



# URBAN GOVERNANCE DIALOGUE

Transforming Urban Governance

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## Fiscal Empowerment of City Governments – Governance Indicators

Over the last two decades, Praja Foundation has been working towards enabling accountable governance. In 2017, Praja embarked on an ambitious journey towards 'Transforming Urban Governance' (TUG) across the country, to advocate policy changes that will change the way Indian cities are governed. As part of the initiative, Praja conducted comprehensive study spanned over 3 years (2017-2020) in 40 cities across 28 states and National Capital Territory of Delhi. Based on this, Praja prepared the Urban Governance Index 2020.

As part of carrying forward the advocacy on policy changes required, Praja has undertaken an initiative to conduct in-depth research by deep diving into one of the four themes of the UGI i.e., Fiscal Empowerment of the City Governments. This was taken up as a result of the observation that the municipal finance domain is plagued with lack of useful data and knowledge resource, which can be used for informed decision making. Hence, in collaboration with the National Institute of Urban Affairs (NIUA) and an advisory group consisting of domain experts, the study was started as part of this thematic research project. As part of the initial phase of the project, Praja has worked on 7 states and 14 cities across the country.

In this edition of the Urban Governance Dialogue E-newsletter, we bring you some of the key insights behind the second indicator of 'Fiscal Empowerment of City Government's – Governance Indicators'.



**Fiscal Empowerment of City Governments:  
Key Financial Indicators and  
Challenges in Data Availability**

Phase 1 Study  
Final Report  
3<sup>rd</sup> December 2021



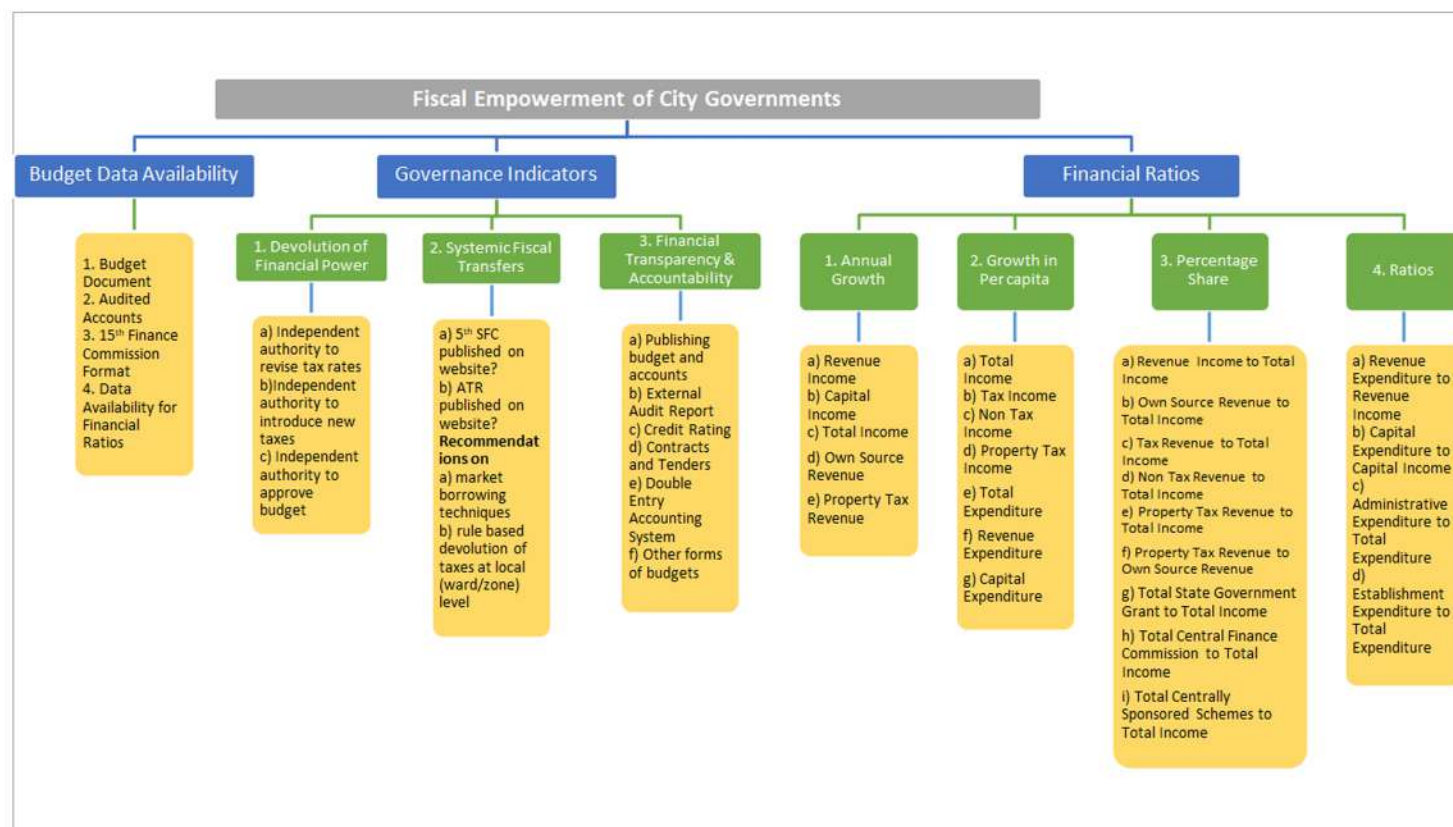
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of City  
Governments:  
Key Financial  
Indicators and  
Challenges in Data  
Availability



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## Framework of the Study



### Fiscal Empowerment of City Governments – Governance Indicators

The 'Governance Indicators' form the second theme of the Fiscal Empowerment Study. This theme focuses on the independent powers that help raise financial resources for the City Government. It also includes the aspect of whether or not the City Government has independent authority to introduce new taxes and revise existing taxes. Another crucial factor covered, is the monitoring of the efficiency in management of the available financial resources and maintenance 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'.

Article 243X of the Seventy-fourth Constitutional Amendment Act, 1992, has recommended State Governments to transfer powers to City Governments to assign and levy taxes and charges. City Governments should aim to be self-sustainable and independent in their functioning. Furthermore, State Governments should ensure that the Constitutional principles are upheld in terms of financial empowerment of the City Governments. For this to take place in its true spirit, the City Governments should be empowered with independent authority to perform the following: (i) Introduce new taxes and charges and (ii) Revise existing rates of taxes and charges being levied. City Governments should hold independent authority to allocate its financial resources, and also be able to independently approve budget.

#### 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 for facilitating financial empowerment of the City Governments in the state.

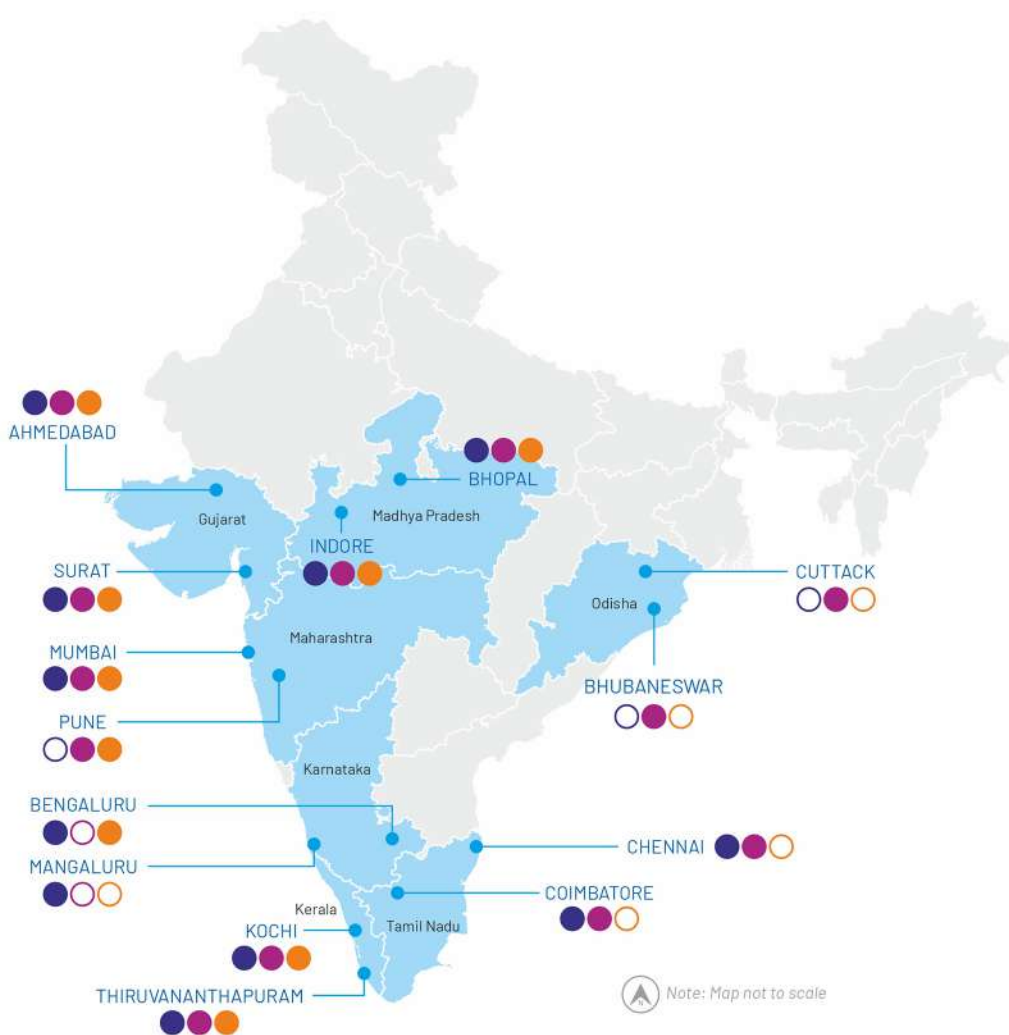
To achieve self-sufficiency, it becomes important for the City Government to have independent authority to introduce new taxes/charges and revise the existing ones. If the City Government does not have this

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.

City Governments should be empowered to prepare and approve its own budgets because it is the City Government which can best represent the mandate of its citizens. This can be done through city level planning and prioritising projects and schemes, based on the financial resources available. Hence, City Governments should be allowed to hold independent authority to allocate its financial resources accordingly, and also be able to independently approve budgets.

Study Observations:

- 3 out of the 14 cities (Pune, Bhubaneswar and Cuttack) do not have independent authority to introduce new taxes from the assigned list of taxes according to the respective Municipal Acts.
- 2 out of the 14 cities (Bengaluru and Mangaluru) do not have the independent authority to revise existing tax rates/charges according to the respective Municipal Acts.
- 5 out of the 14 cities (Mangaluru, Chennai, Coimbatore, Bhubaneswar and Cuttack) do not have independent authority to approve the budget according to the respective Municipal Acts.



According to the State Municipal Corporation Act, does the City Government/council have	Yes
Independent authority to introduce new taxes/charges from the assigned list of taxes	Dark Blue Dot
Independent authority to revise the existing tax rates/charges	Purple Dot
Independent authority to approve the budget	Orange Dot



2. Systemic Fiscal Transfers

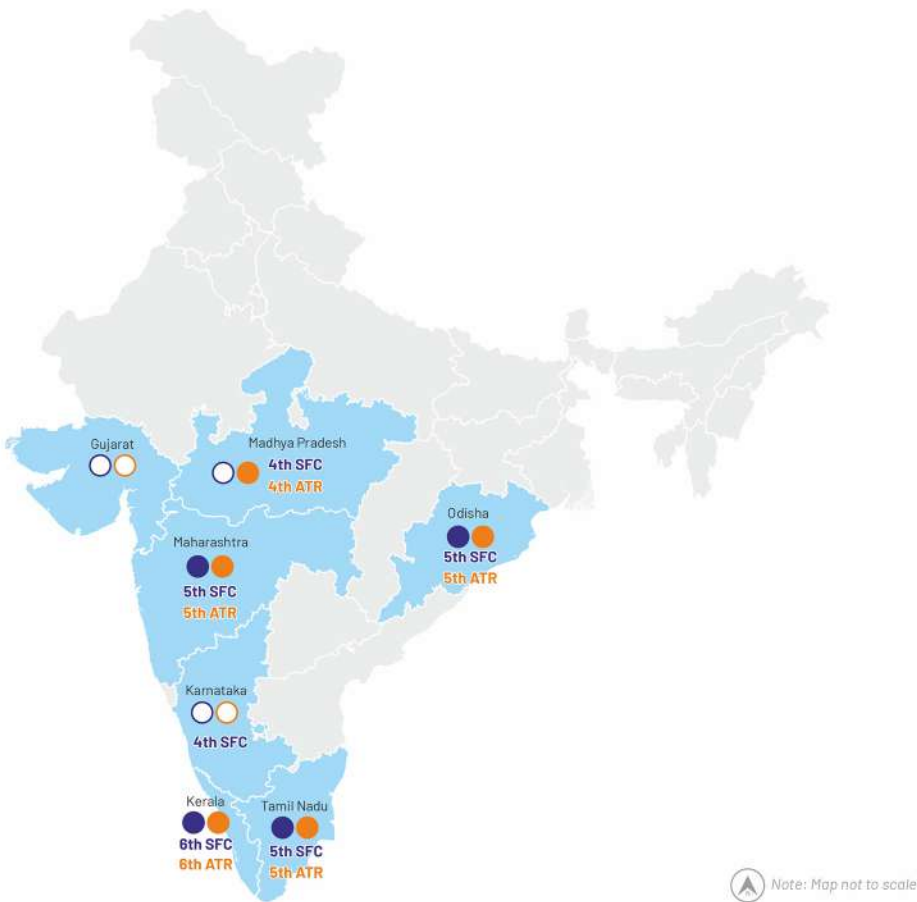
Systemic Fiscal Transfers correspond to the transfer of designated funds, by the State Governments to the City Governments as recommended by State Finance Commission (SFC). This becomes an important component of the income pool, which City Governments receive as grants from the State Government.

As per Article 243Y of the Constitutional (Seventy-fourth Amendment) Act, 1992 , states should constitute State Finance Commission (SFC) every five years in order to conduct the review of financial status of Local Governments in the state and furnish an SFC report with recommendations. Hence, in this context, since the Constitutional (Seventy-fourth Amendment) Act, 1992 came into force, the latest SFC to be constituted in each state is supposed to be the 5th SFC.

The Constitutional provision of Article 243Y Clause (2) states that the SFC should also file an Action Taken Report (ATR) with details on the actions taken with respect to the recommendations made in the SFC report to the State Legislature. Hence, from the perspective of transparency of the recommendations and the actions being taken, the ATR file of the latest SFC should be published on an official website by the State Government.

Study Observations:

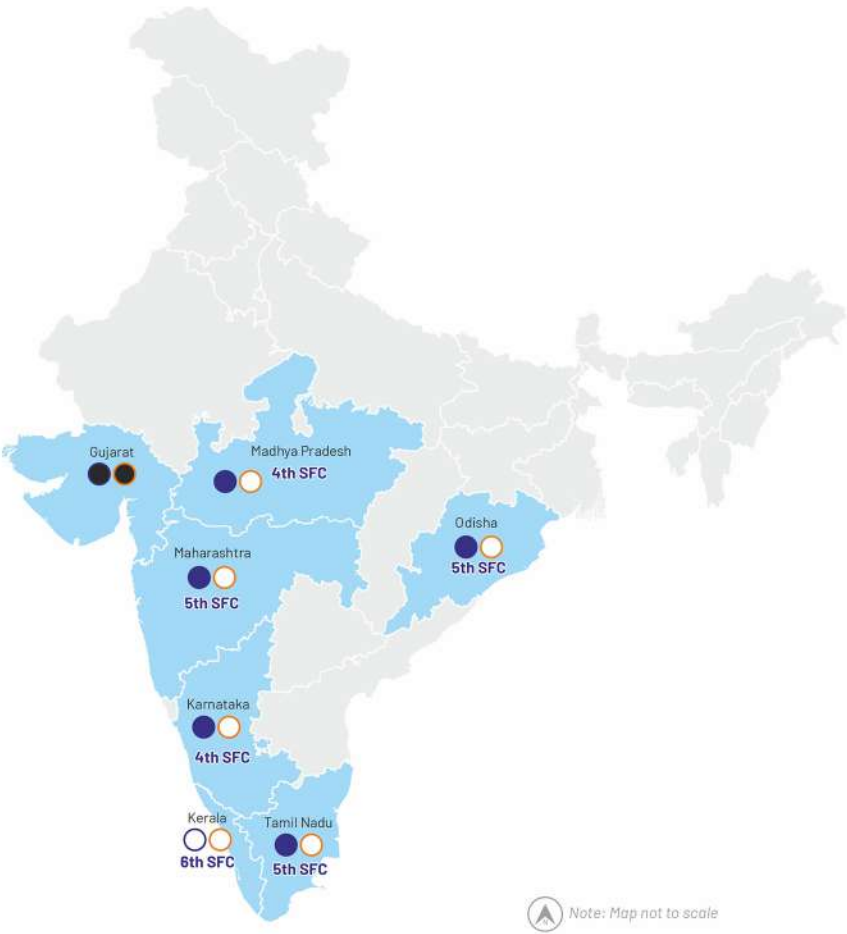
- All states formed before 1994 should be implementing 6th SFCs but the case is not the same for most of the cities.
- Kerala has the 6th SFC report published on the official website.
- Gujarat SFC reports and ATR are not published in the public domain.



	Yes
5th SFC report published on official website?	●
Action Taken Report of latest SFC published on the official website?	●

Study Observations:

- SFC of all 7 States, except Kerala, includes recommendations on market borrowing techniques.
- None of the SFC reports of 6 States include provision on rule based devolution of taxes to the local level (ward/zone) of the city (SFC report of Gujarat not available in the public domain).



Does the latest SFC report have recommendations		Yes
Relating to market borrowing techniques for the City Govt.		●
Regarding rule based devolution of taxes to the local level (ward/zone) of the City		●
NA		●

3. Financial Transparency & 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 warrant that the public funds are being used in the correct manner.

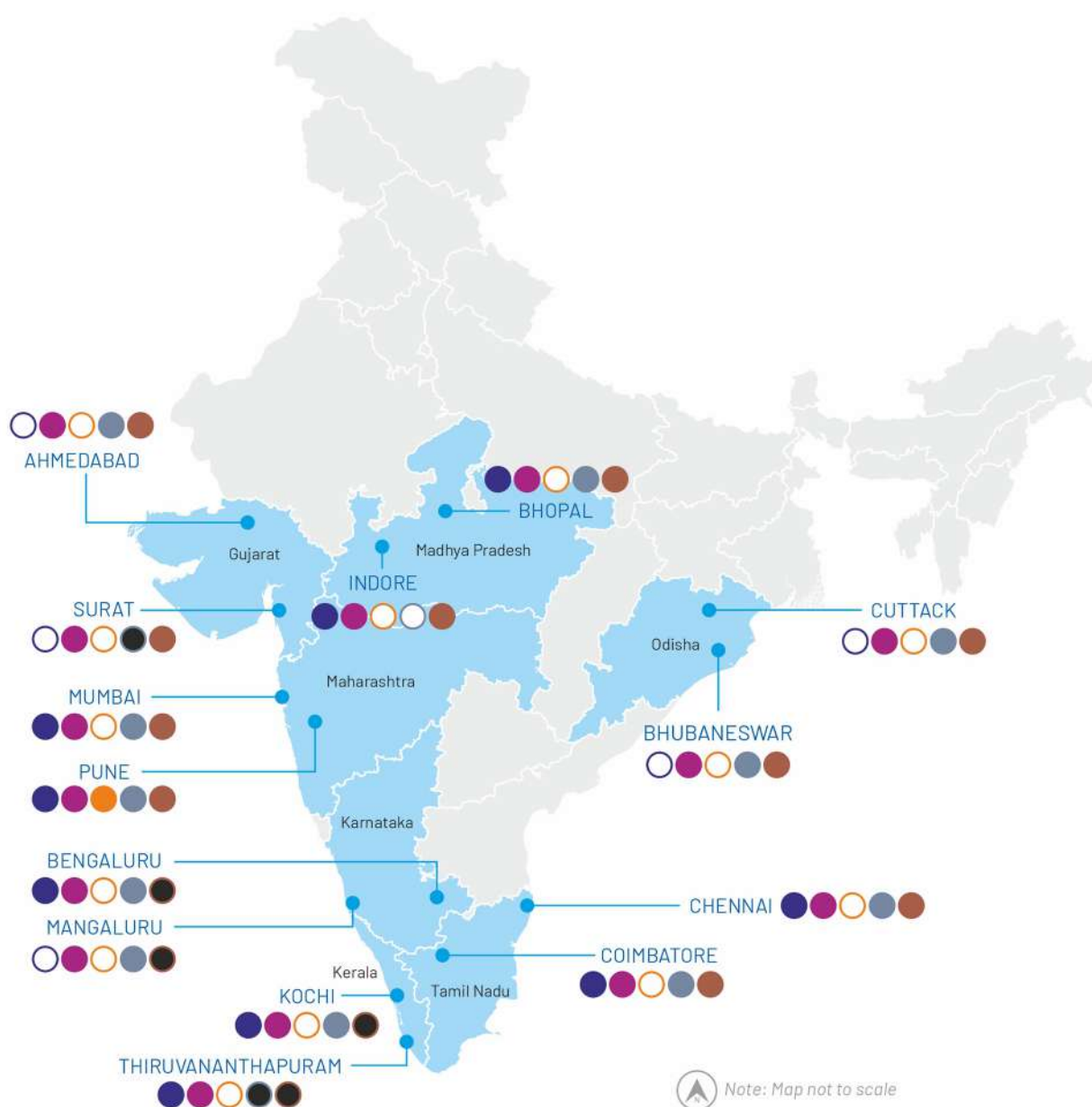
In the context of public finance, the accounts of the Centre and the State are subjected to scrutiny by an independent agency. On similar lines, as the City Government also runs on public money, there should be accountability through established checks and balances. Therefore, the accounts of the City Governments should also be audited either by the State Government or by an independent agency of the City Government.

It is the 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.



**Study Observations:**

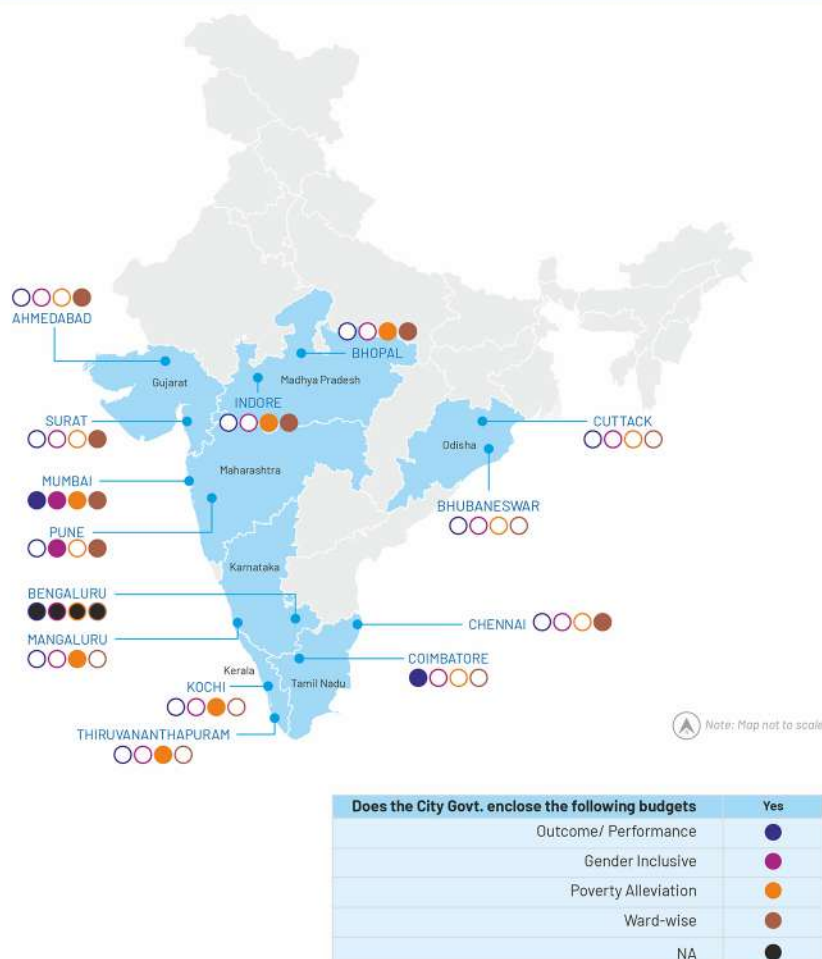
- The State Municipal Acts applicable for 5 out of the 14 Cities (Ahmedabad, Surat, Mangaluru, Bhubaneswar and Cuttack) do not mandate publishing of budget and accounts.
- The State Municipal Acts applicable for all the 14 Cities include provision for conducting an external audit of Municipal accounts.
- Only 1 City (Pune) out of the 14 has published its credit ratings.
- All Cities (data not available for Surat, Indore and Thiruvananthapuram) have the contracts and tenders published on the City Government website.



Indicators	Yes
Does the State Municipal Act make it mandatory to publish the budget and accounts?	●
Does the State Municipal Act have a mandatory provision on external audit of Municipal accounts?	●
Does the City Government publish its Credit Rating in the financial statements/budget/website?	●
Are the contracts and tenders dealt by the City Governments published on the City Govt. website?	●
Is accrual based double entry accounting system implemented by City Government?	●
NA	●

**Study Observations:**

- Only 2 Cities out of the 14 (Mumbai and Coimbatore) publishes the outcome/performance budget.
- Only 2 Cities out of the 14 (Mumbai and Pune) publishes gender inclusive budget.
- 7 Cities out of the 14 (Ahmedabad, Surat, Mumbai, Pune, Chennai, Indore and Bhopal) have ward wise budget included in the budget document.

**Consultation Summary:**

In the consultation session, participants discussed on the devolution of powers to the City Governments. State Finance Commission does not make rule-based devolution to City Governments due to lack of proper data. City Governments should be given independent authority to approve budgets and implement reforms as and when needed; rather than awaiting state intervention. Respective legislatures should be changed to empower City Governments. The City Governments should also hold the authority to revise the tax rates, as factors impacting tax rate vary from city to city. State Finance Commission reports and recommendations need the same sanctity as the Central Finance Commission.

The aim behind data collected for accounts is for SFCs but experts agree that capacity building should be done for timely collecting and maintaining of data. It was suggested that the report should further study the details on recommendations and the kind of recommendations approved, rejected or pending. The recommendations of the State Finance Commission which are accepted and implemented are also important to understand. Furthermore, as the municipal corporation increases in size over time, they should also have a direct share in the union funds. It was also highlighted that the delay in implementing the SFC recommendations is extremely high and thus the next SFC report comes into action, causing the state to reject the previous recommendations.

**Consultation Recommendations:**

- Constitutional Amendment needs to be made to create consolidated funds for local governments (rule-based devolution).
  - Some percentage of GST from the Finance Commission can be assigned to the Municipal Corporations.
  - SFCs, as an institution, must be strengthened and their performance should be improved for achieving fiscal autonomy and rule-based finance system.
  - Independent authority to be given to City Governments for budget approval.
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We would like to know your views and feedback based on the above information shared.  
Feel free to reach us at [urbandialogue@praja.org](mailto:urbandialogue@praja.org)

Kind Regards,



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