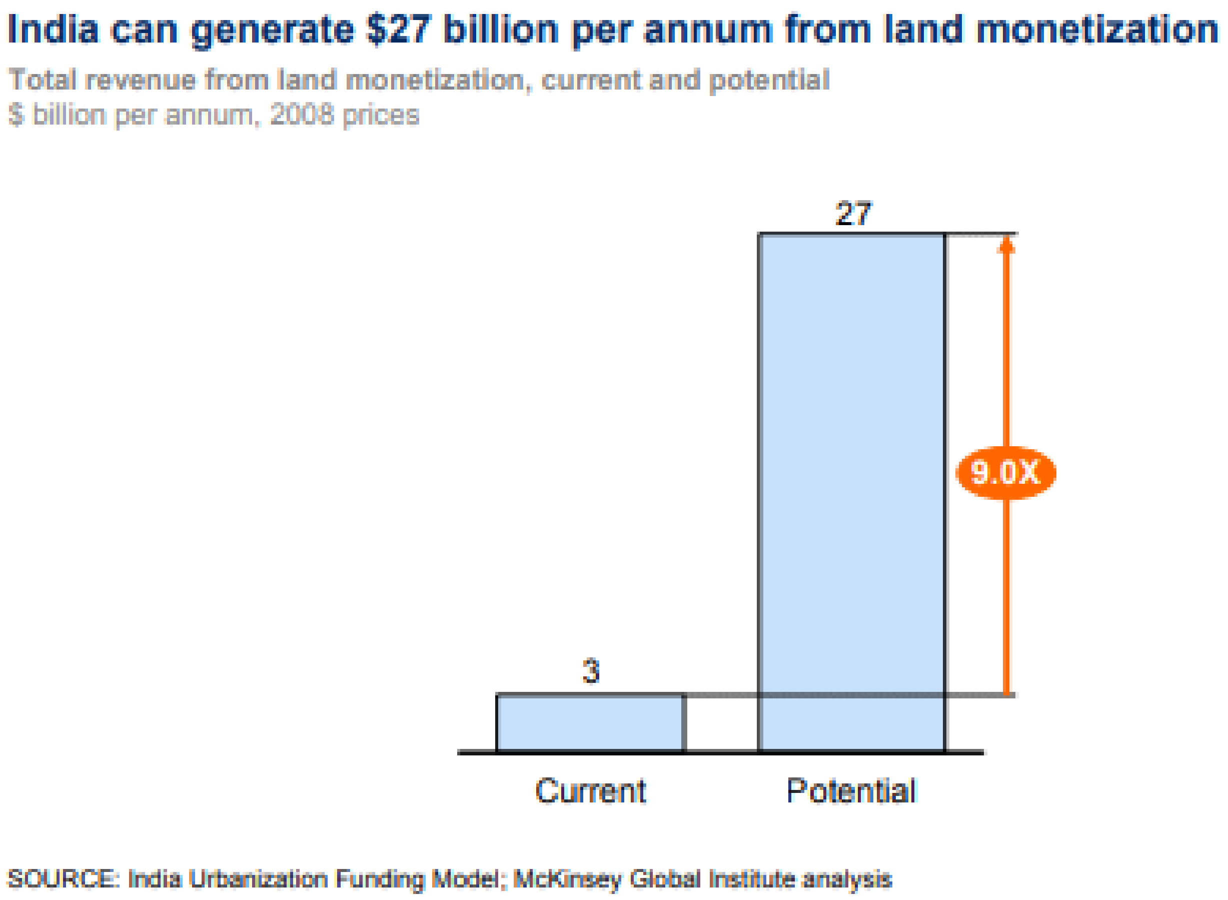


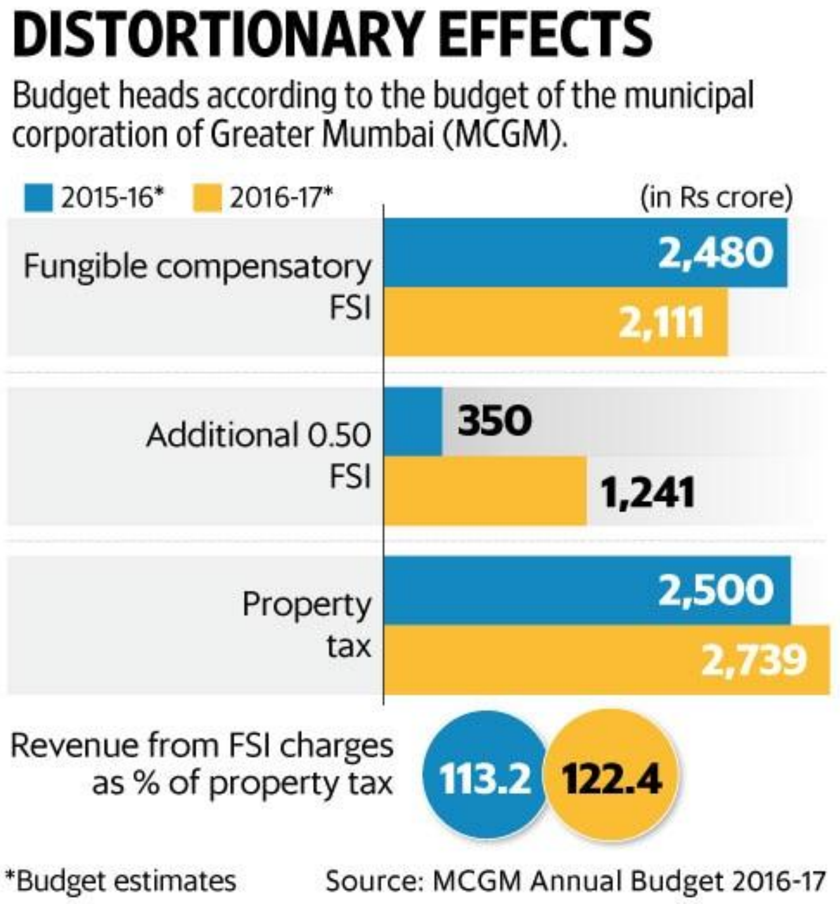
Note - Data is not available for several ULBs including Greater Mumbai Municipal Corporation, Ahmedabad Municipal Corporation, Chennai Municipal Corporation, Kolkata Municipal Corporation, Jaipur Greater Municipal Corporation.

Non-tax revenues like fees and user charges, and other taxes, also contribute significantly to the own revenues of ULBs

Source: Based on https://www.cityfinance.in/v1/own-revenue-dashboard

Raising revenues from land-based fiscal tools





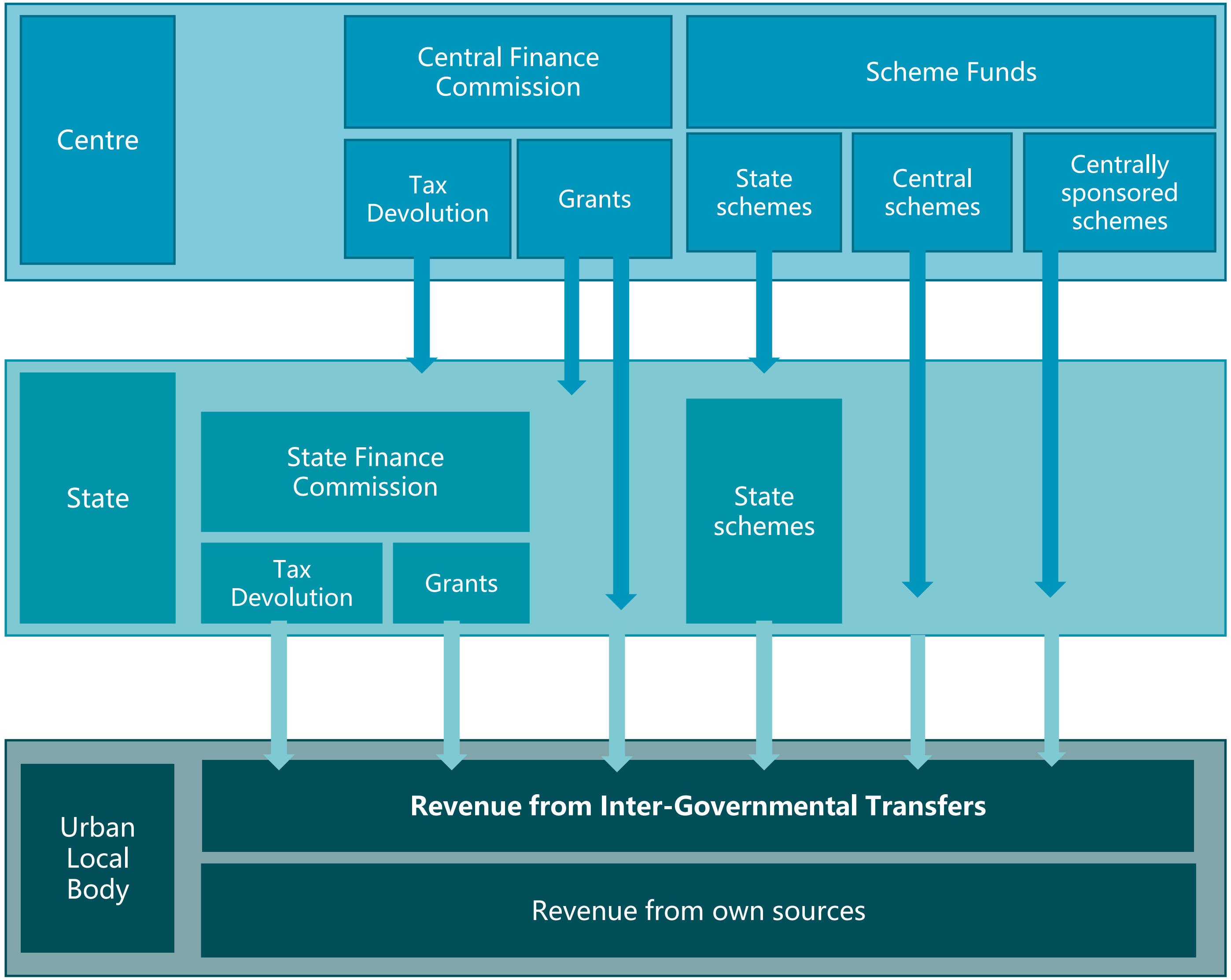
Source: Mckensy (2010), India's urban awakening: Building inclusive cities, sustaining economic growth

Source: https://www.livemint.com/Opinion/ZMstrafhHFb9sdqhG3kOsJ/Raising-revenue-from-landbased-financing.html

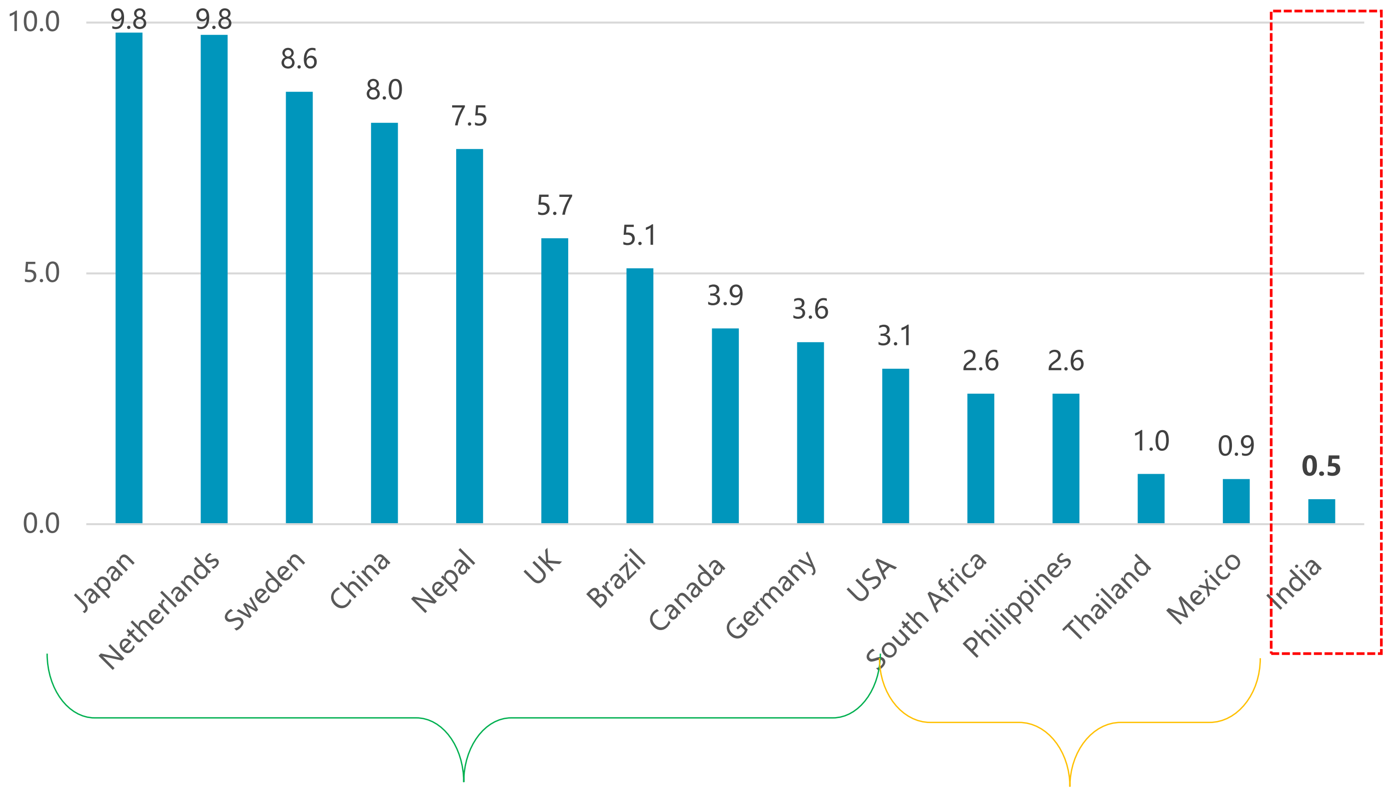
Inter Governmental Transfers

Inter-Governmental Transfers

- Intergovernmental transfers (IGTs) are financial flows from the central government to state and local governments
- IGTs are meant to bridge fiscal gaps, ensure equitable service delivery, and promote national objectives
- IGTs are primarily through the Central and State Finance Commission (FC) recommendations (tax devolution and grants) and Central ministries (conditional grants for specific schemes)



Intergovernmental transfers to local bodies is very low in India



Developed Countries:
IGT is **3% to 10% of GDP**

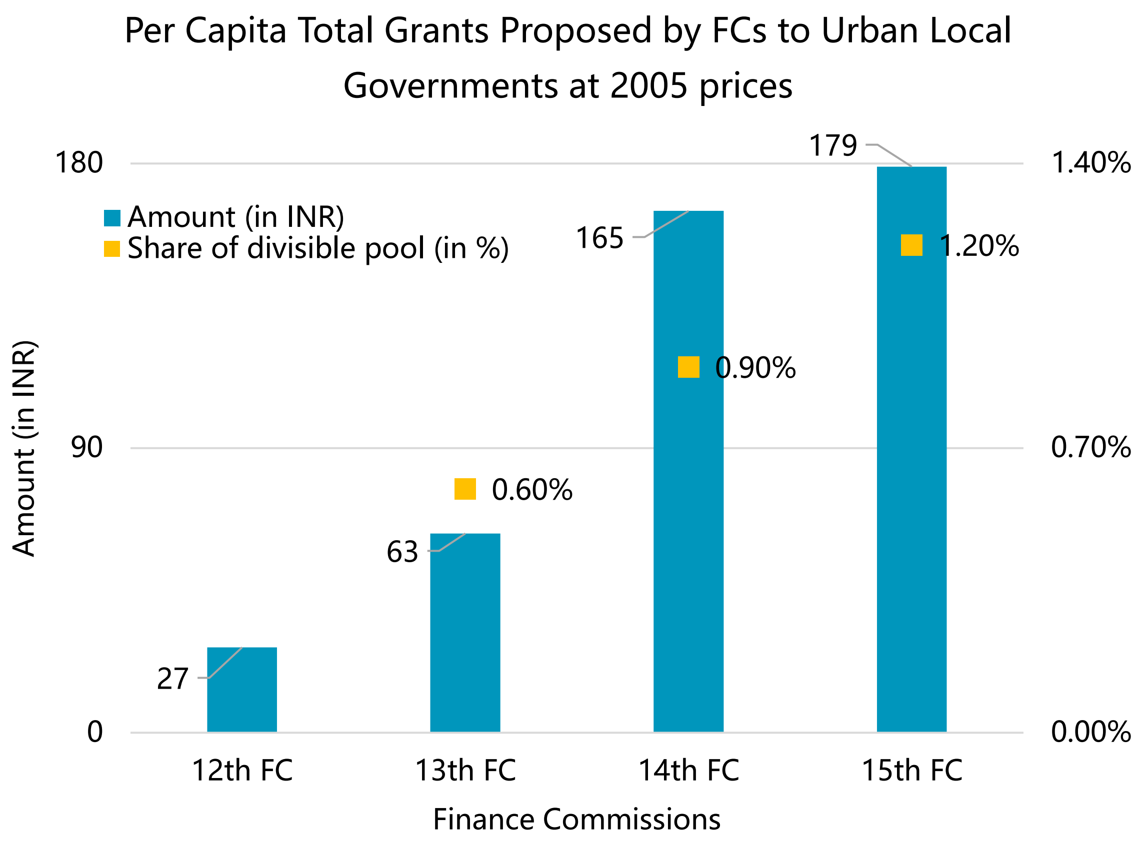
Developing Countries:
IGT is **1% to 2.6% of GDP**

The experience of other countries with higher levels of IGTs suggests the need to increase grants significantly to ULGs in India

- Municipalities in **Brazil** receive significant transfers through the **Municipalities' Participation Fund**, which is **23.5% of the income taxes** and industrialized products taxes.
- In **Philippines,** the **Local Government Code of 1991 mandates that 40% of internal revenue collections** of the third preceding fiscal year are transferred to local government units

Sources: For Netherlands, Sweden, Italy, UK, Canada, Germany and Mexico: OECD (2022); for Japan: OECD (2021); for Brazil: OECD (2016a); for South Africa: OECD (2016b); for US: Tax Policy Center (2020); for China: Yongzheng Liu (2019:); for Philippines: Diokno-Sicat, J (2019: 8); for Thailand: Statista Research Dept (2020); for India: Ahluwalia et al (2019).; Mehta and Mehta 2015;Diokno-Sicat 2019.,

While the per capita allocations to ULGs had increased from the 12th to 14th FC, the 15th FC allocations to ULGs have been almost stagnant as compared to the 14th FC.

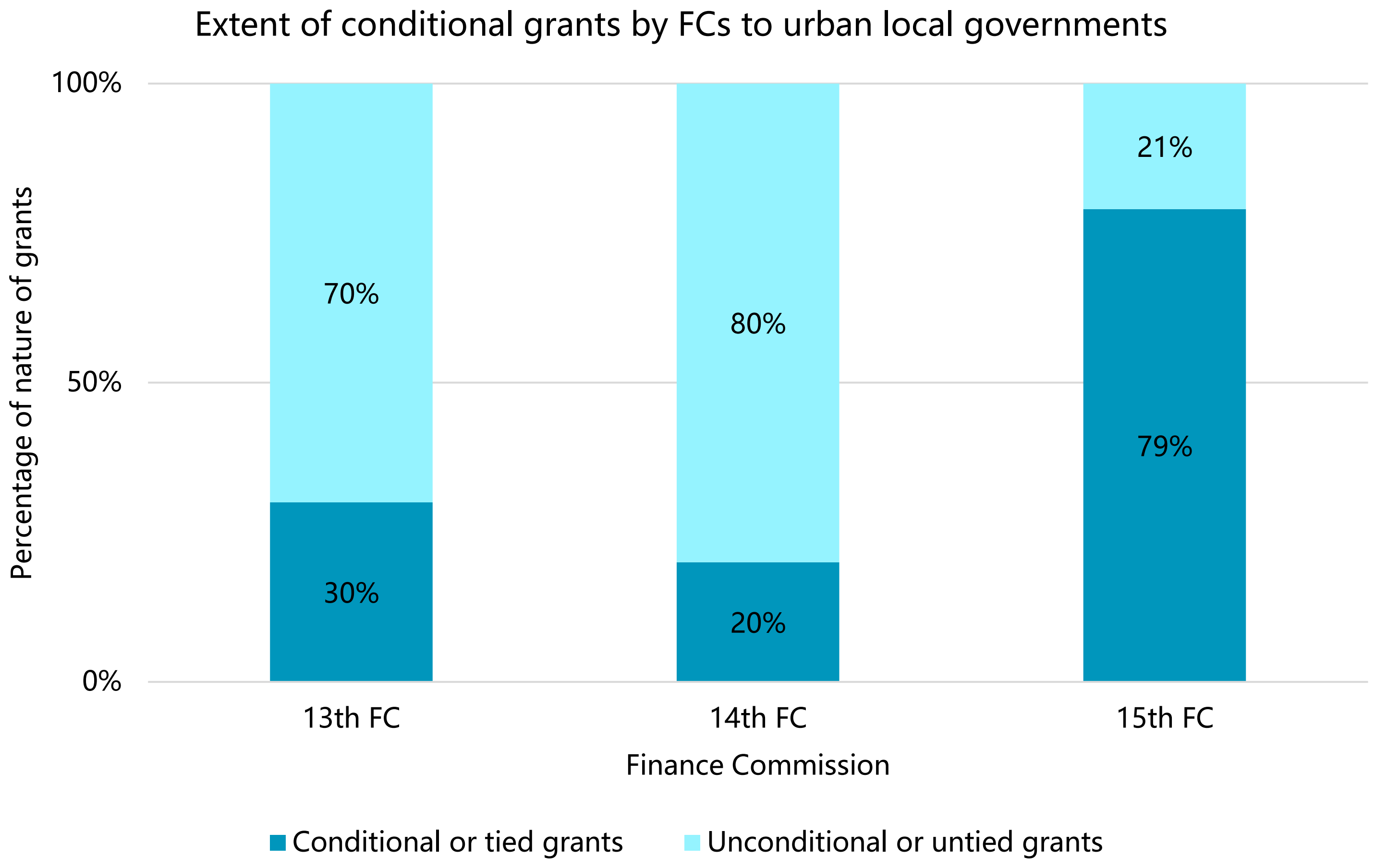


The share of the divisible pool for ULGs has increased marginally from 0.7% to 0.9% and 1.2%.

- The **14th FC** had allocated **4.3 percent** of the divisible pool (Rs 2,87,436 crore) to Panchayati Raj Institutions (PRIs) and ULGs, of which 30 percent (Rs 87,000 crore) was allocated to ULGs.
- In comparison, the **XV- FC has allocated 4.1 percent** of the divisible pool (Rs 4,36,361 crore) to PRIs and ULGs, of which the **urban share was reduced from 40 percent in the interim report to 35 percent** in its final report.

Notes and sources: The grants include both basic and conditional grants as specified by each FC for each year. Population is as per NCP (2022), grant amounts are from Fifteenth Finance Commission (2020) Fourteenth Finance Commission (2015), Twelfth Finance Commission (2005) and Thirteenth Finance Commission (2010). Percentage of divisible pool Fifteenth Finance Commission (2020), Fourteenth Finance Commission (2015), Twelfth Finance Commission (2005) and Thirteenth Finance Commission (2010). For CPI, World Bank Data (2022) is considered.

The share of conditional grants to ULGs increased to a whopping 79% of total grants for the 15th FC



The XIV-FC reduced the number of conditions and also reduced the conditional grant proportion. However, the XV-FC laid down many conditions, some of them as 'mandatory' or 'entry' conditions.

- A trend of making a portion of grants to ULGs as tied or conditional grants. This approach was initiated by the XIII-FC with 30 percent of funds tied to several conditions.
- There is probably no justification for entry-level conditions over which ULGs themselves have no control.

Sources: Mehta M. Mehta D., Bhavsar D (2024). "Sixteenth Finance Commission and Urban Local Governments" published in Economic and Political Weekly as Commentary, Vol.37; p.17-20

Rich cities, poor city governments!!!

The level of IGTs to ULBs in India has remained largely unchanged between 2017 and 2024 at a rate near to 0.5% of GDP.

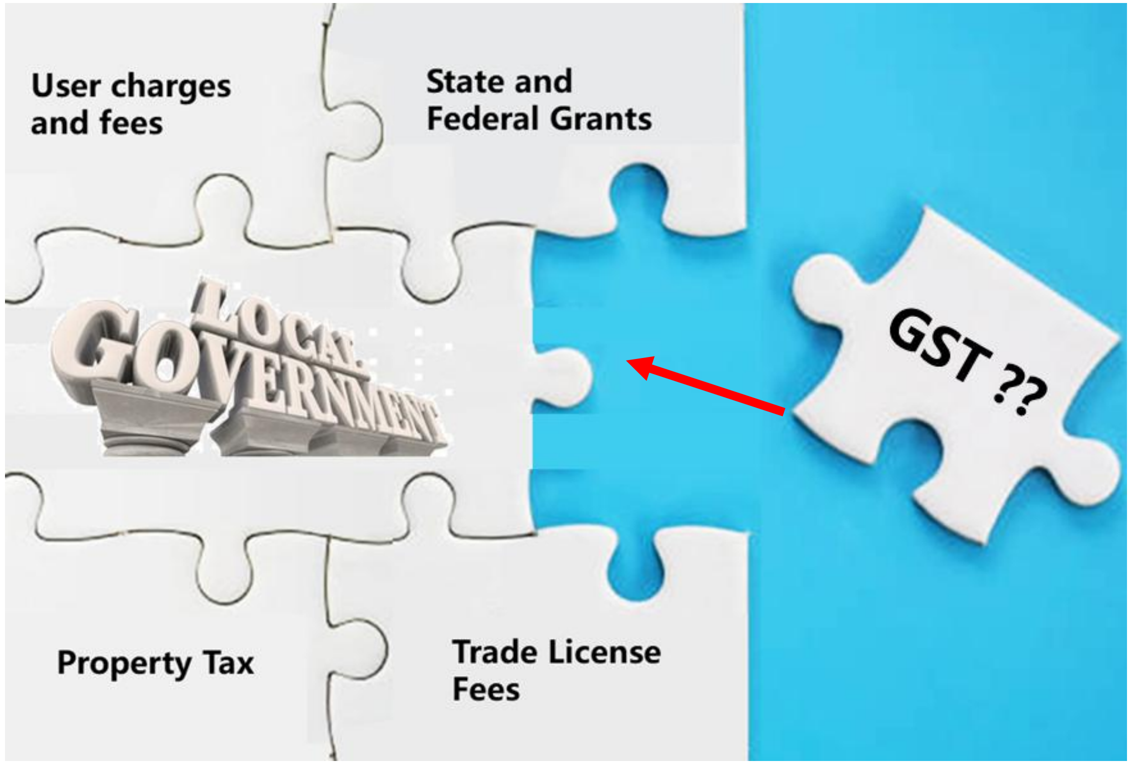
FY 2024-25 estimates indicate that ULBs in India received an estimated IGTs about **INR 1.3 lakh crore.** Of this, around **INR 0.3 lakh crore** of funds transfers to ULBs through major urban development scheme grants such as AMRUT, SBM, Smart Cities.

Jha (2019) and Udas-Mankikar (2018) estimate that *"In compliance with the new GST regime, the Municipal Corporation of Greater Mumbai (MCGM) has had to abolish octroi, which on average had contributed almost 35 per cent of its annual total revenue"*

Sources: Mehta M., Mehta D., Bhavsar D., Yadav U., Jaiswal J., and Sareshwala S. (2020), "Strengthening Finances of Municipal Governments," prepared as Input to the Report by NFSSM Alliance on Municipal Strengthening for Improved Urban Services, mimeo.; MoHUA Budget, GoI, 2025, Press Bureau Information, Government of India, 2025 (Link), MoHUA Budget, 2026

Cities are the economic base and need a share of GST

- Vijay Kelkar highlighted the **vertical imbalance in India's federalist structure a**nd advocated for a greater share of GST resources for the Third Tier by allocating **"1/6th of this with the 3rd Tier".**
- He also highlighted **equitable sharing of the GST with the third tier** will go a long way in strengthening the fiscal base of our urban governments" (Dhoot 2024).
- The **net GST** collected in FY 2024-25 was **INR 19.5 lakh crore.** Sharing ratio of PRIs: ULB as 50:50) would amount of **Rs. 1.6 lakh crore per annum** for ULBs. This would help to nearly **double the current level of IGT allocations.**
- Local governments currently have no formal representation in GST decision-making to raise these issues. It is recommended to institutionalised mechanisms for representation of voices of local government at the GST council.



Sources: Mehta M. Mehta D., Bhavsar D (2024) "Sixteenth Finance Commission and Urban Local Governments" published in Economic and Political Weekly as Commentary, Vol.37; p.17-20; Press Bureau Information, Government of India, 2025 (Link), MoHUA Budget, Demand no.60, 2026

Innovative Finance

Emerging innovative financing mechanisms for Urban Infrastructure

Urban infrastructure has been generally financed through public funds however, innovative financing mechanisms need to be explored for additional and more effective funding

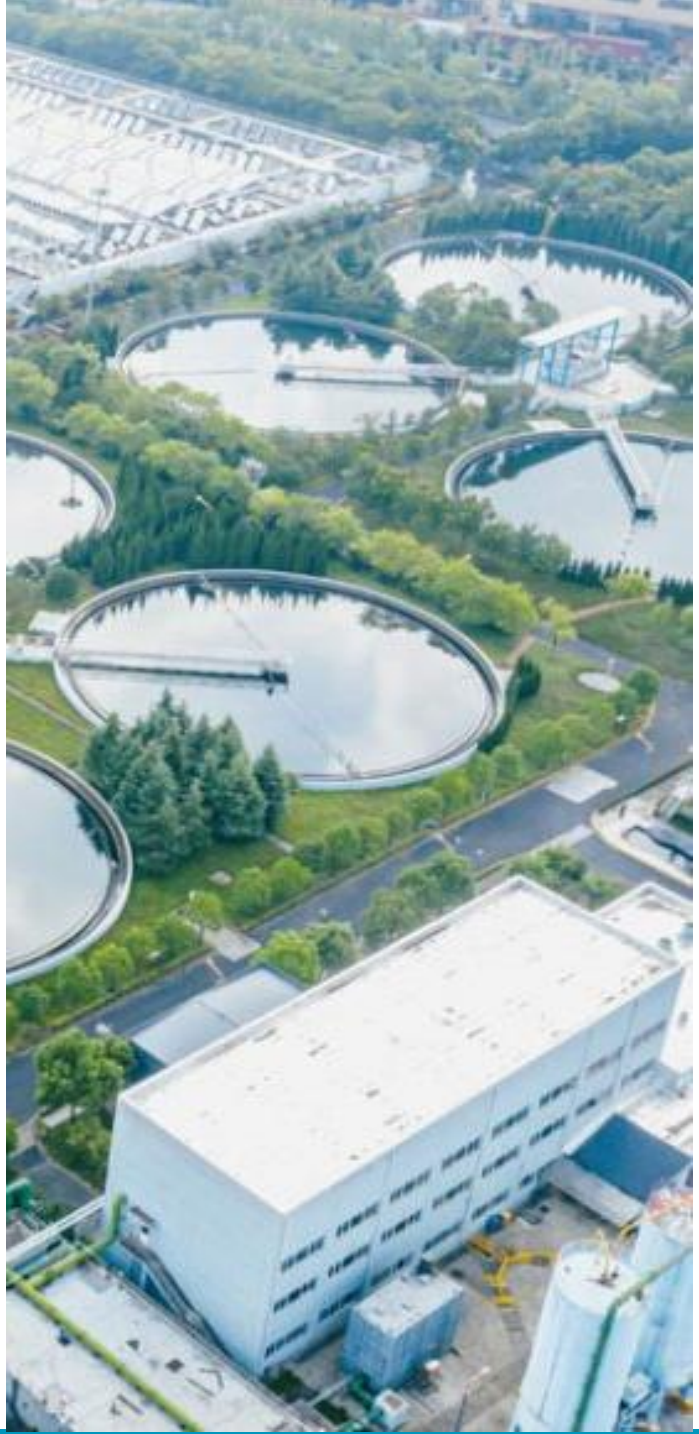
Own sources, Transfers and programs

- Taxes, fees, user charges
- Public sector programs
- State and Central Transfers
- Grants from Finance Commissions

+

- Philanthropic Funding, social impact investors
- Private sector investment
- Capital Market Borrowing

- **Results Based Finance**
- **Blended Finance**
- **Green / Municipal Bonds**



Leveraging private resources and impact investments

Results based funding

Funders makes payments only if and when pre-agreed outcomes/ results are achieved

Blended finance

Leveraging private or commercial funding to achieve development outcomes – through PPPs, borrowing etc.

Municipal bonds / Green bonds

Borrowing from local banks and financial institutions, community finance institutions or capital markets using municipal or green bonds mechanisms

Benefits of using innovative financing mechanisms

Efficiency of private sector

Used to leverage additional private sector or commercial funds. Help in bringing efficiencies of private sector operations.

Improved performance

Innovative models provide incentives for improved performance and effectiveness by using performance linked approaches, particularly for public-private partnership (PPP) models

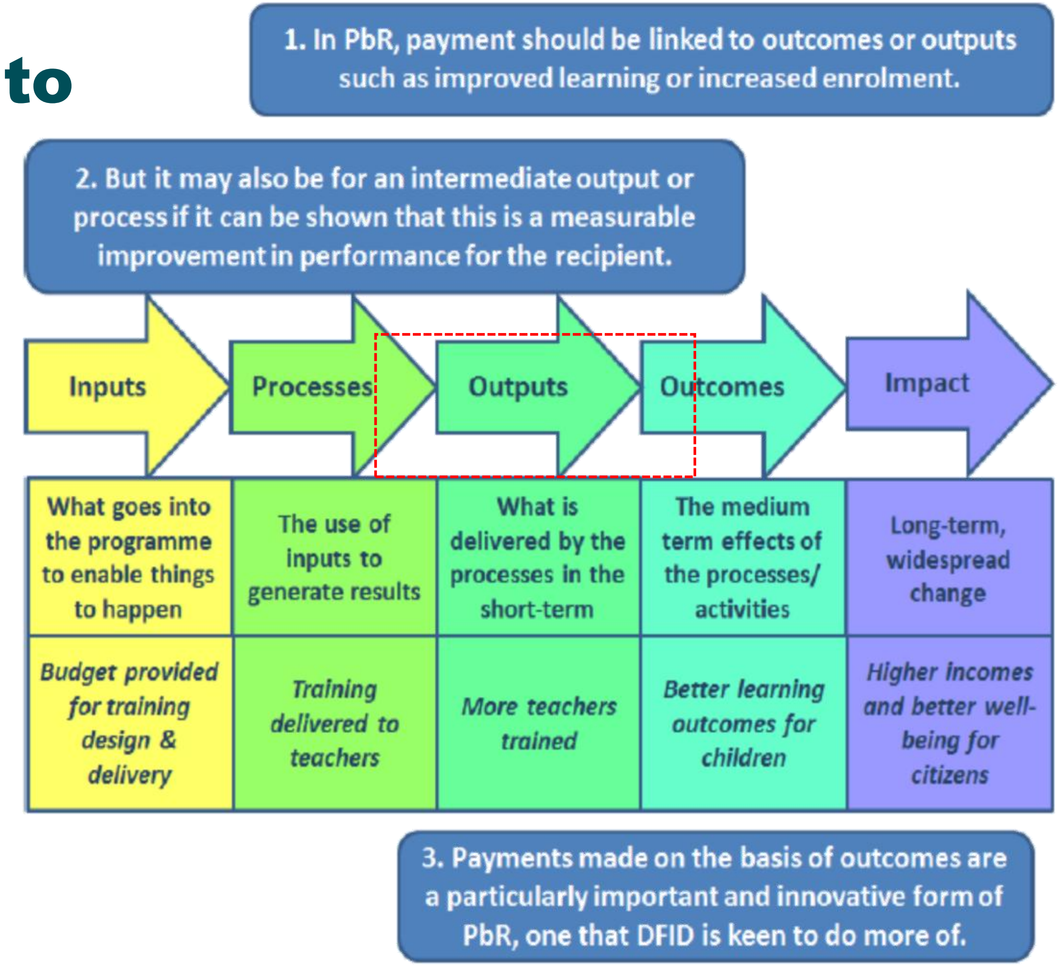
Social & environmental impacts

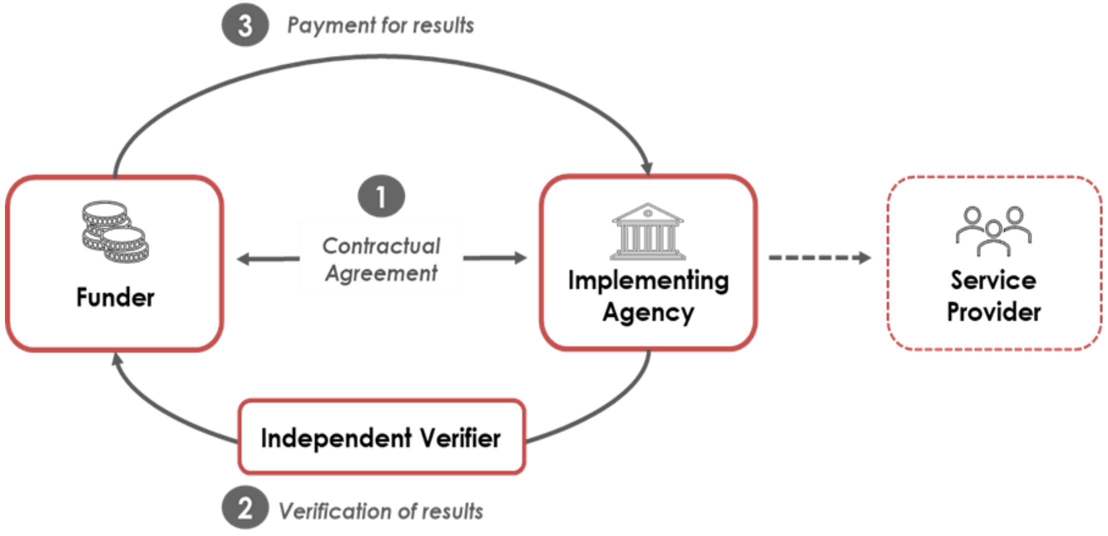
Emerging interest globally on impact investing for funding activities.

Results based approaches have started to become the norm

What is Results based financing ?

Public funds or those from donors or social impact investors are made available not as “inputs” but only on delivery of “outputs or agreed performance”, generally for innovative approaches





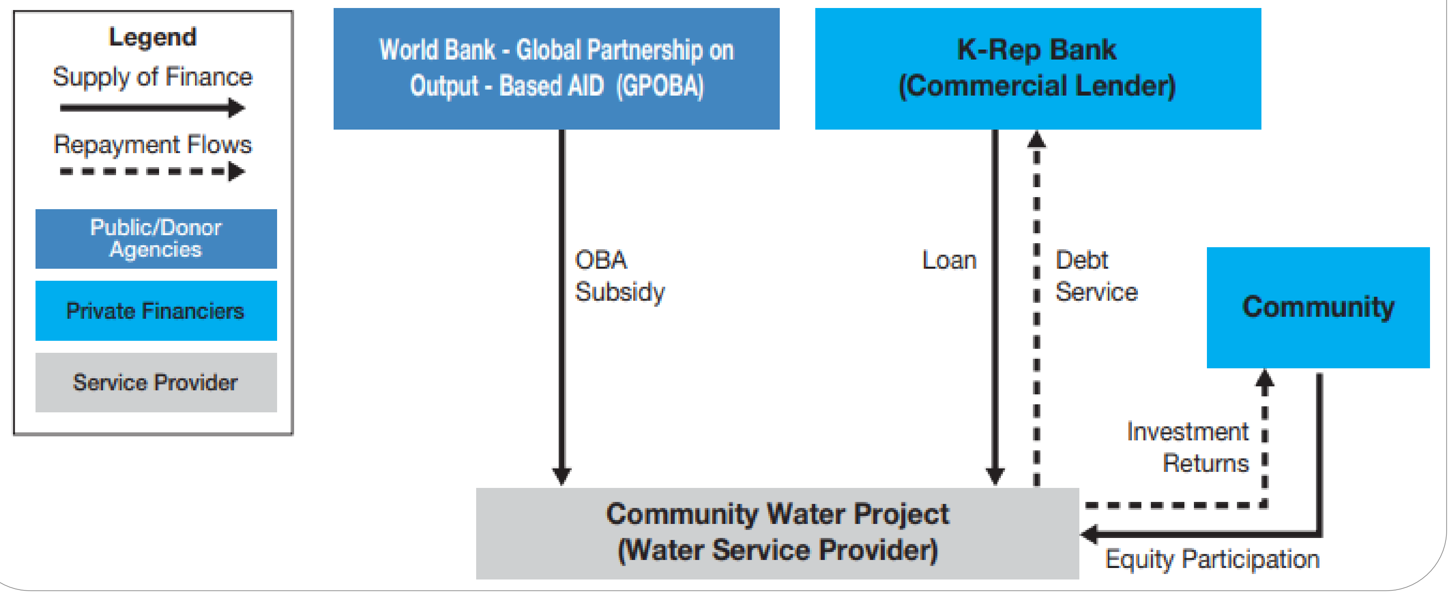
- Different methods such as (RBA, RBF, COD, OBA, P4R etc.) reflect a combination of financier, recipient and results for payment. Some are linked to outputs (OBA) or some to outcomes (COD, SIB, DIB, P4R, etc.)
- Extent of financing /funding linked to results can also vary

Source: from DFID (2014), “Sharpening incentives to perform: DFID’s strategy for Payment by Results”, p. 6.

Mobilising commercial finance with Results-based partial subsidies

- The World Bank launched the **pilot loan program in 2007 with K-Rep Bank**, a Kenyan commercial bank specializing in microfinance lending.
- The objective was to **incentivize rural and peri-urban communities to access loan financing** so as to rehabilitate and expand small-piped water systems.
- By 2012, **35 communities** had borrowed **US$3.4 million** from K-Rep Bank, raised **US $1.2 million of equity**, and accessed **OBA grants of US $2.8 million**. This enabled provision of access to 190,000 people.

Scaling Up Blended Financing for Water and Sanitation in Kenya: Maji ni Maisha Financial Structure



Source: World Bank Group (2016), "Scaling up blended finance for water and sanitation in Kenya" in "Case studies in blended finance for water and sanitation", p. 2.

Program for Results – P4R by the World Bank

Unique features of World Bank's PforR approach include using a country's own institutions and processes, and linking disbursement of funds directly to the achievement of specific program results -Disbursement Linked Indicators (DLIs)

- Finances and supports borrowers' programs
- Disburses upon achievement and verification of agreed results
- Strengthens institutional capacity, processes, procedures needed to achieve desired results
- Provides assurance that Bank financing is used appropriately and that environmental and social aspects are addressed

Program-for-Results Financing (PforR) → Implementation: Program systems → Funds for specific expenditure program

Morocco National Initiative for Human Development 2

($300M Bank financing supporting a $1.1B Government program)

The Morocco program—the first PforR operation—focused on improving access to participatory local governance mechanisms, basic infrastructure, social services, and economic opportunities in a defined area.

Vietnam Results-Based Rural Water and Sanitation Program

($200M Bank financing supporting a $260M Government program)

The program supports eight provinces in the Red River Delta region to provide sustainable water supply, sanitation, and hygiene services using a results-based approach in alignment with the National Target Program.

Examples of P4R

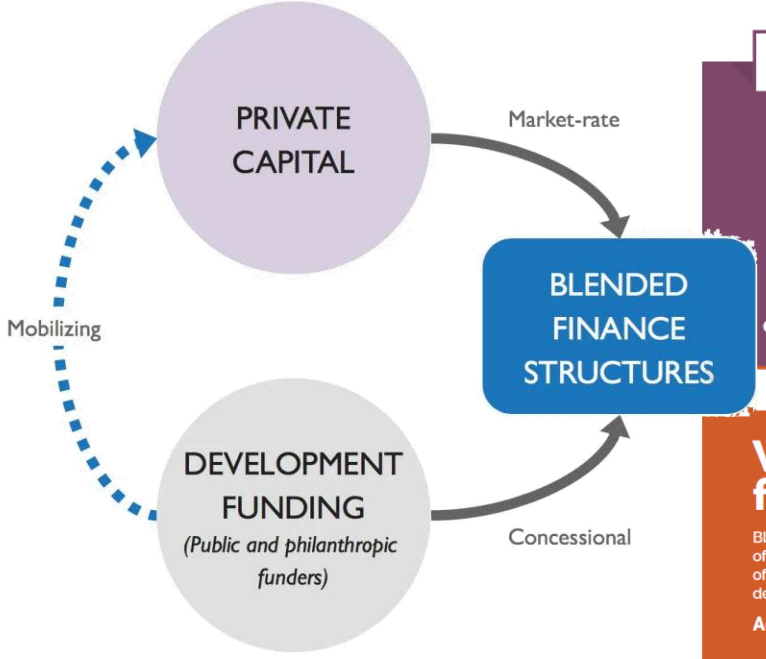
Program Outcomes	Access to Services	Participatory Governance	Systems Improvements
Percentage of children aged 12-23 months immunized with Pentavalent 3 vaccine	Percentage of population provided with access to improved water supply in rural communes	Percentage of women and youth in local governance bodies	Percentage of key staff (in specific units) trained in environmental and social safeguards and management guide

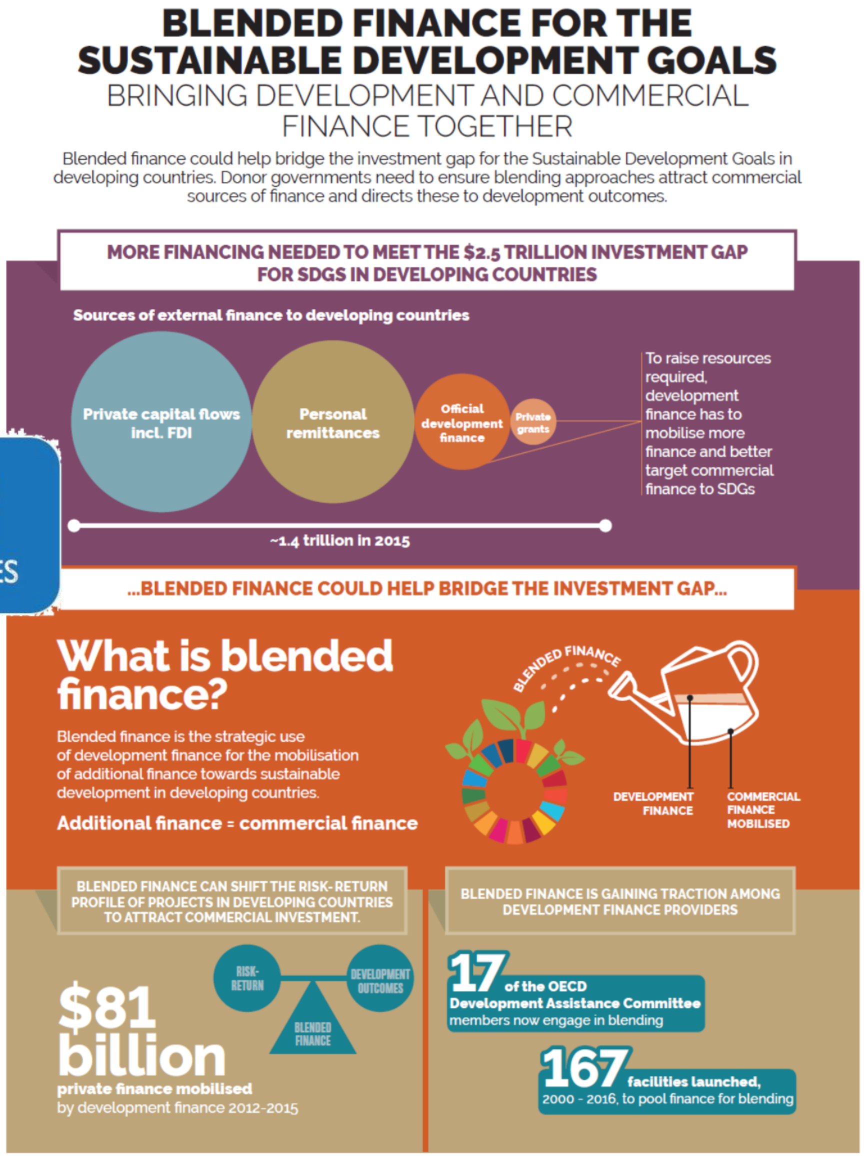
Source:World Bank (2023). New approaches by the World Bank: 'Program for Results' (P4R) financing in Urban Development- and https://thedocs.worldbank.org/en/doc/904551435264587829-0290022019/original/PforRbrochure.pdf

Blended finance

What is blended finance?

- "Strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets" (OECD)
- Blended finance can help risk-return profile of projects to attract private and commercial finance to project and activities that help achieve SDGs in different sectors





Source: OECD (2018), Making Blended Finance Work for the Sustainable Development Goals, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264288768-en.

Blended Finance for water and sanitation examples in Maharashtra

PPP for solar powered WASH infrastructure operations

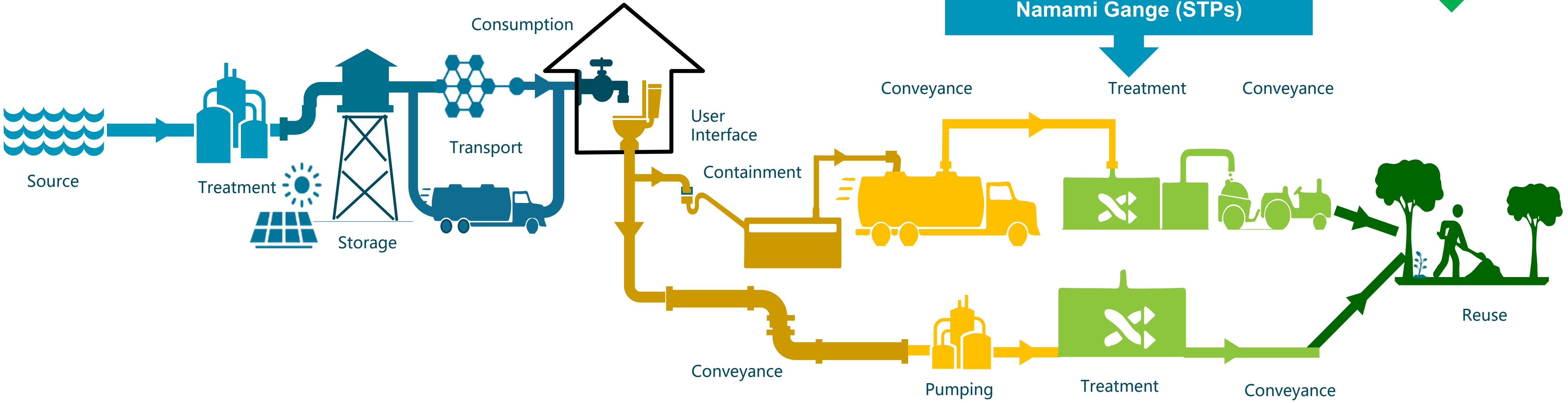
Sanitation credit, Jalna

Performance Linked Annuity Model (PLAM) for scheduled desludging, Wai /Sinnar

Municipal Bonds for wastewater treatment: Metro cities in India

Hybrid Annuity Model (HAM): Namami Gange (STPs)

Reuse with PPP, private sector: Nagpur, Anjar and Gandhidham, Surat



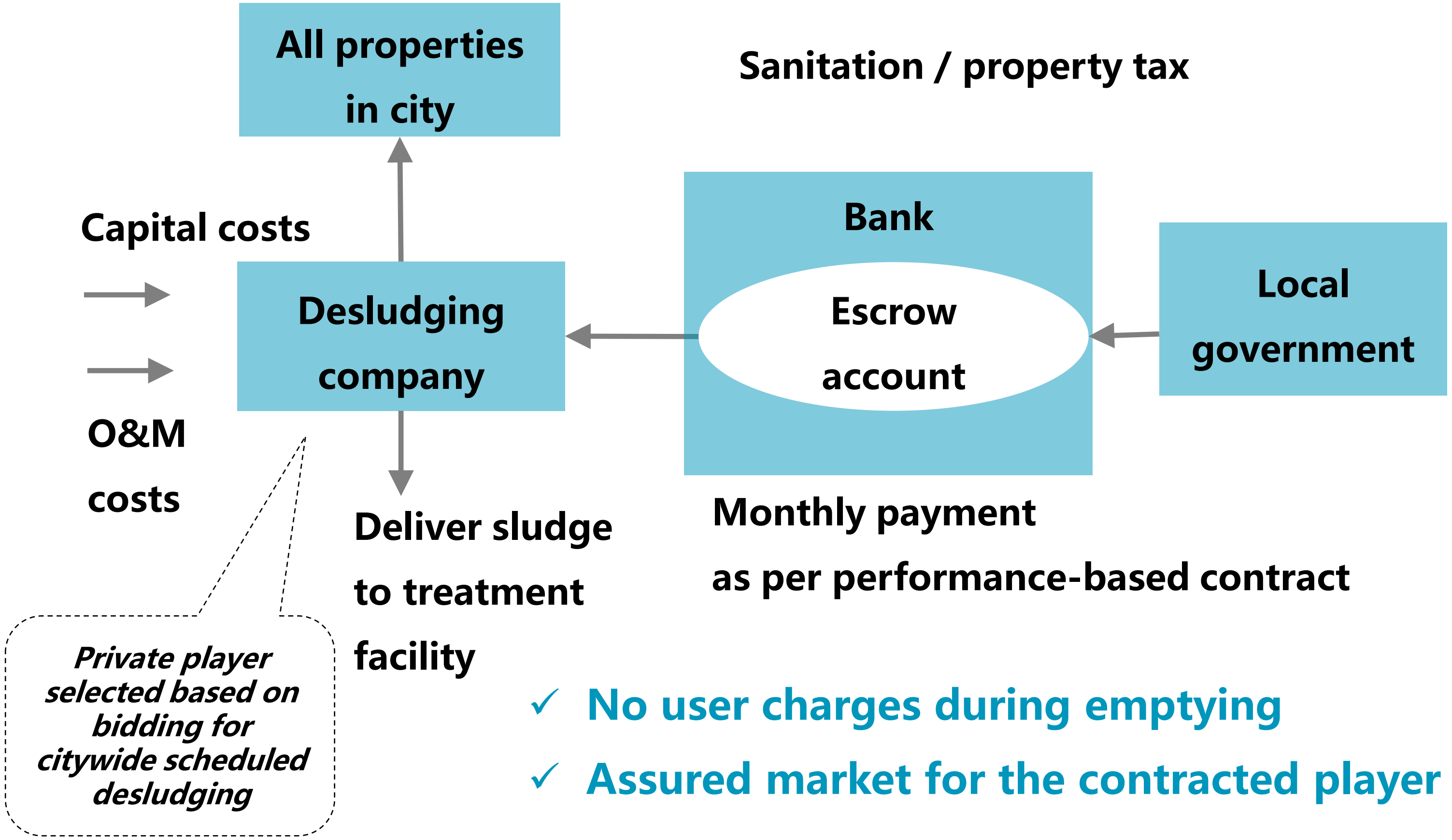
Mitigation measures

Adaptation measures

Performance linked annuity model (PLAM) for engaging private operators in scheduled desludging services in Maharashtra

- **Lack of ULB capacity** to implement scheduled desludging
- **Hired private operator** through **transparent bidding process** wherein Private operator need to bring in trucks and manpower
- **Finance through Sanitation Tax -** Households paying small sanitation tax to finance operations instead of high emptying charges.
- **Risk coverage through Escrow Mechanism -** Local government is supposed to keep 3 month payment in the account to mitigate private operator's payment risk.

Desludging service once in 3 years



- ✓ No user charges during emptying
- ✓ Assured market for the contracted player

Reuse for thermal plant using a PPP Model – Nagpur, Maharashtra

- **Mahagenco – a thermal power plant firm in Nagpur**, purchases sewage water from the Nagpur Municipal Council. An STP along with secondary and tertiary treatment, was constructed and is operated and maintained by a private provider.
- **Capital cost - US$28 million**. **Private provider- 54%** of capital cost and O&M cost, **Local government gave 46%** of capital cost and land for STP. Private provider pays the local government a fixed amount **of US$2.25 million a year for 110 million liters a day** of raw wastewater.
- **Benefits**
  - Reduction of net freshwater extractions by the power sector, freeing up freshwater resources for other uses.
  - Wastewater reuse significantly contributes to climate mitigation through its embedded carbon sequestration potential.

Nagpur Municipal Council

54% Capital costs +Land

Sale of sewage

Sewage Treatment Plant

46% Capital costs + O&M

Use of treated water

Mahagenco (thermal power plant firm)

Source: MOHUA, "MAHAGENCO- Nagpur Municipal Corporation WasteWater Reuse Project at Nagpur"

In India, USD 490 million mobilized through municipal and green bonds for water and sanitation projects

35 municipal bonds
by
14 Urban Local Governments
+
2 state development authorities raised pooled bonds to implement 23 WASH projects

Type of projects

Augmentation of water supply projects

Development of sewage treatment systems

FY 1997- 2017

Total USD 288 million mobilized for WASH projects

FY 2017-2023

USD 202 million mobilized for WASH projects + USD 21 million leveraged in the form incentive-based grants offered by GoI to raise bonds

128 USD million for Wastewater treatment

Type of investors

Retail investors

Institutional investors

Source: SEBI (2023), Retrieved from SEBI database, available on https://www.sebi.gov.in/

Note: INR to USD calculated as base index of that particular year

Green bonds for WASH investments in India

Enabling environment and incentives by GOI and Regulatory framework by SEBI for issuance of green bonds

Vadodara Municipal Corporation

Municipal Bond of INR 100 crore (FY 2023)

- Deployment of funds for **Sindhrot water supply project** to cater drinking water needs of the city and liquid waste management project.
- Bid subscribed for **36 times**
- Bond has **AA rating.**
- VMC's '**successful listing**' of municipal bond now case study for US Treasury.

Green Bond of INR 100 crore (FY 2024)

- Enhancing **liquid wastewater management** infrastructure across Vadodara for developing 2 STPS of 121 MLD and 1 APS with drainage network.
- Bid subscribed for **44 times**
- Bond has **AA+ Stable rating.**
- Recorded as the **first certified green municipal bond f**or sustainable WASH infrastructure.

Indore Municipal Corporation

Green Bond of INR 100 crore (FY 2024)

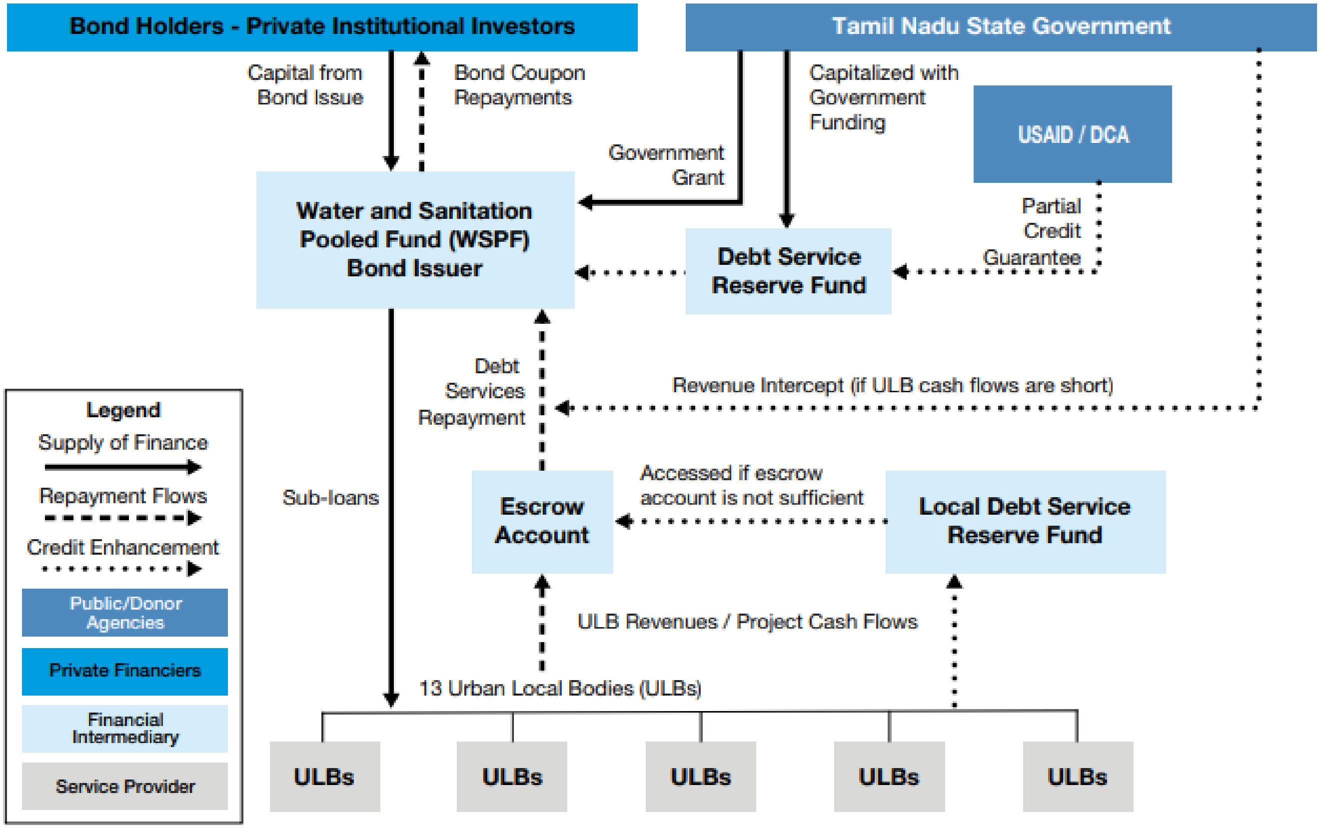
- Set up a **60-megawatt solar power plant** that would generate electricity to bring water from Narmada river which is some 80 km from Indore
- Bid subscribed for **5.9 times**
- Bond has **AA+ Stable rating.**
- **Selling of carbon credits** worth INR 52 lakhs which is encashed for O&M of WASH solar project

Sources: The Indian Express (2022). VMC's 'successful listing' of municipal bond now case study for US Treasury. Retrieved from https://indianexpress.com/article/cities/baroda/us-treasury-department-book-vadodara-municipal-bond-listing-bse-8247788/; The Climate Bonds Initiative (2024). Retrieved from https://www.climatebonds.net/resources/press-releases/2024/02/vadodara-municipal-corporation-initiates-india-and-asias-first, , Retrieved from https://www.business-standard.com/article/economy-policy/indore-s-first-municipal-green-bond-a-beacon-for-india-s-urban-local-bodies-123030500436_1.html

Pooled Bonds to enable access to small municipalities

Pooled financing, where multiple **smaller municipalities issue bonds together**, can help them access capital markets more easily and at lower costs, facilitating infrastructure projects and urban development.

Pooled Municipal Bond Issuance in Tamil Nadu, India: Financial Structure



Key Benefits

- ✓ Diversification of risk
- ✓ Structuring possible to enhance credit quality
- ✓ Optimum use of credit enhancement
- ✓ Credit enhancement by multilaterals or Government
- ✓ It becomes possible for small ULBs to access credit markets

The success of pooled finance model in the States of Tamil Nadu and Karnataka subsequently led Government of India to create a central fund called the Pooled Finance Development Fund (PFDF) – with Rs 2500 crore allocated under 12th Plan.

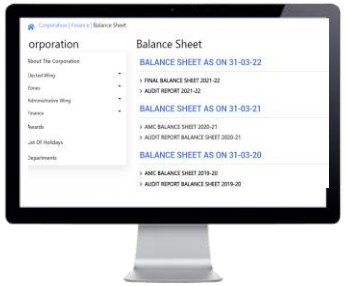
Source: Based on Kudwa Roopa (2004), "Financing Municipalities and relevance of Credit Rating - the Indian experience", CRISIL, Presentation made at International Conference on Financing Municipalities and Sub-National Governments, Washington; World Bank (2016). Pooled Municipal Bond Issuance in Tamil Nadu (India), p.2

Creditworthiness assessment for cities

Creditworthiness Assessment

Framework for cities

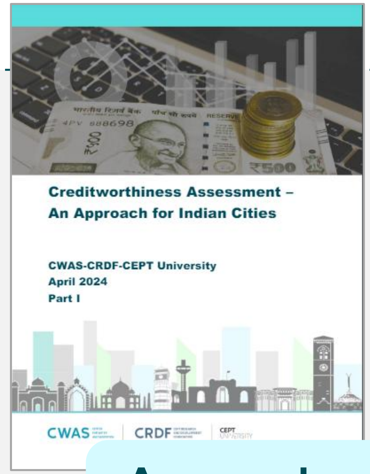
- Cities can use a **creditworthiness self-assessment tool as** a pre-cursor to formal credit rating
- Our Framework uses both **financial performance indicators and service level indicators**
- It uses **publicly available datasets**

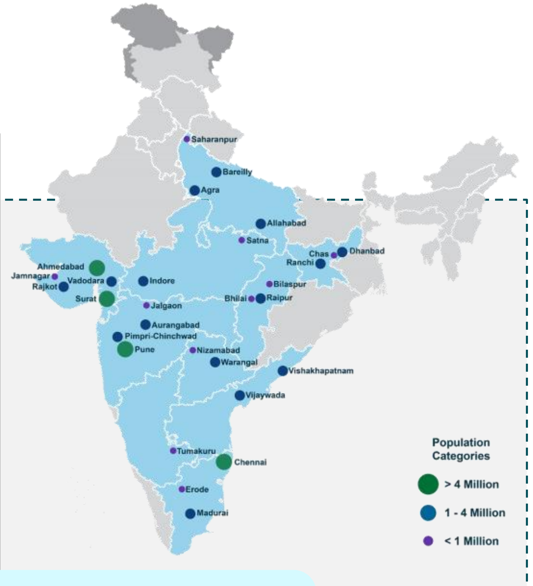


WASH and administrative Data – Performance Assessment System (www.pas.org)

City Balance sheets, Audited account statements and City Budgets

Both larger and smaller cities have 'significantly' higher potential to borrow compared to their actual borrowings





Approach and framework for 30 Indian Cities

A Simple Excel Based Tool to assess creditworthiness and borrowing capacity of a city

Source: CWAS (2024). Creditworthiness Assessment for Indian cities

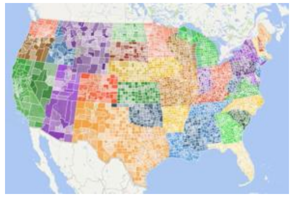
ESG assessments for cities

ESG Assessments, disclosures and investing

Measuring sustainability and societal impact to better determine future performance

Popular amongst corporates but city governments are also adopting

Access new markets for development funds
Build credibility for investors



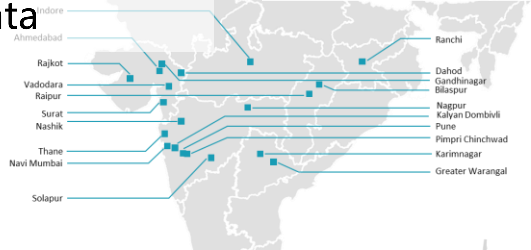
US Municipal Bond marketplace - ISS ESG Muni QualityScore maintains ratings and data for all cities

Toronto's Debt Issuance Program linked to strategic ESG outcomes and reporting

Vancouver, Montreal adopting TCFD recommendations in financial reporting

ESG for Indian cities

Indian cities already reporting on multiple ESG relevant topics as part of govt. initiatives – publicly available data



Framework by CWAS and PwC India

19 themes, **62 indicators** - City mandates, service performance, Laws and policy, National commitments/ programs

Tested on **20 cities** - ESG ratings, profiles

Source: CWAS (2023). ESG Assessments for cities in India

Our recommendations to Sixteenth Finance Commission

Cities in India occupy just 3.0% of the nation's land, but their contribution to gross domestic product (GDP) is a massive 60.0%. (Niti Aayog and ADB (2022)

Continued support to National, state and local governments

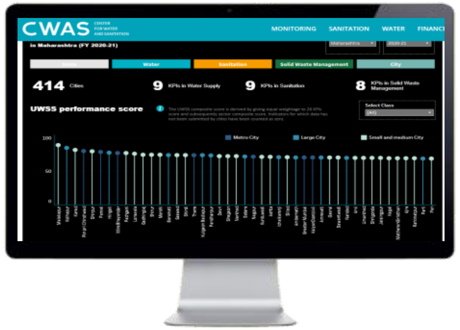
Recognising role of cities in enhancing economic growth

Untied grants to ULBs to strengthen 'cooperative federalism'

Strengthening monitoring of service delivery

Reduce conditionalities and increase the share of untied funds to ULBs

Support ULBs to become climate resilient and contribute to meeting the NDCs



Performance Assessment System (www.pas.org)

Sixteenth Finance Commission and Urban Local Governments

MEERA MEHTA, DINESH MEHTA, DHRUV BHAVSAR

The Sixteenth Finance Commission need to recognise the important contribution of urban local governments in economic development, increase allocations to them, reduce conditional and tied grants, provide funds for climate mitigation and adaptation measures, and provide monitoring services and strengthen monitoring systems in ULGs.

The authors acknowledge the support of Saubiya Sareshwala and Jigisha Jaiswal in preparation for this article.

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The Sixteenth Finance Commission held its first meeting under the chairpersonship of Arvind Panagariya in February 2024. Its terms of reference are as listed in Article 280(3) of the Constitution of India. The Press Information Bureau (PIB 2024) release states that

> the XVI-FC acknowledged the need for wide-ranging consultations with various stakeholders, including State Governments, Local Bodies, Ministries of Government of India, and experts.

It is in this context that we provide a few points for the Sixteenth Finance Commission's consideration.

This article pertains to the specific terms of reference, listed in Article 280 (3)(c) as the measures needed to augment the consolidated fund of a state to supplement the resources of the municipalities in the state based on the recommendations made by the finance commission of the state.

India strives to make itself a developed nation in the coming years. Urban centres play an important role in contributing to gross domestic product (GDP) growth. For example, a NITI Aayog and ADB (2022) report states that

> Cities in India occupy just 3.0% of the nation's land, but their contribution to gross domestic product (GDP) is a massive 60.0%. Similarly, 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.

The experience of other developed nations of "inter-governmental transfers" (IGTs) to urban centres provides important guidance to the Sixteenth Finance Commission to enable urban local governments to play an important role in the nation's economic development.

In this context, there is a case to be made for the Sixteenth Finance Commission to enhance the share for urban local governments (ULGs) as we discuss in this article. We argue that, of late, transfers to ULGs are tied funds and linked to various government programmes. There is a need to reduce conditionalities and increase the share of untied funds to ULGs. As in the past, the Sixteenth Finance Commission will need to continue support for monitoring service delivery by ULGs and strengthen the monitoring system. One area that can be considered for tied funds by the Sixteenth Finance Commission would be for making municipalities more climate-resilient. This will contribute to meeting the nationally determined contributions (NDCs), as well as help reduce flooding in the rainy season and water crisis in summer, both of which have a serious impact on economic output.

Intergovernmental Transfers for Urban Local Governments

As befits a developed nation, ULGs will

Sources: Mehta M. Mehta D., Bhavsar D (2024) "Sixteenth Finance Commission and Urban Local Governments" published in Economic and Political Weekly as Commentary, Vol.37; p.17-20

Thank you

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About us

The Center for Water and Sanitation (CWAS) is a part of CEPT Research and Development Foundation (CRDF) at CEPT University. CWAS undertakes action-research, implementation support, capacity building and advocacy in the field of urban water and sanitation. Acting as a thought catalyst and facilitator, CWAS works closely with all levels of governments - national, state and local to support them in delivering water and sanitation services in an efficient, effective and equitable manner.

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