

## Chapter 80

# The Efficiency of India's Cities: Is There a Case to Finance Them?

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### ABSTRACT

*One reason for unsatisfactory public service delivery in Indian cities is that city finances are in poor condition. Recent research shows that given the fragmented institutional arrangements for land in India's cities, there is a case for transferring revenues from land leasing and sales to cities. In this paper, the author determines whether such transfer of revenues to India's cities from the state governments is justified. The author uses stochastic frontier analysis to determine the efficiency of Indian cities, taking the case of roads. The author has found India's cities to be highly efficient in the provision of roads and there is only one percent inefficiency in the provision of roads by city governments. Hence transfer of finances to cities in a phased manner is recommended. Thus this paper shows a direct link between behavioral economics and concrete, practical applications at the organizational level.*

### INTRODUCTION

The year 2007 was important for urbanization since the number of urban inhabitants surpassed rural dwellers as a percentage of the total world population. The world population is expected to become two-third urban by 2025. The urbanization pattern in India also has been undergoing significant change, consistent with the world-wide phenomenon. The share of urban population in the total population of the country grew from 11% in 1901 to 26% in 1991, and 29% in 2001. While India adopts a very conservative definition of

what is 'urban,' the 'urban' population in India is expected to increase to about 500 million by 2021.

While the urbanization phenomenon is widely accepted as being an inevitable by-product of development, there are many undesirable outcomes that have resulted. According to the Government of India's Ministry of Urban Development, 20 percent of the country's urban households do not have access to safe drinking water, 58 percent do not have safe sanitation, and more than 40 percent of garbage generated is left uncollected for want of proper waste management.

There is no consensus on what the cause is of the poor state of such public service delivery in India's cities. Some studies point to institutional overlaps and governance as factors causing problems in the delivery of public services (Savage & Dasgupta, 2006; Sridhar, 2006). Another set of studies point to weak municipal finances as the core of the problem (see Reedy, 1986; Sridhar & Mathur, 2009). There is evidence that cities that have access to liquid sources of revenue such as octroi<sup>1</sup> are able to provide public services such as solid waste management much better than others (Sridhar & Mathur, 2009). Given this evidence, it is plausible to believe that finances play an important role in public service delivery.

One reason for exploring innovative sources of development finance is that city finances in India are in poor condition. Most of India's cities have now abolished the highly buoyant source of revenue, the octroi, is now generally accepted to be distortionary in its effects. This is because the tax led to delays at checkposts, related productivity losses and corruption.

Further, the property tax base in India's cities has not yet become a resilient source of revenue and does not reflect the capitalization that has been occurring in property value as a result of growth of the local economy. The sphere of municipal taxation was in India sometime ago enlarged to include land tax and tax on land values, however, with the exception of a few local bodies in Tamil Nadu, little progress has been reported regarding the levy/enhancement of land taxes by local bodies. A high tax rate on land encourages improvements on land and provides a disincentive for large speculative landholdings. A high land value tax (similar to a vacant land tax) would decrease the market value of land and provide a stimulus to develop land to its full potential.

One of the means by which local governments increase revenues in the absence of an effective taxation system is through public land leasing (Ding, 2005)). While it is important to understand

that land is a non-renewable resource and can be exhausted, one option that has been given much less attention in municipal finances is their land assets. In fact, many cities and municipal governments have access to substantial land assets such as public buildings, housing, and municipally owned enterprises. It is also easy to understand that since local governments make infrastructure investments on their land such as water supply networks, roads, and schools, which are likely to be capitalized in the land value. Further, urbanization and economic growth drive up land prices. In fact, Sridhar (2004) summarizes the disparity in real estate prices between the central business district and the suburbs of some of India's metropolitan areas. Hence, municipal governments have every right to capture the outcome of economic growth which manifests itself in increased land prices, and also their own investment through sale (see Peterson, 2007). Land in urban areas is a scarce resource which needs to be optimally utilized if the objective of affordable housing is to be attained and in order to halve global poverty by 2015, as set out in the Millennium Development Goals (MDGs). But the institutional arrangements for land use are quite fragmented in India's cities, as demonstrated by Sridhar and Reddy (2010) who, in line with other studies, make a case for transfer of revenues from land leasing and sales from the urban development authorities (UDAs) to municipal corporations. However, it is a question open to examination as to whether cities are efficient in public expenditure to be able to use the resource thus transferred to them.

Given we are interested in examining how preferences, attitude, and behavioral issues influence economic agents involved in business and organizations, in this paper, I have examined the case for whether or not Indian cities are efficient in the provision of public services (taking the case of roads) so that one may decide whether or not a case for transferring revenues from public land leasing and sales, to cities, exists.

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