

Urbanisation as an Engine of Economic Growth in India: Revisiting the City–Productivity Nexus in the Context of Economic Survey 2025–26

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Abstract

India's cities generate a strikingly large share of national output from a small share of national land, yet they are widely described as falling short of what cities elsewhere have achieved. The Economic Survey 2025–26 calls this an "unfinished promise": the population has arrived, the productivity has not fully followed. This paper surveys the evidence behind that judgement. It examines what economists mean when they say cities make people more productive, asks how urban India really is once we look past the Census definition, reviews the empirical record on whether Indian cities deliver the productivity gains that theory predicts, and considers the two constraints most often blamed for the shortfall: inadequate infrastructure and financially powerless municipal governments. The picture that emerges is not one of a failed urbanisation. It is one in which the machinery of urban productivity has been built but never properly switched on.

Keywords: Urbanisation, Agglomeration, Labour Productivity, Municipal Finance, Indian Cities, Economic Survey 2025–26

Introduction

India is described, often in the same week and sometimes by the same people, as a country that has not urbanised enough and as a country whose cities are buckling under population they cannot handle. Both claims lean on one number: the 2011 Census found 31.1 per cent of Indians living in urban areas. Read one way, that is a low figure for an economy of India's size, and a sign of untapped potential. Read another, it is already too much for the water pipes, the buses and the drains. The Economic Survey 2025–26, presented to Parliament on 29 January 2026, does something more interesting than picking a side. It argues that the number itself is the problem, and that the real issue lies elsewhere entirely. The Survey's opening move is to stop thinking of cities as places where people live and start thinking of them as economic machinery. Cities, it says, should be treated as "a form of critical economic infrastructure" (Government of India, 2026, para. 15.1). And judged as machinery, India's cities are underperforming. The Survey's own phrasing is that population scale "has not translated proportionately into urban productivity, liveability, or global economic influence" (para. 15.4).

The explanation it offers is worth quoting, because everything in this survey follows from it:

"International evidence suggests that urbanisation delivers growth dividends when cities are able to internalise agglomeration economies through efficient labour markets, infrastructure networks, and institutional coordination. In India, urban infrastructure investment in domains such as transport, housing, water, sanitation, or governance capacity has lagged behind the economic importance of cities. This has led to high population density manifesting as congestion, informalisation, and infrastructure stress, diluting potential productivity gains." (para. 15.6)

Strip away the vocabulary and the claim is this. Cities make people richer, but only if certain things are in place. When those things are missing, packing people together produces traffic jams instead of prosperity. India has the density. It has been slower to build everything else.

This matters because the two possible readings of India's urban record point in opposite policy directions. If cities simply do not deliver much in India, then pushing people towards them is a mistake and effort belongs in rural non-farm employment. If cities would deliver but are being prevented from doing so, then the thing to fix is not the rate of urbanisation but the capacity of urban institutions. The rest of this paper asks which of these the evidence supports.

2. Why living in close proximity is supposed to work?

The idea that cities raise productivity is old and unusually well established. Economists group the mechanisms under three headings, and they are easier to recognise in daily life than the terminology suggests.

Sharing. Expensive things get cheaper per user when more people use them. A specialist hospital, a container port, a fibre backbone, a court that hears commercial disputes competently — none of these makes sense for a village, and all of them make sense for a city of five million. Firms in dense places also share a supplier base: a small manufacturer in an industrial cluster can buy a component locally today rather than ordering it from three states away.

Matching. Larger labour markets produce better fits between workers and jobs. A person with an unusual combination of skills has a realistic chance of finding the one employer who needs exactly that combination only if there are thousands of employers within commuting distance. The same logic applies to firms looking for workers, landlords looking for tenants, and investors looking for founders.

Learning. Knowledge moves through conversation, imitation and job-switching, and all three happen more in dense places. This is the least measurable of the three mechanisms and quite possibly the most important.

Together these are called agglomeration economies, and the empirical literature has spent decades measuring their size. The usual summary statistic is what happens to productivity when a city doubles in population. A World Bank meta-analysis by Grover, Lall and Timmis (2021), pooling estimates across developing economies, puts the figure for India at roughly 12 per cent. That number deserves a moment's attention, because it is the opposite of what most people expect. Twelve per cent per doubling is at the high end of what is found in wealthy countries. The mechanism, in other words, appears to work perfectly well in India. Whatever is going wrong is not that Indian cities lack the underlying capacity to make people more productive.

Against this sit the costs of density, which are equally real: congestion, higher rents, pollution, pressure on water and waste systems. What any measurement actually captures is the net of the two. A disappointing result can mean either that the benefits are weak or that the costs are unusually high — a distinction that turns out to be central.

3. How urban is India, actually?

Before asking whether Indian cities deliver, it is worth asking how many of them there are, and here the ground is less solid than it looks.

The Census defines a place as urban if it is either a statutory town — notified as such by the state government — or if it satisfies three conditions at once: a population above 5,000, at least 75 per cent of male workers in non-agricultural work, and density of at least 400 persons per square kilometre (Government of India, 2026, para. 15.8).

The first route is administrative and therefore political. A settlement becomes a town when a state government decides to make it one, and states have reasons to delay: reclassification changes which rural programmes a

place qualifies for and which municipal obligations it acquires. The second route is stricter than it appears, particularly the requirement about male workers, which can leave a settlement classified as rural long after it has stopped looking or functioning like a village.

The Survey confronts this directly, and its conclusion is dramatic. Using the Degree of Urbanisation methodology built on satellite-derived settlement data, it reports that India was 63 per cent urban in 2015 — "nearly double the urbanisation rate reported in the 2011 Census" (para. 15.10). Its Kerala case study is starker still: adding spatially identified urban settlements to the statutory count lifts that state's urbanisation from 53.8 per cent to roughly 80.8 per cent in 2020, and to 82.6 per cent by 2025 (Box XV.1).

Two consequences follow, and neither is merely technical.

The first is that we have been measuring the wrong thing, and doing so in a way that is not random. Statutory boundaries are drawn differently in different states, so the gap between official and functional urbanisation varies systematically across the country. Any national conclusion drawn from Census urban shares inherits that distortion.

The second is a data gap that will shape Indian urban research for years. The Census has produced no state-level urban share since 2011. The 2021 round was postponed; the sixteenth Census was approved by the Union Cabinet in December 2025 at a cost of ₹11,718.24 crore, with house-listing scheduled for April to September 2026 and population enumeration in February 2027. For roughly a decade and a half, the country's basic measure of how urban it is has simply not existed, and researchers have made do with projections, surveys and satellite imagery.

4. Do Indian cities deliver?

With that caveat in place, what does the evidence say?

The most direct comparison comes from Chauvin, Glaeser, Ma and Tobio (2017), who examine urban areas in Brazil, China, India and the United States side by side. They find clear evidence that agglomeration and human-capital effects operate in all four countries. But the Indian results contain a puzzle. The gap between urban and rural wages in India is very large. The relationship between a city's size and what its residents earn is only modest.

In a well-functioning spatial economy, those two facts should not coexist. A large urban wage premium ought to pull migrants until it narrows, and bigger cities ought to pay more than smaller ones in proportion to their productivity advantage. That neither happens suggests something is blocking the adjustment — the cost and difficulty of moving, housing markets that cannot absorb newcomers, or social and linguistic barriers to entering urban labour markets. Chauvin and co-authors suggest spatial equilibrium is something that emerges with development rather than something that holds from the start. A second piece of evidence is the concentration of Indian output. The Survey reports that India's ten largest cities hold about 9 per cent of the population but produce close to 28 per cent of GDP, a ratio of roughly three to one, against about 1.5 in the United States and Germany and 1.8 in China (para. 15.18). This is genuinely ambiguous and is often quoted as though it were not. It can be read as proof that agglomeration works powerfully in India. It can equally be read as a sign that productivity is trapped in a handful of places and has not spread through the urban system the way it has elsewhere. Both readings are consistent with the number; distinguishing them requires knowing why the other cities lag. A third strand concerns the shape of Indian urbanisation. It is unusually top-heavy: over 70 per cent of the urban population lived in Class I cities in 2011, and the 52 million-plus cities accounted

for 42.3 per cent of urban residents (para. 15.8). At the same time, much of the recent growth has happened at the edges, beyond municipal boundaries, along transport corridors — Debroy and Misra (2024) document urban expansion tracking road networks with rapid conversion of agricultural land, and the Survey notes that in sixteen large cities the periphery grew faster than the core between 2000 and 2020. These peri-urban belts are functionally urban and administratively rural, which means they are governed by institutions with neither the mandate nor the money to serve them.

Finally, there is a structural oddity. Mohan (2025) argues that Indian urbanisation is slowing, and points to the significant share of manufacturing output originating in rural areas. This inverts the East Asian pattern, where urban factories pulled workers off the land. If Indian industry does not concentrate in cities, one of the strongest historical engines of urban productivity growth is running at low power.

5. The first constraint: infrastructure that never caught up

The Survey's explanation for the shortfall begins with physical capacity, and the figures it assembles are difficult to argue with.

Fewer than 27 per cent of Indian households are connected to underground sewerage systems (Box XV.4). Metro and regional rapid transit systems covered roughly 1,036 route kilometres across about 24 cities as of 2025 (para. 15.30) — substantial in absolute terms, thin for a country with more than fifty million-plus cities. Urban India is served by approximately 47,650 buses, of which around 61 per cent operate in just nine megacities (para. 15.32), against a Ministry norm of 40 to 60 buses per lakh of urban population.

The investment requirement is correspondingly large. Athar, White and Goyal (2022) estimate that India needs to invest about USD 840 billion in urban infrastructure over fifteen years, roughly USD 55 billion a year.

The mechanism connecting these deficits to productivity is straightforward. Agglomeration works through proximity, and proximity is measured in travel time rather than distance. When a city of ten million functions as several disconnected labour markets because crossing it takes two hours, the matching benefit of size largely disappears. The people are close together; the opportunities are not.

This is why the Survey warns that relaxing building-height restrictions without matching trunk infrastructure "will result in unproductive outcomes" (para. 15.25). Density without the systems to serve it produces the costs of agglomeration and few of the benefits.

6. The second constraint: cities without money

The second explanation concerns who governs cities and with what resources, and it is the more damning of the two.

The 74th Constitutional Amendment of 1992 handed urban local bodies a long list of responsibilities — planning, land use, water, public health, sanitation — without handing over the means to fund them. States kept control of municipal tax powers, borrowing approvals and, usually, staffing. The Survey's verdict is that Indian cities "function primarily as implementation units rather than autonomous economic actors" (para. 15.19).

The numbers, drawn largely from the Reserve Bank of India's *Report on Municipal Finances*, are worth setting out plainly.

Indicator	Figure
Municipal corporation revenue, share of GDP (2023–24)	0.6%
Central government revenue, share of GDP	9.2%
State government revenue, share of GDP	14.6%
Property tax, share of GDP — India	0.12–0.15%
Property tax, share of GDP — OECD average	~1.1%
Own-source revenue as share of spending, large Indian cities	30–40%
Own-source revenue as share of spending, smaller cities	below 20%
Own-source revenue as share of GDP, OECD cities	2–4%

The RBI's 2024 edition, covering 232 municipal corporations, reports total municipal revenue of roughly ₹1.7 lakh crore in 2023–24, of which property tax contributed ₹32,450 crore. Municipal borrowing rose from ₹2,886 crore in 2019–20 to ₹13,364 crore in 2023–24, which sounds impressive until one notes that outstanding municipal bonds total about ₹4,204 crore — some 0.09 per cent of India's corporate bond market.

What makes this more frustrating than it first appears is that the shortfall is administrative rather than structural. Indian property is not untaxable; it is largely untaxed because it is unrecorded. The Economic Survey 2016–17 reported that satellite-based assessments in Bengaluru and Jaipur found actual collections amounting to only 16 per cent and 5 per cent respectively of estimated potential.

Cities that have fixed the record-keeping have seen the money appear. Awasthi and Nagarajan (2020) document a sequence of such cases: Pune's shift to a capital value system in 2011–12 raised property tax revenue by 29 per cent; Visakhapatnam mapped 352,000 properties using GIS, added 50,000 previously unrecorded properties and 47,000 vacant plots to its register, and roughly doubled collections from ₹77 crore in 2010–11 to ₹169 crore in 2013–14; Ranchi expanded its assessed base by 55 per cent by outsourcing collection in 2012–13; Raipur achieved a 68 per cent increase in 2017–18 through GIS mapping, door-to-door survey and drone imagery.

These are not marginal gains from clever tax design. They are what happens when a city finds out what it already owns.

7. What the Survey proposes

The Economic Survey's recommendations follow from its diagnosis, and are more specific than such documents usually are. Property tax should become a self-updating levy in all large cities, with mandatory

periodic revaluation using GIS and transaction records. Cities meeting revenue-effort benchmarks should be permitted to issue bonds without state guarantees. Central transfers should shift from scheme-tied grants to performance-linked urban block grants that reward cities for raising their own revenue (para. 15.66). Spatial monitoring tools of the DEGURBA type should be institutionalised alongside the Census rather than replacing it (Box XV.1).

Money has followed. The Urban Challenge Fund announced in the Union Budget 2025–26 carries an outlay of ₹1 lakh crore and co-finances up to 25 per cent of a bankable project's cost, on condition that at least half is raised through bonds, bank loans or public-private partnerships (para. 15.64). The design is deliberate: it treats central money as leverage for local capacity rather than as a substitute for it.

8. What we still do not know

An honest survey should be clear about the limits of its own evidence, and there are three worth naming.

The conditional claim has not been tested. The Survey's central proposition is that urbanisation raises productivity *when* infrastructure and municipal capacity are adequate. Stated that way it is a claim about an interaction, and it has not been examined on Indian state or city data covering the period since 2011. The supporting evidence is a mixture of international comparison and inference.

We do not know whether municipal money causes growth. This is harder than it sounds, and the difficulty is worth understanding. Municipal revenue in India is mostly property tax, and property tax is a charge on the value of local buildings — which is more or less what "a prosperous city" means. Richer cities collect more by definition. Any simple comparison will find that financially stronger cities grow faster and will have demonstrated nothing. Separating cause from consequence requires something like the reform episodes described in Section 6, where revenue rose for administrative reasons unconnected to the local economy.

The arithmetic counsels modesty. Municipal revenue is 0.6 per cent of GDP and property tax within it around 0.15 per cent. A 30 per cent increase in property tax collections is therefore about 0.045 per cent of GDP in additional resources, and only part of that reaches capital spending. Reformed cities may well grow faster, but if they do, the explanation probably lies less in the extra rupees than in what the reform produced alongside them: a spatial register of the building stock, which is a planning instrument as much as a tax instrument, and a credit record that unlocks borrowing.

9. Conclusion

The evidence reviewed here does not describe a country whose cities have failed. It describes something more specific and more fixable.

The productivity mechanism works in India — the estimated returns to city size are, if anything, above what wealthy countries record. The population is in place, and considerably more of it is functionally urban than official statistics admit. What is missing is everything that converts proximity into productivity: transport that makes a large city function as a single labour market, water and sanitation systems that can carry the load, and municipal governments with enough money and authority to build and maintain both.

The Survey's phrase for this is "unfinished promise," and the phrase is apt in a way that is easy to miss. The promise is unfinished rather than broken. The capacity is real and the constraint is institutional, which means it responds to policy. India's urban problem, on this reading, is not that too many people have moved to its cities. It is that the cities were never given the means to make the move worthwhile.

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