

## A Memorandum to the Sixteenth Finance Commission of India (XVI-FC)

*Submitted by National Faecal Sludge and Septage Management (NFSSM) Alliance*

### Preface:

Urban India stands at an inflection point, grappling with rapid urbanisation, growing climate risks, and increasing demands for improved quality of life. Among urban services, water and sanitation remains foundational with its potential to drive equitable, climate-resilient transformation across sectors like health, infrastructure, and urban planning.

Many ULBs, particularly in small and medium towns, face challenges in sustaining water and sanitation service delivery due to limited revenue generation, insufficient technical capacity, and institutional fragmentation. The Government of India's flagship missions like Swachh Bharat Mission (Urban) and AMRUT have enabled creation of infrastructure and coverage, however challenges persist in operations and maintenance (O&M), adaptation to climate risks, and financial sustainability.

The 16th Finance Commission presents a critical opportunity to reshape this trajectory by embedding performance-linked transfers, enabling institutional and digital strengthening, and incentivizing innovation, the Commission can empower ULBs to function as capable, accountable, and future-ready service providers. This submission, led by the NFSSM Alliance, draws from over a decade of groundwork in faecal sludge and septage management (FSSM), service delivery, decentralized and inclusive sanitation, used water management and enabling innovation and technologies. It builds on the learnings of the 13<sup>th</sup>, 14<sup>th</sup> and 15<sup>th</sup> Finance Commissions, which laid the foundation for performance-based financing and digital governance.

In this context, the NFSSM Alliance proposes the below priorities towards empowering ULBs as core service delivery agents:

1. **Continue providing performance-based grants** that are simple, predictable, and aligned with national missions like the Swachh Bharat Mission (Urban) and AMRUT. These grants to link intergovernmental transfers to measurable outcomes, making it easier for ULBs, especially those with limited capacity to access complex conditional funding.
2. **Incentives for institutional and financial strengthening**, including earmarked support for climate resilience, innovation, and digital transformation, enabling cities to build local capacity for revenue recovery, integrate climate considerations into planning, and making sanitation a budgetary priority for equitable service delivery.

This envisions **water and sanitation as a driver and not a by-product of urban development**. Through this lens, the 16th Finance Commission can help unlock a new era of municipal transformation one that equips India's cities to adapt, innovate, and thrive in the face of growing urban complexities.

## Detailed Recommendations to the 16<sup>th</sup> Finance Commission:

Observation & Context	Recommendations & Expected Impact
<b>Recommendation 1: Continue performance-based funding for urban transformation, with strengthened monitoring systems</b>	
<p><b>Context:</b></p> <p><b>Performance-based funding</b> has been a key feature of the 13<sup>th</sup>, 14<sup>th</sup> and the 15<sup>th</sup> Finance Commissions. The 15th FC allocated ₹38,196 crore to million-plus cities based on outcomes in water, sanitation, and air quality<sup>1</sup>. Moreover, most small and medium ULBs, home to 85% of urban India<sup>2</sup>, instead receive tied grants, continue to face barriers to access performance-based grants due to complex eligibility requirements, lack of interoperability between digital systems, and weak monitoring infrastructure.</p> <p>Digital platforms like <b>SBM MIS</b>, <b>Swachh Survekshan</b>, and Odisha's <b>SUJOG</b> have demonstrated the feasibility of data-driven fund tracking and service monitoring, however adoption remains limited, and operational integration is often weak.</p>	<p><b>Recommendations:</b></p> <p><b>1. Institutionalize interoperable Digital Public Infrastructure (DPI) for monitoring and fund disbursement:</b></p> <ul style="list-style-type: none"> <li>• Enhance the existing grant management system on <b>City Finance</b> and integrate interoperable platforms such as <b>SBM MIS</b>, <b>DIGIT</b>, Performance Assessment System (<b>PAS</b>), Public Financial Management Systems (<b>PFMS</b>), <b>UPYOG</b>, and <b>SUJOG</b> to strengthen monitoring and a unified view of financial outlays, service delivery outputs, and verified outcomes.</li> <li>• Leverage the National Urban Digital Mission (NUDM) to scale UPYOG as the digital backbone for ULBs, drawing from models like Odisha's SUJOG, which has improved service coverage and grievance redress through localized, integrated digital systems.</li> <li>• Establish these systems as the Single Source of Truth (SSoT) for fund disbursement, grievance redress, and performance reporting, backed by state-level policy mandates and capacity support.</li> <li>• Ensure interoperability with financial, scheme or program management and service delivery systems to enable a unified view of outlay, output and outcome.</li> </ul> <p><b>2. Link performance-based grants to macro- governance reforms and transparency measures:</b> Link performance-based grants aligned to city size appropriate governance and transparency reforms that encourage progress across ULB capacities, such as:</p> <ul style="list-style-type: none"> <li>• Notification and adoption of Government of India's (GoI's) Service Level Benchmarks (SLBs) and System of National Accounts (SNA)-Benchmarks to institutionalize performance tracking.</li> <li>• Timely publication of audited annual accounts (preferably in machine-readable formats) and city budgets (e.g., by October and May respectively).</li> <li>• Mandatory disclosure of targeted statements on: <ul style="list-style-type: none"> <li>○ Subsidy allocations for water and sanitation</li> <li>○ Gender budgets and budgets earmarked for urban poor, women, and child development.</li> </ul> </li> </ul>

<sup>1</sup> See XV-FC Report, p. 48; XIII-FC – see Table 10.4, p. 174

<sup>2</sup> NITI Aayog, A Study to Qualitatively Assess the Capacity Building Needs of Urban Local Bodies (ULBs)

	<ul style="list-style-type: none"> <li>• Leveraging verifiable platforms such as SBM MIS, Swachh Survekshan, PAS, and City Finance dashboards to ensure transparency in reporting and enable flexible compliance pathways for ULBs.</li> <li>• Introduce standardized audit protocols linked to GoI's SLB frameworks to track quality of service delivery, particularly during climate events.</li> <li>• Develop sector-specific SOPs to validate sanitation performance and fund utilization.</li> </ul> <p><b>Impact Towards:</b></p> <ul style="list-style-type: none"> <li>• Predictable, performance-tied funding empowers small and medium ULBs to sustainably manage sanitation service delivery.</li> <li>• ULBs adopt DPI for transparent, real-time monitoring for municipal operations with major focus on water and sanitation.</li> <li>• Scaled integration of climate resilience into water and sanitation operations, reducing public health and infrastructure risks.</li> <li>• Strengthened accountability through standardized audits and publication of Service Level Benchmark supported by verified performance reports.</li> </ul>
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**Recommendation 2: Incentivizing Institutional Strengthening in ULBs, through governance, financial mechanisms and earmarked support for innovation and climate-resilience**

<p><b>Context:</b></p> <p>India's 4300+ ULBs particularly the small and medium towns carry the bulk of service delivery responsibilities but are structurally under-equipped to perform.<sup>3</sup></p> <p>Most small and medium ULBs operate with limited budgets (typically under ₹100 crore),<sup>4</sup> critical staffing gaps, weak financial systems, and no authority to set tariffs or recover costs. As a result, infrastructure built under SBM-U and AMRUT is often underutilized, with chronic failures in O&amp;M, planning, and citizen responsiveness.</p>	<p><b>Recommendations:</b></p> <p><b>1. Implement a Tiered, Performance-Linked Fiscal Grant Architecture:</b></p> <ul style="list-style-type: none"> <li>• <b>Flexible Grants:</b> Recommend that up to 80% of municipal grants <b>be flexible and performance-linked</b> with subject to <b>basic governance-linked</b> eligibility conditions, as: <ul style="list-style-type: none"> <li>○ <b>Publication of audited annual accounts</b> (by October, in machine-readable format)</li> <li>○ <b>Timely publication of city budgets</b> (by May each year)</li> <li>○ <b>Adoption of Government of India's Service Level Benchmarks (SLBs)</b></li> </ul> </li> <li>• ULBs that meet the minimum entry conditions can access <b>tied grants</b> across a broad <b>range of municipal functions</b> including sanitation, water supply, solid waste management, roads, drainage, street lighting, and parks and so on, based on local priorities.</li> </ul>
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<sup>3</sup> MoHUA, Report on Capacity Building for Urban Local Bodies (CBULBs)

<sup>4</sup> NITI Aayog, A Study to Qualitatively Assess the Capacity Building Needs of Urban Local Bodies (ULBs)

<p>To address persistent capacity deficits and unlock sustainable urban transformation, the 16th Finance Commission must go beyond funding infrastructure. It must strengthen the institutional foundations of ULBs through performance-linked grants, governance mandates, embedded technical support, and digital accountability systems with sanitation serving as the entry point.</p> <p>Sanitation systems are highly vulnerable to climate impacts, including urban flooding, water scarcity, and heatwaves. Despite capital investments through SBM and AMRUT, operational and adaptive capacities remain weak, particularly in smaller ULBs.</p> <p>Pilots in Sangli (co-treatment of septage at STPs), Alibag (greywater bioremediation), and Uttarakhand (CWIS-based faecal sludge and sewage co-treatment) have demonstrated replicable, low-cost, and climate-smart sanitation solutions. However, these innovations remain dependent on fragmented or project-based funding.</p> <p>The 15th FC acknowledged the need for climate adaptation but lacked specific earmarking for sanitation resilience.<sup>5</sup> Meanwhile, programs like the Majhi Vasundhara Abhiyan and National Mission for Clean Ganga (NMCG) have mainstreamed environmental performance and decentralized wastewater treatment offering opportunities for convergence with the 16th Finance Commission grants.</p>	<ul style="list-style-type: none"> <li>• <b>Performance-linked components</b> within the flexible pool of funds, can further incentivize cities that demonstrate improvements in fiscal transparency, digital reporting, or inclusive service delivery.</li> </ul> <p><b>2. Incentivise ULBs with Performance-Linked Innovation and Climate-Resilience Grants:</b></p> <ul style="list-style-type: none"> <li>• Allocate <b>performance-linked innovation and resilience grants (20%)</b> as a second-order incentive for ULBs that meet core governance benchmarks. These grants should support the <b>pilot and scale-up of climate-resilient, digital, and inclusive sanitation solutions</b>, including:             <ul style="list-style-type: none"> <li>○ <b>Co-treatment units</b>, greywater reuse, and modular STPs (e.g., Sangli’s plug-and-play co-treatment model for cities with STPs)</li> <li>○ <b>Decentralized, nature-based sanitation systems</b>, such as Alibag’s bioremediation and Indapur-Junnar’s urban-rural FSM convergence offering low-cost alternatives to conventional sewerage</li> <li>○ <b>Urban-rural convergence strategies</b>, including shared sanitation infrastructure in peri-urban areas (e.g., Uttarakhand’s CWIS and Maharashtra’s regional co-treatment models)</li> </ul> </li> <li>• Leverage <b>output-based aid and Program for Results (P4R)</b> models to tie disbursements to clearly defined milestones such as energy efficiency, nature-based treatment outcomes, and convergence with rural sanitation systems.</li> <li>• Promote <b>adaptive O&amp;M financing</b> by linking operational support to quality, uptime, and safety metrics—especially in climate-vulnerable towns with weak sewerage infrastructure.</li> <li>• Further, catalyse cross-sector collaboration through <b>city-level innovation labs</b> (e.g., Maha-INNOWASH), <b>challenge funds</b>, and <b>blended finance platforms</b>, while encouraging <b>convergence with national missions</b> such as Jal Jeevan Mission, AMRUT 2.0, and SBM 2.0 to enable joint planning and pooled O&amp;M financing.</li> </ul> <p><b>3. Integrate Digital Public Infrastructure (DPI) and Service Level Benchmarks (SLBs) as Core Monitoring and Eligibility Tools</b></p> <ul style="list-style-type: none"> <li>• Mandate ULB onboarding to platforms like SBM MIS, DIGIT, PFMS, UPYOG, CityFinance and PAS.</li> <li>• Institutionalize SLB-based service outcome verification for all tied grants.</li> </ul>
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<sup>5</sup> 15th Finance Commission Final Report

	<ul style="list-style-type: none"> <li>• Ensure systems track disaggregated data (gender, slum inclusion) to promote equity.</li> </ul> <p><b>Impact Towards:</b></p> <ul style="list-style-type: none"> <li>• Strengthened ULB capacity through improved governance, financial systems, and institutional resilience</li> <li>• Greater grant accessibility and flexibility for small and medium towns, enabling context-specific investment in core urban services</li> <li>• Accelerated deployment of climate-resilient sanitation systems, including decentralized, modular, and nature-based solutions in peri-urban and high-risk areas</li> <li>• Scaled innovation via simplified, outcome-linked grants supporting proven models such as co-treatment and urban-rural FSM convergence</li> <li>• More inclusive governance, with disaggregated tracking of outcomes for slum populations, women, and other vulnerable groups</li> </ul>
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## ANNEXURE

### Introducing NFSSM Alliance

The NFSSM Alliance is a collaborative, multi stakeholder platform driving transformative change in India’s sanitation sector. It is a national working group comprising 30+ organisations and 120+ experts across India. By harnessing collective knowledge, fostering strategic partnerships, and nurturing innovation, the Alliance works to create an enabling environment for universal, equitable, and inclusive sanitation for all.

Since its inception, the Alliance has worked in close collaboration with national, state, and city governments, as well as key ministries and missions such as the Ministry of Housing and Urban Affairs (MoHUA), Ministry of Social Justice and Empowerment (MoSJE), Department of Drinking Water and Sanitation (DWS) under the Ministry of Jal Shakti, National Mission for Clean Ganga (NMCG), National Urban Livelihoods Mission (NULM), Central Public Health and Environmental Engineering Organisation (CPHEEO), NITI Aayog. The Alliance has also worked with state departments such as Housing and Urban Affairs Department (HuDD), Govt. of Odisha and the State Finance Commission of Haryana among others.

### Citations:

- SDG 6.0 Urban WASH Lab – MAHA-UWES-C (Maharashtra Urban Water, Sanitation and Environmental Support Centre)
- Tamil Nadu State Investment Plan for FSM – Indian Institute for Human Settlements (IIHS)
- TNUSSP – Back to Look Forward – Indian Institute for Human Settlements (IIHS)
- Financing Faecal Sludge and Septage Management: A landscape study of four Indian states – Center for Water and Sanitation (CWAS), CRDF, CEPT University
- Guidebook for ULBs to implement FSM plans – UDD Maharashtra, CEPT University, AILSG
- Septage Management in Jhansi Town: Towards Inclusive Sanitation in Uttar Pradesh – Centre for Science and Environment

- Faecal Sludge and Septage Management (FSSM) in Uttar Pradesh – Centre for Science and Environment
- Septage Management in Chunar Town: Towards Inclusive Urban Sanitation in Uttar Pradesh – Centre for Science and Environment
- Municipal Strengthening for Improved Urban Services – NFSSM Alliance
- Report on Municipal Strengthening for Improved Urban Services – SLBs and performance-based funding
- XIV-FC and XV-FC Reports – See XV-FC Report, p. 48; XIII-FC – see Table 10.4, p. 174
- Municipal Strengthening for Improved Urban Services – MIS, PAS, Smart City dashboards
- CWAS Training Report on Financing and Contracting Options for FSSM – operational bottlenecks
- U20 Knowledge Paper – Climate and Sanitation
- SDG 6.0 – Maharashtra Report
- Swachh Bharat Mission and AMRUT II – MoHUA Budget Estimates and Allocations
- SDG 6.0 and CSE Case Studies (Sangli, Alibag, etc.)
- CWAS Financing Report – Conditional O&M Payments
- CWAS Report on P4R, Blended Finance, and PPP Innovation Models
- eGov Report – State of Urban Digital Governance in Odisha, Department of Housing and Urban Development
- Public Finance Models on DIGIT Platform
- NIUA Report – Good Practices in Climate Action
- Uttarakhand CWIS Initiative – Co-treatment and FSSM Enhancement
- IWA Report – Inclusive Urban Sanitation Stories
- Strengthening Institutional and Financial Mechanisms for Urban Resilience – ScienceDirect
- National Urban Learning Platform (NULP): NIUA, MoHUA, UK Government
- Capacity Building Needs of Urban Local Bodies – NITI Aayog
- MoHUA Report on Capacity Building for Urban Local Bodies (CBULBs)