

# URBAN GOVERNANCE DIALOGUE

Transforming Urban Governance

September, 2021



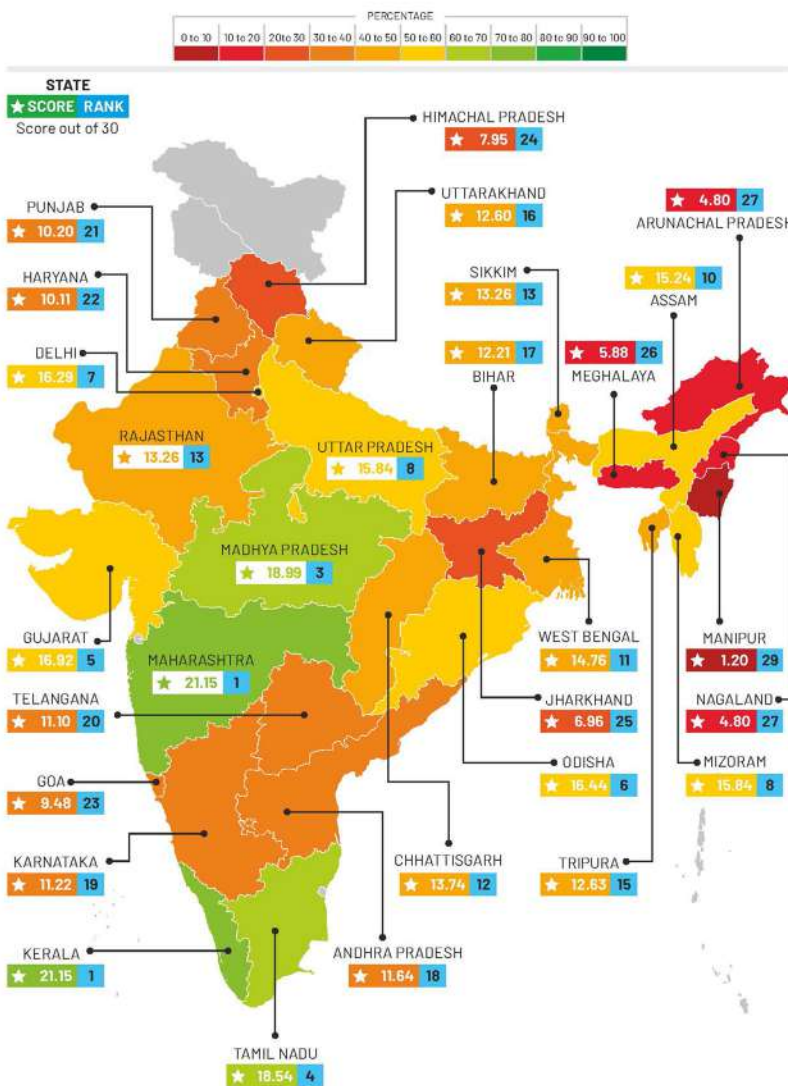
Edition 34 – Date - 15th September, 2021



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## Urban Governance Index - Fiscal Empowerment

Performance of state governments on fiscal empowerment of city governments:



Note: Map not to scale



In this edition of Urban Governance Dialogue E-newsletter, we bring to you the background and key insights behind the fourth theme of Praja's Urban Governance Index: Fiscal Empowerment. This is in continuation to our series of e-newsletters delving upon each of the four themes of the Urban Governance Index.

## Fiscal Empowerment

'Fiscal Empowerment' forms the final theme of Praja's Urban Governance Index. This theme focuses on the independent powers that help raise financial resources for the city government. It also includes the aspect of rule based fiscal transfers that help the city government to boost their financial resources. Another crucial factor covered is the monitoring of the efficiency in management of the available financial resources and maintaining of transparency of financial resources in the public domain. This theme therefore incorporates three sub-themes: 'Devolution of Financial Power', Systemic Fiscal Transfers' and 'Financial Accountability'.

### SUB-THEME 1 Devolution of Financial Power

For city governments to act as self-governing institutions, attaining financial self-sufficiency is important. State governments are primarily responsible to facilitate financial empowerment of the city governments in the state.

#### **Independent authority to introduce new taxes/charges and to revise existing taxes/charges:**

To achieve self-sufficiency, it becomes important for the city government to have independent authority to introduce new taxes/charges and revise the existing ones. If the city government does not have this power, the goal of self-sufficiency becomes extremely bleak, and they remain dependent on the state government to enhance their revenue generation capacity. This, in turn, negatively affects service delivery mechanisms and resultantly, the quality of life of the citizens.

#### **Independent authority to approve the budget:**

City governments best understand the financial resources required with respect to the needs of the city and therefore adopt mechanisms such as gender budgeting, participatory budgeting, etc. However, by restricting of city governments of the authority to approve the budget they prepared, the city governments will not be able to guarantee a budget provision that is in accordance with what the city really needs.

#### **Provision to include the budget allocated by the parastatal agencies:**

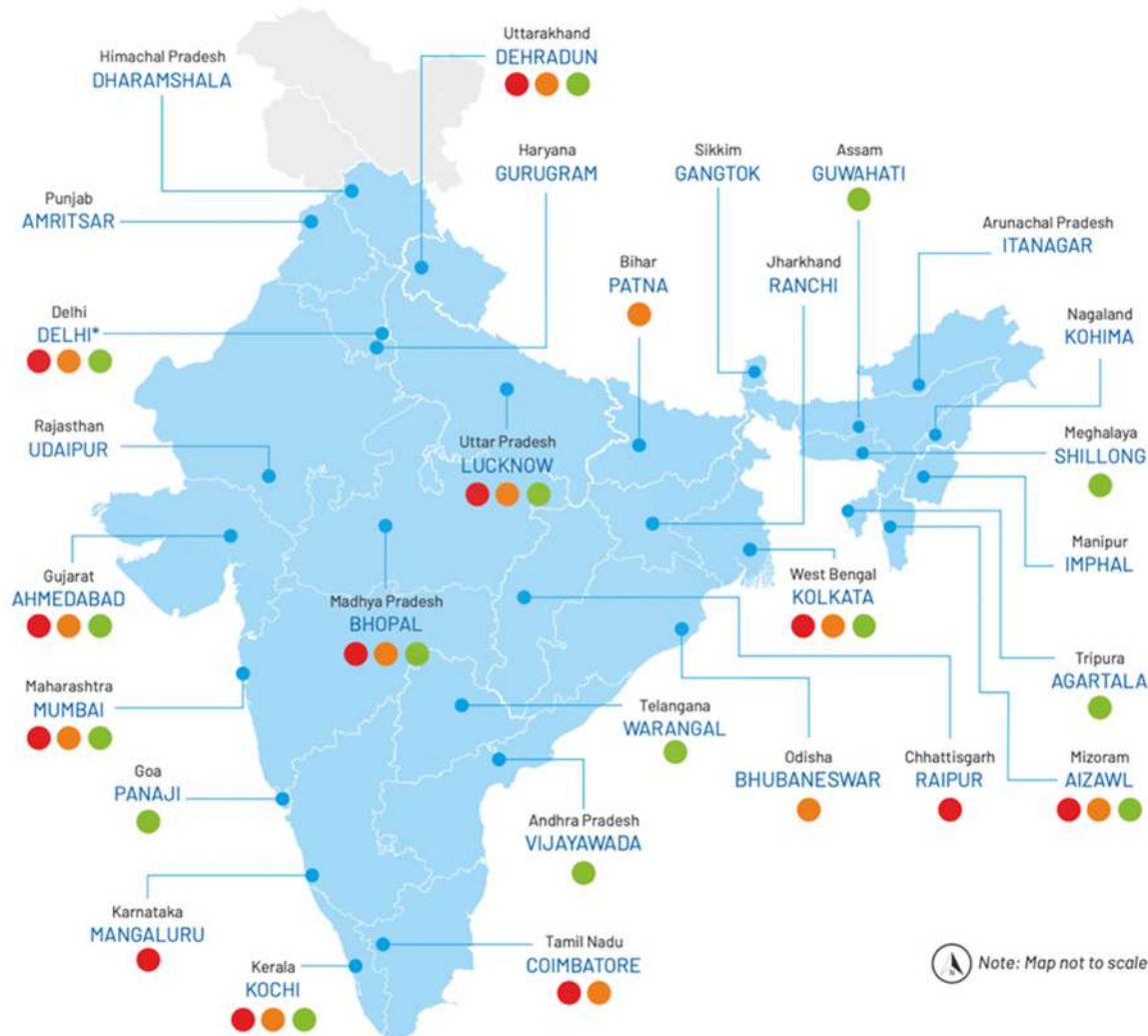
Most Indian cities have numerous parastatal agencies that are responsible for providing services that were recommended by the Constitution (74th Amendment Act 1992) to be transferred. In order to oversee whether the service delivery is appropriate, it becomes important that the budgets of the parastatal agencies are reflected in the city government budget. In case this is not done, there will not be any record that can show the estimated investments in terms of the service upgradation in the city, thus making it difficult for the citizens to track what investments are flowing into their city.

#### **Provision to access market borrowings:**

The city governments should be able to access funds from the market through borrowing mechanisms under prescribed limits. This will allow city governments to fund large scale projects that are required. Without this option, the potential to independently fund and execute projects become reduced. The city government will remain dependent on the state government for funds as well as for implementation of projects.

## Key Insights

- 17 states do not have independent authority to introduce new taxes/charges
- 17 states do not have independent authority to revise the tax rates/charges
- 14 states do not have independent authority to approve budget
- No state has provision for the city government budget to include budget allocated by parastatal agencies in the city.
- All city governments hold authority to access market borrowings.



\*South Delhi Municipal Corporation

Devolution of Financial Power	Yes
Does the City Government hold independent authority to introduce new taxes/charges as per State Municipal Act?	Red
Does the City Government hold independent authority to revise the tax rates/charges?	Orange
Does the council have independent authority to approve the budget according to the State Municipal Act?	Green

## SUB-THEME 2 Systemic Fiscal Transfers

Systemic Fiscal Transfer corresponds to the transfer of designated funds, by the state government to the city governments as recommended by State Finance Commission (SFC). The SFC is a constitutional body set up at the state level to assess the municipal financial status of the city governments and to give recommendations on the allocation of fund transfers based on formulas encompassing multiple relevant factors. This becomes an important component of the income pool which city governments receive as grants from the state government.

### Publication of 5th State Finance Commission (SFC) Report on the official website:

According to Article 243Y of the Constitution Act, 1992, SFC should be constituted every five years to conduct a review of the financial status of local government bodies in the state and prepare an SFC report with recommendations. This necessitates the timely publication of SFC report and if this is not done, the transparency that is required to improve the financial status of the local government is not maintained.

### Publication of the Action Taken Report of the latest SFC on the official website:

According to the Constitutional provision of Article 243Y Clause (2), it is necessary for the SFC to file an Action Taken Report that highlights the action taken with regards to the recommendations made in the SFC report to the State Legislature. Without this, it becomes difficult for the citizens to understand whether the State Government has acted upon the recommendations of the SFC.

### Receiving a direct percentage share of Goods and Services Tax (GST):

Although the GST has subsumed the taxes levied by the state, it has made a provision of sharing of taxes between the centre and the state. On the other hand, GST has also subsumed certain local taxes, however, there is no direct sharing of taxes allocated to the city governments. Prior to the introduction of GST, the city governments were already financially weak and its introduction has only aggravated the problem and have increased the dependency of the city governments on the state. City governments should be entitled to receive a direct share of GST by the central government.

### Key Insights

- Only 10 (Assam, Bihar, Chhattisgarh, Delhi, Haryana, Himachal Pradesh, Odisha, Rajasthan, Sikkim and Tamil Nadu) out of 28 states and NCT of Delhi have published the 5th SFC/latest (in case of Chhattisgarh and Telangana state) report on the respective SFC's website.
- None of the city governments receive a direct percentage share of the GST.

#### SUB-THEME 3

### Financial Accountability

Financial accountability is an indispensable element to secure fiscal empowerment of the city governments. Holding the governments at local level accountable creates a mechanism that ensures transparency and therefore ensures that the public funds are being used in the correct manner.

### Publication of budget and accounts in the city government's website:

It is citizens' money that is being used for development activities of the city and therefore, it becomes the responsibility of the city government to ensure financial transparency by publishing its annual budgets and accounts. If this is not done, the citizens will not know where their funds were used and if their needs are being prioritised or not.

### Provision for conducting external audit:

If the state government does not have any control to check for any discrepancy arising in the financial accounts of the city governments, the accountability mechanism to supervise said management of finances will be at stake. Therefore, there must be a provision for mandatory external audits of municipal accounts to maintain accountability.

### Key Insights

- Only nine states (Andhra Pradesh, Jharkhand, Kerala, Madhya Pradesh, Maharashtra, Mizoram, Punjab, Tamil Nadu and Telangana) out of 28 states and NCT of Delhi have mandatory provision to publish the budget and accounts in public domain.
- Manipur and Meghalaya do not have provision for conducting an external audit.

### References:

- To know more about UGI 2020 click: [Urban Governance Index 2020](#)
- To view explanatory Videos on UGI click:
  - [Need for an Urban Governance Index](#)
  - [Framework of Urban Governance Index](#)
- To access all the State Level Urban Governance Study reports click: [State - Urban Governance Reports](#)

We would like to know your views and feedbacks based on the above information shared. Feel free to reach us at [urbandialogue@praja.org](mailto:urbandialogue@praja.org)

To watch an explanatory video on Theme 4: Fiscal Empowerment, click on the thumbnail below.



Kind Regards,

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