Brief Summary of the points raised by Dr.Jayaprakash Narayan

(before the Fourteenth Finance Commission)

- One of the success stories of our democracy is the maturing of our federalism, in which successive Finance Commissions have played an important role.
- A lot more remains to be done to strengthen fiscal federalism and to ensure that the right kind of fiscal incentives are created to achieve the constitutional goals.
- The present devolution formula is based on population (25% weightage); Area (10%); Fiscal capacity (47.5%) and Fiscal discipline (17.5%).This formula is arbitrary and rewards states whose fiscal performance is poor. The concept of fiscal capacity distance (based on tax, GSDP ratio and per capita GSDP) and higher devolution for states whose tax: GSDP ratio is low create perverse incentives to States, States which raise revenues are penalized, and states which fail to raise resources are rewarded.

  This needs to be comprehensively reexamined. We propose a more balanced formula creating better incentives. For instance, area could be given 15% weightage, fiscal discipline 25% weightages; and population

60% weightage. Lack of political will to raise own resources cannot be rewarded by perverse incentives.

- The Thirteenth Finance Commission made earnest efforts to recognize that there is now a third tier of federalism in the form of local governments. We need to go far in the direction of strengthening local governments by devolution of adequate resources.

  We urge the Commission to move in the direction of substantial per capita grants to the lowest tier of local governments a village panchayat for rural areas, and an elected ward committee for urban areas. If Rs 1000 per capita (based on 1971 population) is made available to local governments and if it is distributed in a state proportionate to present population in each local government, a good beginning would have been made in treating local governments as third tier of federalism. The population of India in 1971 was 54.81cr, and consequently Rs 54810cr would be required to devolve directly to local governments as part of Finance Commission devolution this scheme of things. This would only amount to 0.5% of the current GDP, and forms part of the annual Finance Commission devolution under Art 275. This would not be additional allocation as far as GOI is concerned. For states there is no loss of resources, if local governments are correspondingly entrusted with specific responsibilities, and are held to account in discharge of these functions through appropriate mechanisms like Local Ombudsmen. Once these resources are transferred at the community level, people will be energized, and service delivery will improve significantly. Over time, this can be enhanced to Rs 1000 per capita on current population.

In addition, Finance Commission should consider providing incentives and resources to village Panchayats or clusters of Panchayats to promote consolidation (one panchayat or cluster for every 10,000 population), build infrastructure (buildings, computerization, equipment, and personnel), and enhance capacity for service delivery. Such funding can also be linked to citizens' charters and service delivery. This will make a panchayat or cluster a viable unit for service delivery and devolution.

- Regarding subsidies, the Commission should make conscious effort to discourage non-merit subsidies, and to promote competition, innovation and outcomes in the administration of merit subsidies.

  In respect of subsidies and pricing of utilities, we propose the following measures:

In respect of Merit-I subsidies, the subsidies are necessary, and should not only be continued, but enhanced. However, the present subsidy administration has no incentives for outcomes. There is evidence to suggest that higher funding and micro-managements are not ensuring better outcomes. For instance, despite Right to Education Act and various programmes, ASER surveys reveal that school outcomes have stagnated, or even worsened. PISA survey, involving 74 nations, and measuring educational outcomes at age 15 (among school-going children) places India 73rd (second from bottom), and China is ranked first (above all OECD countries).

- Public funding is necessary in merit subsidies, but there should be healthy competition among various providers and subsidies should be transferred on per child basis subject to measurement of outcomes and meeting verifiable targets in terms of outcomes. Charter schools, private schools, non-profit schools, aided schools, government schools – all should be on the same footing, and all should be involved in educational delivery, and there should be a shift from salary grant to per capita grant (per child) subject to achieving outcomes.
- In respect of healthcare, there should be competition and choice among multiple service providers – government, non-profit and private – on

standard services and costs basis. Public funding should be available to all providers willing to join the scheme, and revenue will be based on ability to attract patients and billing. Salaries in public institutions should be progressively replaced by sharing of net surplus based on billing and cost control.

Similar models need to be designed in respect of all merit subsidies.

- As far as practicable, all subsidies should be administered by local governments and any savings on account of streamlining should be transferred as incentive – unattached fund – to local governments.
- In sectors like food subsidies, where the market works efficiently and there are no supply constraints, purchasing power of the poor should be the focus in subsidy administration. Cash transfers as food stamps will be ideal in such cases, instead of elaborate, expensive, leakage-prone, poorly targeted, corruption-ridden public distribution system.
- In respect of utilities, particularly power sector, strong and effective mechanisms should be promoted at all costs. Annual losses in power sector are of the order of Rs. 100,000 cr, and inability to generate, distribute and supply power is undermining economic growth and job creation. Therefore in power sector, even where subsidies are warranted, there should be mandatory metering with incentives for

savings on subsidy, and strong steps to promote water harvesting and prudent utilization of water by appropriate cropping in water starved regions.

- There should be strong fiscal disincentives by way of penalizing states which resort to non-merit subsides, particularly populist policies unrelated to constitutional duties – like colour TVs, mixies, grinders, gold chains, etc. If all possible measures are not taken by way of robust incentives to promote prudent and productive utilization of resources, and disincentives to discourage fiscal profligacy and wasteful expenditure in unproductive areas, poverty and backwardness will be perpetuated.
- The Finance Commission needs to enter these uncharted waters by broadly interpreting its mandate, and promoting fiscal responsibility, fair devolution and right kind of incentives to encourage prudent and productive utilization of resources. As a general rule, devolution should be effected to the smallest tier possible, nearest to citizens, in a manner that taxes and services are linked in the people's minds, and authority fuses with accountability.

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