

The 16th FC and Indian cities: A blueprint for municipal finance

It can catalyse municipal-level financial reforms through decentralization, transparency in reporting and accountability



KESAVAN SRINIVASAN & SRIKANTH VISWANATHAN

are, respectively, former deputy comptroller and auditor general and senior adviser, and chief executive officer, Janaagraha.

The new Lok Sabha and Union government are in place. It is now time to get back to business as usual. In our first two pieces on the 16th Finance Commission (FC) and India's cities, we covered specific measures to make the Finance Commission and its work more easily accessible to citizens and the spatial aspects of urbanization that need to be considered. In this final piece, we focus on a substantive public finance reform agenda for India's cities and how the 16th FC could catalyse it.

India's cities have far less money than they need, inadequate absorptive capacity for the money they have, and no accountability for how the monies they spend improve citizens' lives. There are five areas we need to reform:

Fiscal decentralization: Our cities need predictability in the quantum and timing of fiscal transfers. This is directly a function of how well the central FC and the various state FCs approach these tasks and how well their recommendations are implemented. While successive central FCs have established a stellar track record, state governments are not even constituting state FCs on time, let alone implementing their recommendations. While the 15th FC has made the placement of Action Taken Reports of state FCs a grant condition, the failure of state governments to meet this condition will hurt urban local bodies and citizens. We, therefore, need a different incentive mechanism to ensure state FCs live up to the spirit of the 74th Constitution Amendment, which can be built into recommendations of the 16th FC.

In addition to predictable fiscal transfers, our cities also need access to buoyant revenue streams. Stamp duties and real-estate registration charges, vehicle registration charges and GST—all of which are related to the functioning of city governments and their expenditure obligations—have not been devolved to cities through a transparent mechanism. We need to evolve mechanisms whereby a fair share of such revenue streams are devolved to cities, making them partners with stakes in economic development.

An oft overlooked aspect of fiscal decentralization is expenditure power. Very often, the mayor and council of a city do not have delegated authority to incur expenditure that is reasonable relative to the city's budget. They are required to seek approval of the state government for relatively small amounts, which militates against decentralization, besides causing avoidable delays. There is no reason why elected governments at the city level need to be subservient to state-level bureaucrats. This needs to be corrected.

Revenue optimization: Cities do not presently fully exploit the revenue powers devolved to them.



There are five stages in the life-cycle of own revenues that cities need to reform: enumeration, valuation, assessment or metering (in the case of user charges), billing and collection, and reporting. Of these, generally, valuation powers rest with the state government. The spirit of decentralization, which is often invoked zealously by the states with the Union government, has not been extended to the third tier. At the very least, states need to update guidance values or circle rates to keep them in line with market values. Cities need to undertake reforms throughout the life-cycle.

Fiscal responsibility and budget management: The legal framework around financial accounting, reporting and budgeting in cities has to be significantly improved. There is no standardized and thus comparable format for budgets and audited accounts in most states, no definite date for filing audited annual accounts or penal consequences for delays, no mandatory accounting standards based on which accounts are to be prepared, and no management accounting systems and processes. Karnataka's pioneering effort close to two decades ago needs to be emulated nationwide.

Transparency and accountability: There is a need for radical transparency and citizen participation in municipal budgets and works. We need details of all tenders, works and payments to be publicly disclosed in machine-readable formats. We also need participatory budgeting to be meaningfully implemented. If actionable information on neighbourhood-level projects is publicly available, it will

encourage citizen participation in governance and unleash a virtuous cycle of accountability.

State capacity: The finance and accounts and revenue functions are beset with staff shortages and vacancies, apart from inadequate skills. They need to be professionalized and brought up to private-sector standards. Digitalization needs to be accompanied by process reforms. Parallel systems (one or more digital systems alongside manual records) prevalent in most Indian cities need to be replaced with a single source of truth that is digital.

Most of these reforms fall within the remit of state governments and a few within that of local governments (where too the *de facto* decision-maker is the state government). The 16th FC needs to assume thought leadership and provide guidance and incentives like its predecessors, given the long journey ahead on these reforms.

It should also incentivize the ministry of housing and urban affairs to revise the National Municipal Accounts Manual to bring it up to date with modern standards in accounting, reporting and technology. It should raise the bar further on the quality of audited annual accounts, public disclosure of projects and works, and service-level benchmarks by mandating machine-readable public disclosures. Ensuring high-quality financial and performance reporting would set in motion a virtuous cycle that enables several of the other reforms. If there is one reform that the 16th FC needs to focus on, this is it.

This is the third and final article of a three-part series on the 16th FC and India's cities.