CENTRAL TRANSFERS TO STATES IN INDIA

REWARDING PERFORMANCE WHILE ENSURING EQUITY

(Final Report of a Study Submitted to NITI Aayog)

M. Govinda Rao

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Disclaimer

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Designing and implementing an equitable and yet, incentive compatible transfer system has been a challenge in most federations. The challenge is even more serious in India with the States having large and diverging differences in the standards in physical and social infrastructures. Growth and stability of Indian federation critically depends on the convergence of incomes across the States and this can be achieved only when there is a balanced spread of physical infrastructure and human development across the country. To achieve this, it is important to design and implement the transfer system that offsets the revenue and cost disabilities of the states and ensures a required minimum standards of meritorious public services with significant externalities so that people irrespective of their location are able to access these services. This study attempts to review the prevailing system of transfers and attempts to identify reform areas.

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M. Govinda Rao

Central Transfers to States in India: Rewarding Performance While Ensuring Equity

M. Govinda Rao

I. Introduction:

Mismatch between revenue capacity and expenditure need of subnational governments is an inherent feature of all federations. The assignment of revenues and expenditures according to the principle of comparative advantage results in the Central governments having access to most broad based taxes and subnational governments having responsibilities to provide most of economic and social services but inadequate revenue handles to provide them Furthermore, there are wide differences among the States in the capacity to raise revenues as the size of the tax base varies widely. The variations in the tax base among the States results variations in the standards of public services delivered even when the States make uniform effort at raising revenues. Variations in public services can also arise when there are significant differences in the unit cost of providing them. These variations violate the principle of "horizontal equity" or "equal treatment of equals" (Buchanan, 1950, Boadway and Flatters, 1982). These vertical and horizontal fiscal imbalances will have to be resolved through a system of intergovernmental transfers from the Centre to the States.

While intergovernmental transfers are inevitable in all federations, it is important to understand that they soften the budget constraint by loosening the link between revenue raising and expenditure decisions. Efficiency considerations require that public services should be paid for by the people who benefit from them and there should be a strong linkage between revenue raising and expenditure decisions. Intergovernmental transfers tend to soften the budget constraints of the States and adversely impact on efficiency. While the Central transfers to States are inevitable in federations, it is important to design the transfer system carefully to ensure that they do not have adverse effects on incentives in and lead to laxity in tax effort and expenditure economy. Ensuring incentive compatibility is at the heart of designing an efficient transfer system.

In India, the Constitution recognises the problem of fiscal imbalances. It provides for the appointment of the Finance Commission by the President of India every five years to resolve them by making recommendations on tax devolution and grants in aid of revenues. The Commission's recommendations are placed in the Parliament along with the Action Taken Report by the Ministry of Finance. By and large, the recommendations of the Commission are in the nature of general purpose unconditional transfers though some of the Commissions have made some specific purpose non-matching transfers for activities such as education, healthcare, police and judiciary. Specific purpose grants are mostly given through centrally sponsored schemes administered by various central ministries.

In the literature, the objectives of general and specific purpose transfers are clearly stated. The rationale for general purpose transfers is to *enable* all the states to provide comparable levels of public services at comparable tax rates (Rao and Singh, 2005). The emphasis is on enabling the States and therefore, the transfers are supposed to be unconditional. The objective of specific purpose transfers, on the other hand is to *ensure* minimum standards of public services. The focus in these is ensuring minimum standards. This implies that the transfers are required to be conditional and they should equalise the expenditure levels of the states to achieve the minimum standards in respect of specified services.

The objective of this study is to analyse the design and implementation aspects of both general and specific purpose transfers in India. The recommendation of the Fourteenth Finance Commission (FFC) and even more importantly, the abolition of the Planning Commission have brought about a measure of conceptual clarity in the landscape of intergovernmental transfers. The FFC, unlike the past Commissions, has covered the entire revenue account requirements of the States, both plan and non-plan, in its recommendations. Thus, the entire general purpose transfers are given on the recommendation of the FFC and all specific purpose transfer are given by the concerned Central Ministries.

This study attempts to undertake an empirical analysis of the transfers system in India. The report covers discussion on the theoretical rationale for the transfer system and analysis of the structure of policies and institutions in India dealing with the transfer system. The report also makes a broad analysis of general and specific purpose transfers in the Indian context to identify the shortcomings. It also undertakes empirical analysis of the three major centrally sponsored schemes namely, the National Health Mission (NHM), Sarva Shiksha Abhiyan (SSA) and Mahatma Gandhi national Rural Employment Guarantee Act (MGNREGA).

The report is organized into five sections. Section 2 summarises the theoretical rationale for general and specific purpose transfers. Section 3 describes the transfer system in India. Section 4 analyses the equity and efficiency issues relating to general purpose transfers. Section 5 examines important issues relating to specific purpose transfers namely, centrally sponsored schemes. The concluding remarks are presented in Section 6. Detailed discussion on the three schemes is presented in the Appendix.

II. The Rationale for Intergovernmental Transfers:

Indian economic growth has shown a steady acceleration from just about 3.5 per cent per year during the period, 1950-80 to 5.8 per cent during 1980-2000 and further to 7.4 per cent since 2001-02. Although it decelerated after the global financial crisis in 2008, India is one of the countries which turned around fast and is presently one of the fast growing emerging economies. Most observers consider even this to be well below the potential and further reforms to liberalise the economy would help to reach the potential. Nevertheless, the performance seen in recent times shrugs the image of the country as a laggard.

Despite the impressive growth performance, its regional spread has been uneven, and even as some of the low income States have been trying to catch up with their more advanced counterparts, inter-state disparities have shown an increase, particularly after the market based reforms were initiated in 1991. The States with better physical and social infrastructure and market friendly governance were able to grow faster (Panagariya, Chakraborty and Rao, 2015). This has led to significant divergence of incomes among the States with coefficient of variation in per capita incomes increasing from 0.33 in 1991-92 to 0.47 in 2000-01 and marginally reducing to 0.40 in 2014-15. Ironically, most of the low income States are natural resource rich which implies that physical and social infrastructure has been a binding constraint in their development (Rao and Mandal, 2009).

It is important to accelerate growth and development in the low income States for reasons of both inclusiveness and stability in Indian federation for a variety of reasons. Overwhelming proportion of the poor are concentrated in low income States and therefore, accelerating growth in these States is an important pre-requisite for creating income earning opportunities to them. The working age population (15-64 years) in India is presently 63.4 per cent and given the staggering demographic profile in low income States, the high proportion of working age population will continue for a longer period as the fertility rate in these states remains high.

While in developed federations, high mobility of population can take surplus labour to capital rich jurisdictions to overcome adverse effects of uneven development, in countries like India the restrictions on mobility caused by linguistic, cultural and other institutional factors makes it important to ensure an even spread of physical and social infrastructures.

Furthermore, acute inter-State inequalities in the levels of living can be a source of instability and unrest.

Regional differences in social and infrastructures can be mitigated either through regional policies or through intergovernmental transfers. In a small country, the Central government can identify the diverse needs for public services and accordingly allocate resources to achieve the required balance. In a large, diverse federation, this has to be mainly achieved through intergovernmental transfers as the lower level jurisdictions are better placed to provide public services according to the diversified preferences of the people. In almost all the federations, therefore, the policy of intergovernmental transfers plays and important role in ensuring equitable access to public services (Ahmad, 1997) even as they tend to soften the budget constraints at subnational levels.

The rationale for intergovernmental transfers is to offset the fiscal disabilities of subnational jurisdictions. For reasons of redistribution and stabilisation which is predominantly (not exclusively) a Central function, all broad-based and redistributive taxes, money supply function and borrowing powers are exclusively or predominantly assigned to the Centre. At the same time, most expenditure functions are assigned to the States due to their comparative advantage in providing public services according to the diversified preferences of the people in different jurisdictions. In this scheme, vertical imbalance is unavoidable and intergovernmental transfer system has to resolve the imbalance. At the same time, it is important to match the revenue and expenditure decisions at the margin for subnational governments for reasons of efficiency and accountability. The efficient system of tax assignment envisages that tax powers should be assigned to subnational levels up to the point where the marginal efficiency loss due to tax disharmony is matched with marginal efficiency gain from fiscal autonomy. Even with such an assignment system, vertical imbalance is a feature seen in all federations.

In addition to the vertical fiscal imbalances, horizontal imbalances arise from differences in the ability to raise revenues and unit cost of providing public services. Horizontal equity is violated when there are differences in revenue and cost disabilities across States (Buchanan, 1950). The problem is exacerbated when there are origin based taxes and similar other factors alter the net fiscal benefits in different subnational jurisdictions (Boadway and Flatters, 1982). If there is perfect mobility of people across jurisdictions, fiscal differentials tend to be equalized as people migrate from places where the net fiscal benefits are lower to those where they are higher. Even when there is no perfect mobility, if the property market is reasonably well developed fiscal differentials will be capitalized into property values (Oates, 1969). In developing countries like India, there is neither perfect mobility nor a developed property market and the only way left is to offset these fiscal disabilities arising from low revenue capacity and high unit cost of providing public services through intergovernmental transfers. Such transfers have to be unconditional – to *enable* every State to provide a standard level of public service at a normative tax rate.

There is also a case for transfers to *ensure* that people, irrespective of the jurisdiction they live in receive prescribed minimum standards of meritorious public services or those with high degree of spillovers such as elementary education, basic healthcare, water supply and sanitation and anti-poverty interventions. Such transfers have to be purpose specific, but linked to providing the specified minimum standards. The States may be asked to make matching contributions to avoid substituting these transfers to own expenditures. Given the varied levels of service provision prevailing in different states, it is possible to design the transfer system with varying matching requirements (Feldstein,1975).

III. Indian Fiscal federalism:

(i) The Federal Fiscal System and Institutions:

India is a large and diverse developing country. The Constitution describes India as a "Union of States" and a "Sovereign, Secular, Socialist, Democratic Republic". It is the largest democratic federal republic, inhabited by 1.3 billion people spread over 29 States and 7 Union Territories covering an area of 3.29 million square kilometres. The country has a three-tier federal structure with governments at Union, States and Local levels. There are twenty-nine States and seven centrally administered territories – two with their own legislatures (Delhi and Pondicherry). Below the State governments, in urban areas there are 96 municipal corporations, 1,494 municipalities, and 2,092 smaller municipalities (called *Nagar Panchayats*). There are 247,033 rural local bodies or *panchayats,* of which 515 are at the district level, 5,930 at the block level, and 240,588 at the village level. However, the devolution of powers to the third level is uneven among States and their participation in public service delivery is negligible.

There are wide variations in the size and economic structure among the States. In 2011, Uttar Pradesh, at 200 million people was the largest State, and Sikkim, with 0.6 million, was the smallest. The per capita Gross State Domestic Product (GSDP) among the general category States in 2014-15 was the highest in Haryana at Rs.165728 (excluding the small State of Goa which had the per capita GSDP of Rs.304666) and the lowest in Bihar, at Rs.33954.

The Seventh Schedule to the Constitution specifies legislative, executive, and judicial functions in terms of Union,[1] State, and concurrent lists. Most of the broad based taxes are assigned to the Union government and States are given the predominant responsibility of providing social services such as education, healthcare, water supply and sanitation and urban development and co-equal responsibility of providing economic services. Thus assignment system results in a significant vertical fiscal imbalance. The Founding fathers of the Constitution were aware of the problem and provided for the sharing of central taxes with the States and giving grants to them from the consolidated fund of the Centre. To determine the transfer system, they provided for the appointment of an independent Finance Commission by the President every five years. The task of the Commission includes recommending the devolution of Central taxes to the States, laying down the principles of distribution and shares of individual States. The Commission is also required to give grants and address any other matters entrusted to it in the interest of sound finance in the Presidential Terms of Reference[2].

In this report, the focus is on the transfer system in large States which are called the non-special category states. These States cover over 90 per cent of the country. The reasons for confining the analysis to the non-special category states is that predominant proportions of economic activity in these states are determined by government expenditures and overwhelming proportion of these are financed by Central transfers as their revenue base is small. The revenue bases of special category States are small and they have to depend upon Central transfers even to service their loans. For this reason, these States are called upon to make a matching contribution of just 20 per cent for the Centrally Sponsored Schemes.

Table 1 presents the shares of the Central and State governments in raising revenues and implementing expenditures. It is seen that total revenue collected in the country is about 20.5 per cent of GDP and of this, 37.5 per cent is raised by the States. The States, however incur over 60 per cent of the total public expenditures amounting to 27 per cent GDP. Thus, the States' total expenditure 18.3 per cent of GDP of which they raise about 8 per cent of GDP from own sources and receive transfers amounting to about 7 per cent of GDP. The remaining expenditure is financed from borrowing.

[1] The terms "Union" and "Centre" are used interchangeably in this paper.

[2] The Commission is also required to recommend measures to assist the augment the consolidated funds of the States to supplement the resources of the third level government.

Table 1: States' Share in Revenues and Expenditure

Years	Total Revenue (Union+ States)	Total Expenditure (Union+ States)	States' Share in Revenues (Per Cent)			States' Share in Expenditures (Per Cent)		
	Per cent of GDP	Per cent of GDP	Tax Revenue	Non-Tax Revenue	Total Revenue	Current Expenditure	Capital Expenditure	Total Expenditure
1990-91	17.4	26.7	34.4	44.9	35.9	55.2	44.5	53.6
2000-01	16.7	25.8	38.2	40.8	39.1	56.0	57.0	56.5
2005-06	18.9	24.9	37.7	34.7	36.8	55.2	59.4	56.7
2007-08	20.2	24.4	31.9	38.5	32.9	53.5	53.1	54.7
2008-09	18.7	25.7	33.9	40.5	34.7	49.3	64.2	53.8
2009-10	18.2	27.2	37.6	39.6	37.5	51.2	61.5	54.3
2010-11	19.9	26.4	37.6	23.8	35.0	51.3	53.7	53.1
2011-12	18.4	26.8	38.9	38.3	34.0	53.7	60.9	55.8
2012-13	19.1	26.1	39.2	40.8	39.0	54.9	59.6	54.9
2013-14	20.4	27.6	40.3	35.7	37.3	56.0	62.4	56.9
2014-15	20.5	27.3	39.0	37.3	37.3	62.2	56.9	60.7

Source: Indian Public Finance Statistics, Ministry of Finance, Government of India.

Graph 1: Per Capita Revenues and Expenditures of the States According to Per Capita GSDP

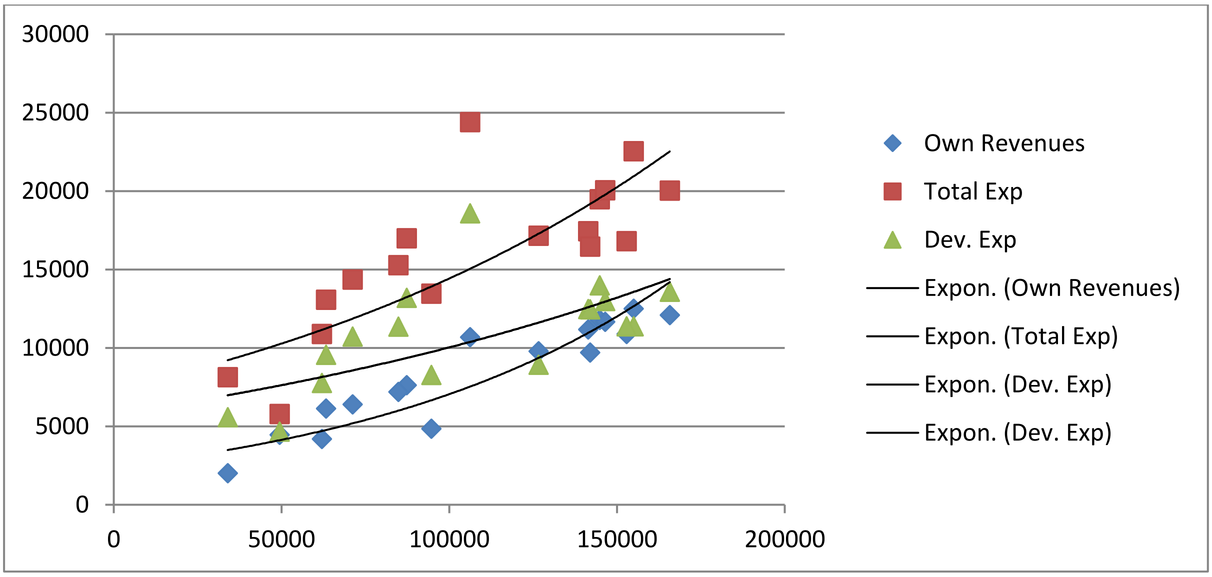


Table 2: Differences in Per Capita Income and Fiscal Variables Among States (2014-15)

States	Per Capita GSDP	Per Capita Revenue	Tax-GSDP Ratio	Central Transfers General Purpose	Transfer Specific Purpose	Total Transfers	Total Expenditure	Dev. Expenditure
	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees
Andhra Pradesh	106263	10687	8.00	5376	2017	7393	24410	18588
Bihar	33954	2026	5.55	3872	1223	5095	8136	5579
Chhattisgarh	87354	7629	6.65	4830	1584	6414	17005	13202
Gujarat	141405	11187	6.85	2067	1263	3329	17446	12486
Goa								
Haryana	165728	12095	6.25	1836	1371	3207	20030	13579
Jharkhand	62091	4199	4.77	3343	1484	4827	10903	7772
Karnataka	144869	11788	7.63	2488	2121	4609	19482	13987
Kerala	155005	12512	6.69	2942	1600	4542	22549	11376
Madhya Pradesh	63323	6135	7.55	3732	1718	5450	13073	9564
Maharashtra	152853	10887	6.42	1795	1426	3221	16822	11383
Odisha	71184	6411	6.40	4392	2295	6686	14356	10740
Punjab	126606	9787	6.95	2371	1266	3637	17153	8932
Rajasthan	84837	7193	6.32	5251	213	5463	15291	11355
Tamil Nadu	146503	11668	7.20	2839	1910	4749	20062	12995
Telangana	141979	9719	5.61	2752	1411	4163	16461	12469
Uttar Pradesh	49450	4460	7.11	3557	1150	4707	5802	4667
West Bengal	94711	4853	4.92	3385	1993	5378	13465	8290
All Gen. Cat States	95802	7895	6.63	3498	1531	5030	14082	9807
Spe.Cat. States								
Arunachal Pradesh	110217	6185.6	2.82	30159.6	25094.3	55253.8	34257	58102
Assam	60621	3630.2	4.77	5325.3	2728.7	8054.0	7700	13156
Himachal Pradesh	147330	11323.6	1.59	11189.5	2675.3	13864.8	17186	31423
Jammu & Kashmir	77559	6278.4	2.68	12231.7	3348.4	15580.2	13060	26032
Manipur	58442	2269.2	1.13	18021.7	5616.2	23637.8	13087	27855
Meghalaya	75156	4005.2	0.10	11587.6	4482.9	16070.5	13211	23018
Mizoram	93136	4297.2	0.06	30945.2	11331.7	42276.9	32982	55607
Nagaland	89607	3207.8	0.37	15122.5	18900.5	34023.0	32907	37886
Sikkim	240274	19361.1	0.51	40251.8	10876.0	51127.9	33186	74434
Tripura	77358	3572.1	0.54	13905.4	6615.7	20521.1	11961	26793
Uttarakhand	153076	8929.2	0.91	7408.8	2795.0	10203.8	12361	24667
All Spl.Cat States	84572	5604.4	0.97	9836.3	4243.8	14080.1	12449	22738
All States	95802	7419	6.58	3757.99	1641.16	5399.15	9977	14637

Source: Finance Accounts of the State Governments, Comptroller and Auditor General, Government of India

There is considerable variation among the States on their fiscal dependence on the Union government. There are seventeen relatively homogenous general-category States, but even these have wide differences in size, revenue-raising capacities and efforts, per capita developmental and total expenditure levels, and fiscal dependence on the Union government (Table 2). Per capita own revenues of the States closely follow variations in per capita GSDP with the correlation coefficient of 0.940 broadly reflecting their revenue capacities (Graph 1). Per capita expenditures of the States – both developmental expenditures (expenditures on social and economic services) and total expenditures also have a positive and significant correlation with per capita GSDP (0. 786 and 0.614). This shows that even after the Central transfers, low income states with low revenue capacity spend significant lower per capita expenditures on social and economic services.

Some important features of the State finances may be summarised here. First, inter-State disparities in per capita incomes (GSDP) are not only high but also have been increasing over the years. In 2014-15, among the General Category States, at Rs. 165728, Haryana the State with the highest per capita income (leaving out a small state of Goa) had five times the per capita income in Bihar, the lowest per capita income State. As mentioned earlier, the coefficient of per capita incomes in the States has steadily increase from 0.30 on 1981-82 to 0.35 in 1991-92 and further to 0.40 in 2014-15 (Panagariya, Chakraborty and Rao, 2015). Second, not surprisingly, per capita revenues vary with per capita incomes predominantly due to variations in revenue capacity. The tax-GSDP ratios do not show a clear trend and therefore, the variations in tax-GSDP ratios are due to both variations in taxable capacity and effort. Third, although per capita transfers are higher in the States with lower per capita incomes, it fails to offset the revenue disabilities of the poorer states fully and more affluent States end up spending significantly higher per capita expenditures than those with their poorer counterparts (Graph 1). It is not surprising that the low income states with poorer infrastructure deficits are unable to catch up with their more affluent counterparts.

IV. The Transfer System in India: General Purpose Transfers:

As mentioned above, the Constitution envisages the appointment of an independent Finance Commission by the President of India every five years to make recommendations on the devolution of Union taxes and grants to be given to the States. Article 280 of the Constitution mandates the President to appoint a Finance Commission every five years. The Commission has a Chairman and four other members whose qualification for appointment is laid down in the Finance Commissions (Miscellaneous Provisions) Act, 1951. The terms of reference (TOR) of the Commission are (i) the distribution of the net proceeds of Union taxes between the Union and States and among the States *inter-se*; (ii) grant in aid of revenues to be given to the States; (iii) measures to augment the consolidated funds of the States to supplement the resources of rural and urban local governments in the States based on the recommendations of the State Finance Commissions and (iv) Any other matter referred to the Commission by the President in the interest of sound finance. Under the last item, a number of tasks have been assigned to the Commission in the past such as setting the fiscal rules and targets for the Union and States, measures to be taken for sustainable development and the protection of ecology and environment, rescheduling and writing off of States' loans, examination of public expenditure management systems, review disaster management systems, strategic approach to public enterprise reform and incentivizing the States to undertake tax reforms. So far 14 Finance Commissions have submitted their reports. Their recommendations have been well regarded and mostly accepted and implemented by the Governments.

The role of the Finance Commission as envisaged in the Constitution was curtailed when the Planning Commission was appointed though a Cabinet Resolution in 1950. The Planning Commission took over the powers to make grants for plan purposes. The scope of the Finance Commissions' review was confined to assessing the non-plan requirements of the States and making tax devolution and grants to meet these requirements. However, the Fourteenth Finance Commission's TOR did not restrict its scope to assessing merely the non-plan side of the States' budgets and the Commission made recommendations to cover the entire revenue account. Thus, when the Planning Commission itself was abolished in August 2014, it did not create any discontinuity. However, even as the Finance Commission is empowered by the Constitution to give all transfers –general or specific, or revenue and capital given its temporary nature, the Fourteenth Finance Commission decided that it will stay away from giving specific purpose transfers which required continuous monitoring.

After the Fourteenth Finance Commission made the recommendations, the entire architecture of the transfer system has changed. A clear distinction has emerged in respect of general purpose and specific purpose transfers in Indian fiscal federalism after the report of the 14^{th} Finance Commission was implemented. All general purpose transfers are now recommended by the Finance Commission and all specific purpose transfers are given by the respective Central ministries. Although the 14^{th} Finance Commission made a recommendation that the design and implementation of specific purpose transfers should be decided by a Committee comprising of the representatives of Central and State governments as well as domain experts (India, 2014, Chapter 12), the Central government has continued the practice of taking decisions on these transfers at the relevant Central ministry level.

The 14th Finance Commission was also concerned with the intrusion of the Central government in States' domain through the proliferation of specific purpose transfers through Central sector and Centrally Sponsored Schemes. Its analysis showed that between 2005 and 2012, the Central government's spending on State subjects increased from 14 to 20 per cent and its spending on Concurrent Subjects increased from 13 to 17 per cent. Taking into account the need to cover plan revenue expenditure requirements and to provide the fiscal space to the states to cover the expenditures under the State List to reduce the Central governments intrusion into State subjects, the Commission increased the share of the States in the divisible pool of taxes[3] from 32 per cent recommended during the 13th Finance Commission to 42 per cent. Thus, according to the Commission's reasoning, the increase was partly on account of the inclusion of plan expenditure requirements of the States which was given by the Planning Commission based on the Gadgil formula and partly to provide greater flexibility to the States by giving them untied transfers. The Commission adopted a formula for distribution comprising of a mix of variables representing revenue and cost disabilities. It gave 50 per cent weightage to deviation from the highest per capita income, 27.5 per cent weightage to population, 15 per cent weightage to the area and 7.5 per cent weightage to the forest area.

Table 3 : Trends in General and Specific Purpose Current Transfers

Years	Gen Purpose Transfers	Specific Purpose Transfers	Total Current Transfers	Share of General Purpose in Total Current Transfers
2011-12	3.63	1.97	5.60	64.78
2012-13	3.61	1.63	5.24	68.89
2013-14	3.48	1.76	5.24	66.39
2014-15	3.41	2.74	6.15	55.49
2015-16	4.32	1.74	6.06	71.23
2016-17 RE	4.69	1.84	6.53	71.81
2017-18BE	4.61	1.80	6.41	71.93

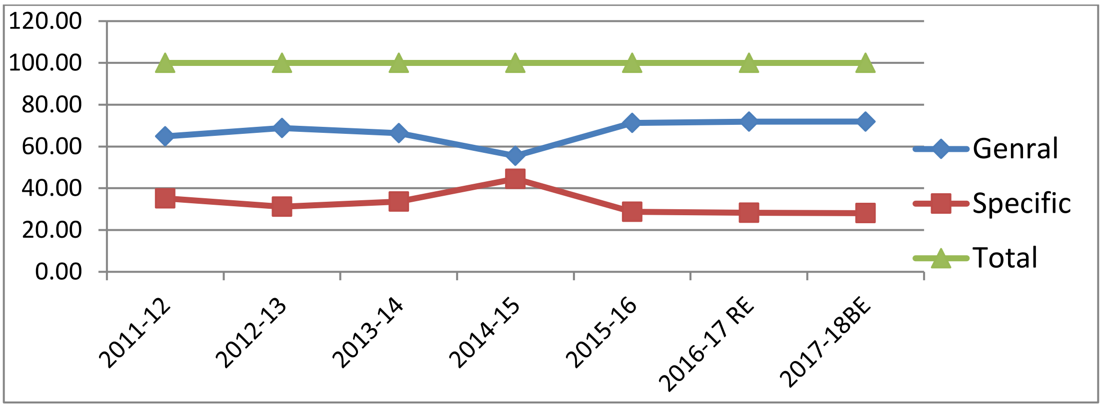
Source: Budget Documents of the Union Government.

The 14th Finance Commission's recommendations have substantially altered the landscape of federal fiscal transfers. While there was a no significant change in the total transfers to the State in 2015-16 over 2014-15 in the first year of the award, the share of general purpose transfers rose significantly from 55.5 per cent to 71 per cent. In other words, the sharp increase in tax devolution by the 14th Finance Commission resulted in the share of general

[3] Divisible pool of taxes comprises of total central taxes (excluding the revenue from earmarked taxes) minus the revenue from cesses and surcharges and cost of collecting the taxes.

purpose transfers going up significantly, but this was countered by the Central government reducing the specific purpose transfers (Chakraborty and Gupta, 2016). Thus, about one percentage point increase in general purpose transfer was countered by equivalent reduction in allocation to Central Schemes.

Graph 2: Share of General Purpose and Specific Purpose Transfers



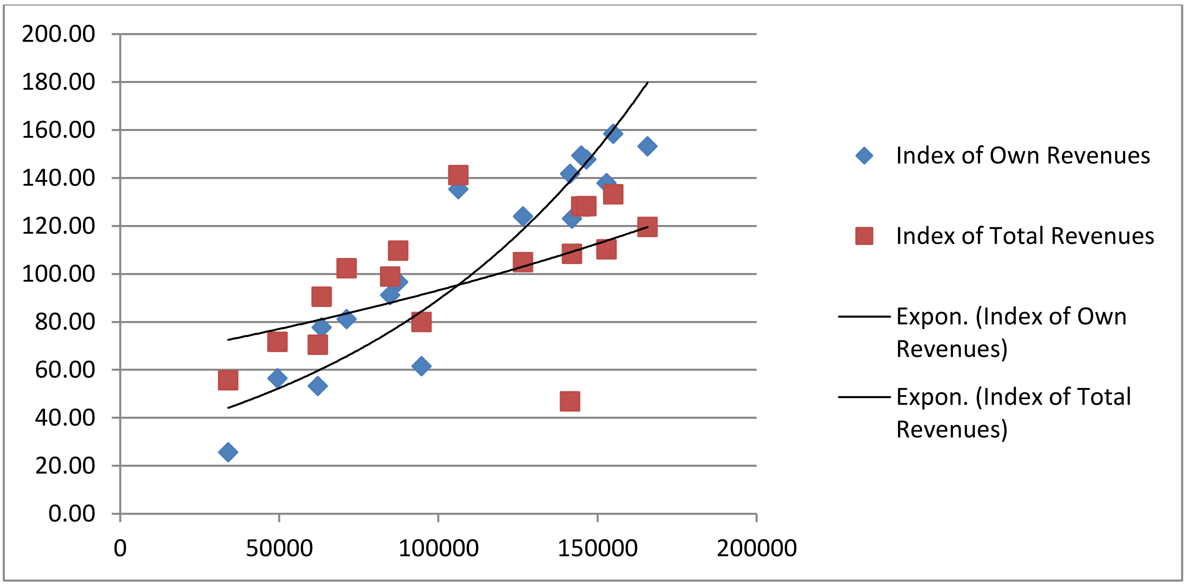
V. Specific Purpose Transfers:

In addition to the tax devolution and grants given to the States based on the recommendations of the Finance Commissions, the Central government gives specific purpose grants for various purposes through the respective ministries. The objective of specific purpose transfers, as mentioned earlier, is to *ensure* minimum standards of services in respect of those services that are considered meritorious or those services with significant inter-state spillovers. However, in Indian context, this has been used as a patronizing instrument to serve political objectives of the ruling parties at the Centre to woo the States and the electorate by expanding its reach to spend on the State subjects.

In 2012, there were 147 such schemes initiated by various Central ministries and many of them were directly implemented by numerous implementing agencies specifically created for the purpose and the grants were given to them directly bypassing the States. In 2013, these schemes were consolidated into 66 and in 2014, based on the recommendation of the Expert Committee on Efficient Management of Public Expenditure the Central Government channeled all the grants through the State governments (India, 2911). After the 14th Finance Commission made the recommendation to increase the tax devolution to 42 per cent of the divisible pool, the Central government appointed a Committee of selected Chief Ministers of the States with the Chief Minister of Madhya Pradesh as the Convener to further consolidate and rationalise the schemes. The Committee consolidated the schemes into 28 and classified them into "Core of the core", "Core" and "Optional" with matching requirements from the States stipulated at 30 per cent, 40 per cent and 50 per cent respectively.

There are six "core of the core" schemes including the MGNREGA and 22 "core" schemes. In addition to these, there are 45 Central Sector schemes implemented in States to for specified purposes. The total amount of funds spent on all Central Sector and Centrally Sponsored Schemes in 2016-17 amounted to 1.8 per cent of GDP constituting about 28 per cent of total transfers. Of these, only 5 schemes– National Rural Employment Guarantee, National Health Mission, Elementary Education, Rural Roads and Housing schemes constituted 66 per cent of specific purpose transfers.

Graph 3: Progressivity of the Transfer System



Note: The vertical axis represents index of own revenues and total revenues with the States' average set at 100. The differences in the slopes represent the extent of equalization in the transfer system

The analysis of the various components of transfers shows that the general purpose transfers are most equalizing with the elasticity coefficient of (-) 0. 452 (significant at 1% level) and the specific purpose transfers are the least equalizing with the elasticity coefficient of 0.162 which is not significant. The overall transfer system is equalizing with the elasticity coefficient of (-) 0.267. This is shown in Graph 3. The index of own revenues of the States (with all-state average specified at 100) increases steeply with per capita incomes. The index of total revenues (including transfers) too shows a positive slope with per capita incomes, but is flatter than the former reflecting the extent of equalization. Thus, it is seen that the (i) Finance Commission transfers are equalizing but offset the fiscal disabilities of the States only partially; (ii) the Central schemes are not equalizing at all and (iii) Even after the fiscal transfers are considered, per capita revenues accruing to the States are positively correlated with per capita incomes of the States. The resources in low income States enable them to incur much lower levels of spending than their richer counterparts.

The lower levels of per capita expenditures in States with lower per capita incomes is clearly brought out in Table 4, where per capita expenditures under various categories are regressed on per capita incomes in the States for the year 2014-15 in a double-log function. It is seen that total as well as almost all expenditure categories except capital expenditures show a positive and significant relationship. In the case of total state expenditures, per capita expenditures are higher by 0.65 per cent when per capita incomes are higher by one per cent. The relevant elasticity is 0.69 in the case of current expenditures. 0.65, in the case of expenditures on social services and 0.43 in the case of economic services. Within social services, the elasticity is 0.64 in the case of education and 0.72 in the case of healthcare.

The analysis shows that despite equalising transfers, public expenditures are higher in more developed States. This trend leads to increasing inequalities in infrastructure levels and human development causing divergence of incomes across Indian States. The matter is particularly concerning in the case of education and healthcare where the elasticities are high and given the staggered demographic profile in poorer States, the requirement for public spending in these states is much higher, but these states continue to spend lower per capita expenditures due to their lower taxable capacity and inability of the transfer system to offset their fiscal disabilities. While these Graphs confirm the fact that the transfer system could offset the fiscal disabilities of poorer States only partially and inequalities in per capita expenditure on social and economic services continue to persist.

Table 4:
Elasticities of Per Capita Expenditures with Respect to Per capita Incomes in the States

Expenditure Category	Constant (a)	Regression Coefficient (b)	Adj. R^2
1. Revenue Expenditures	1.5486 (1.2189)	0.6906 (6.2535)*	0.70
2. Capital Expenditures	2.6142 (0.8169)	0.4248 (1.5202)	0.077
3. Expenditures on Economic and Social Services	2.9471 (2.0104)	0.5488 (4.3063)*	0.52
4. Expenditure on Social Services	1.1281 (0.8551)	0.6511 (5.6781)*	0.66
5. Expenditure on Economic Services	3.5793 (1.8422)	0.4274 (2.5307)*	0.25
6. Expenditures on Education	0.4324 (0.2499	0.6420 4.2681)*	0.52
7. Expenditures on Public Health	-1.6654 -(1.0743)	0.7185 (5.3322)*	0.63
8. Total Expenditures	2.0866 (1.6440)	0.6562 (5.9465)*	0.68

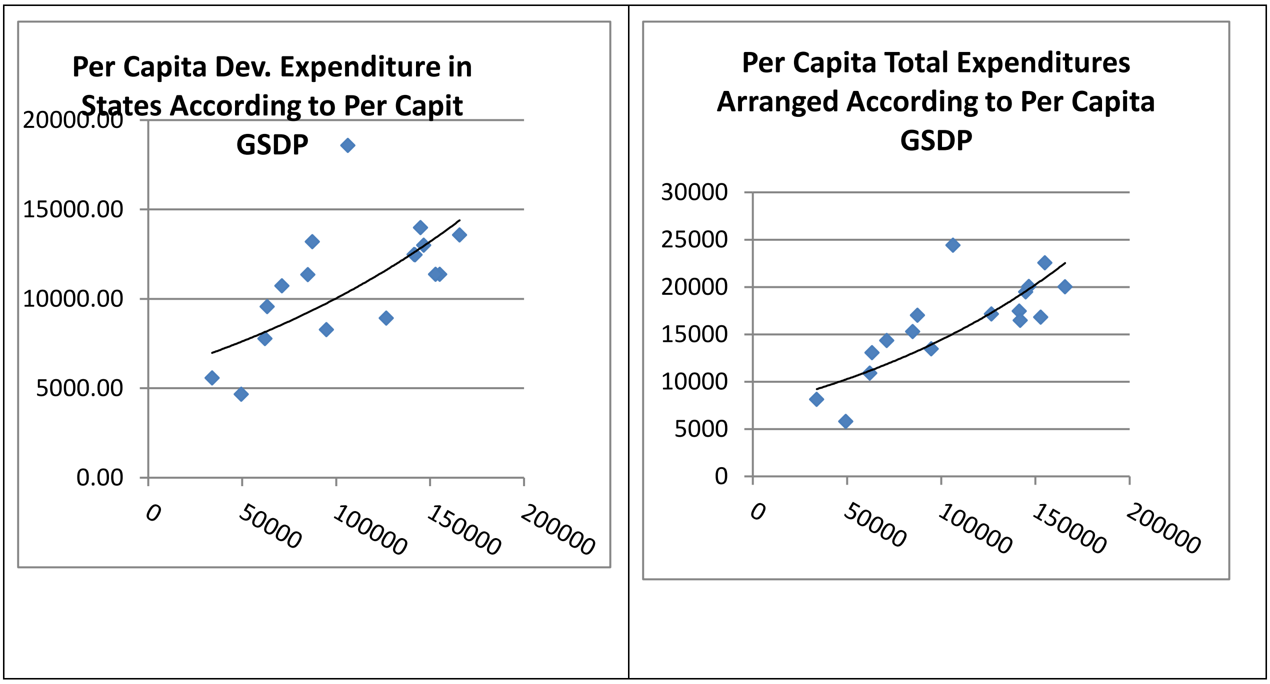
Estimated Equation is: Per Capita Expenditure = Log a + b log Per Capita income + ∈
Note: * denotes significant at 1 per cent level.

Considering the wide variations in per capita GSDP among the States with the richest State having more than five times the per capita GSDP of the poorest, completely offsetting the fiscal disabilities to enable the low income States to equalize their per capita expenditures may simply not be politically feasible in India. First, presently the Union government does not have fiscal space to meet its own obligations and cannot be expected to make any significant increase in the transfers. Second, there are significant deficiencies in the standards of physical and social infrast5ructures provided even by high income States and they too need to spend large amounts on the developmental heads. Therefore, there is a clamour for higher transfers from all the States. Third, there are arguments that equitable transfers may reduce the overall growth of the economy which, in the long run may prove inimical to the interests of the poorer States themselves. Therefore, the general purpose transfers, which are supposed to enable all the States to provide comparable levels of public services at a comparable tax rates can do so only to a limited extent.

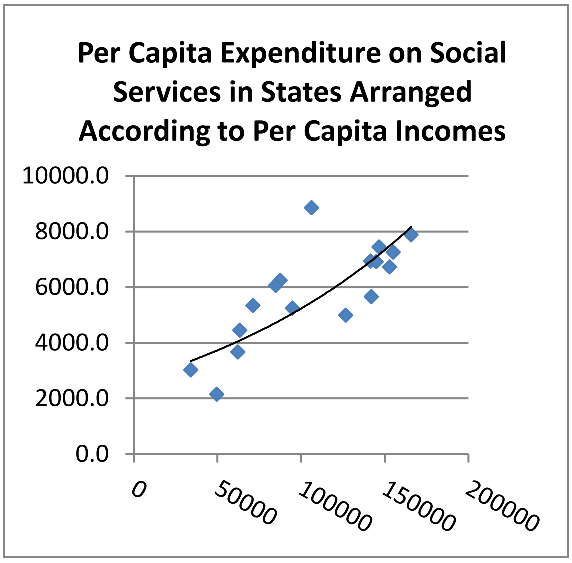
It is in this context that the role of specific purpose transfers becomes critical. In particular, equalization in specific meritorious services such as education and healthcare, rural roads and anti-poverty interventions can help in augmenting the services in these areas. However, as pointed out above, in Indian context, the central government has adopted 28 schemes under Centrally Sponsored Schemes and another 45 Central Sector schemes competing for assistance. With too many schemes for equalization and with limited fiscal space available for giving grants this has meant thin spread of resources without much impact on service levels. Most of these schemes are in the areas specified in the State List and truly belong to the domain of the States and if the latter are not able to provide these services adequately, they should be enabled to provide them through general purpose transfers rather than through conditional transfers. Of course, specific purpose grants should be given to augmenting services with high degree of inter-state externalities or those which are considered highly meritorious, but these will have to be a few to make a difference in the service levels.

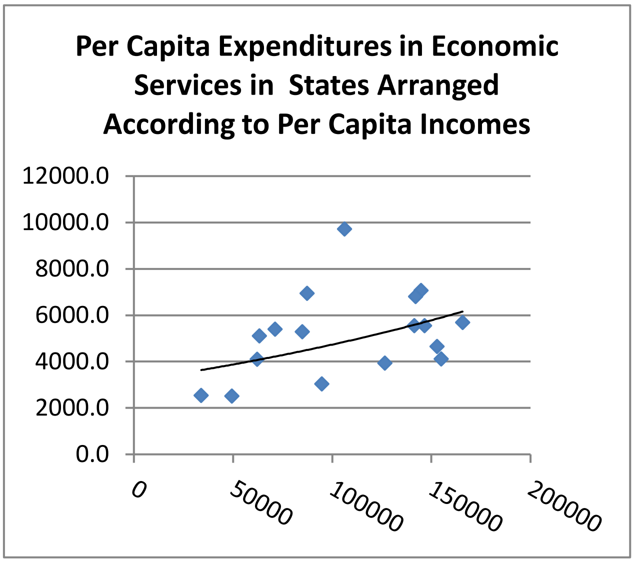
In terms of assistance, as mentioned earlier, of the many, the grants for 5 schemes constitute 66 per cent of total grants under central schemes and it is useful to examine in some detail the design and implementation of these schemes. A case study of schemes for rural employment, elementary education and healthcare schemes reveal out some important shortcomings in both the design and implementation mechanisms.

Graph 4: Per capita Development and Total Expenditures in States According to Per capita Incomes

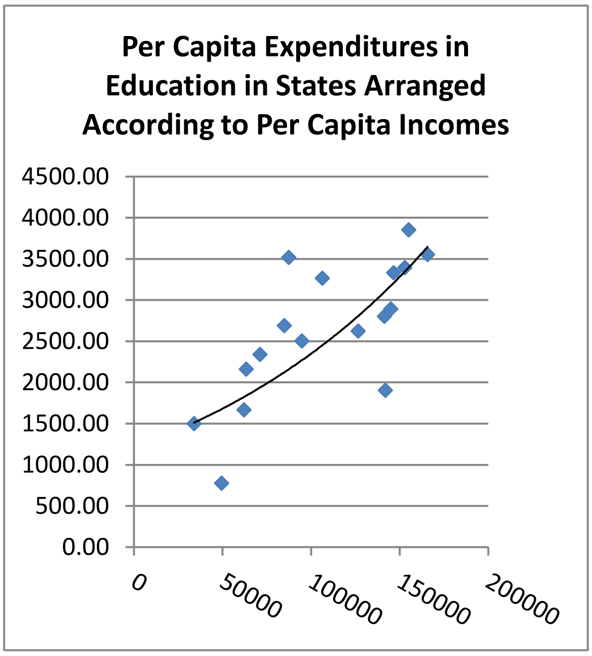


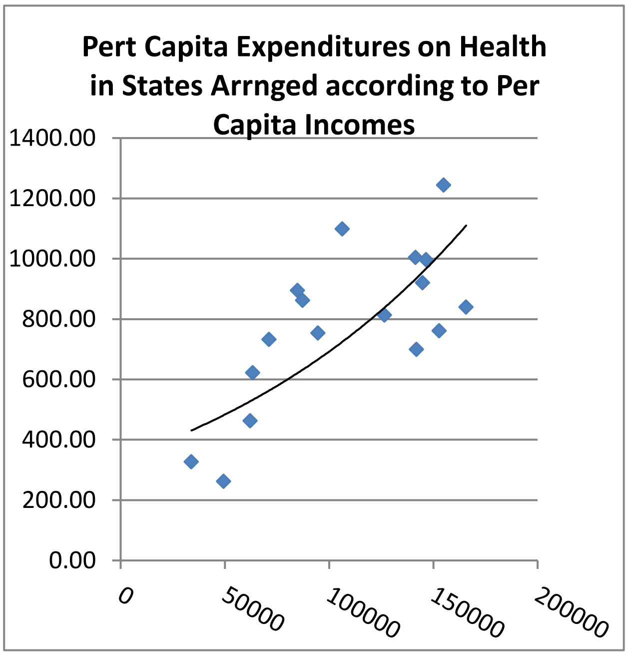
Graph 5: Pattern of Per Capita Expenditures on Social and Economic Services in states According to their Per Capita Incomes





Graph 6: Per Capita Expenditures on Education and Healthcare in States Arranged According to their Per capita Incomes





A close examination of the grants for these schemes brings out some revealing aspects. In the case of elementary education, for example, each State is required to prepare the action plan for 42 different interventions including teachers' salary, textbooks, teachers' training uniforms, transport, residential schools and libraries. (Appendix – 1B) The work plan for the year after consolidation for all States is approved by a Committee chaired by the Union Education Secretary. The first instalment is given after the budget is approved and the second tranche is given only after fulfilling the formalities on spending including the furnishing of "utilization certificates". Invariably, by the time, they have to release the second instalment there are budget cuts or new developments would have taken place requiring additional allocation to some other sectors or the government was not able to raise the budgeted volume of revenues. In the event, often, the final grant given is significantly lower than the originally approved amount. The detailed analysis of national Health Mission and MGNREGA presented in the Appendix-1A and 1C too suffer from the same malice.

The above brief description brings out a number of shortcomings in the schemes. First, there are too many schemes and within each scheme, too many sub-schemes with different objectives to be financed. This results in the thin spread of resources and it is not possible to clearly specify the target in terms minimum standards of services to be achieved.

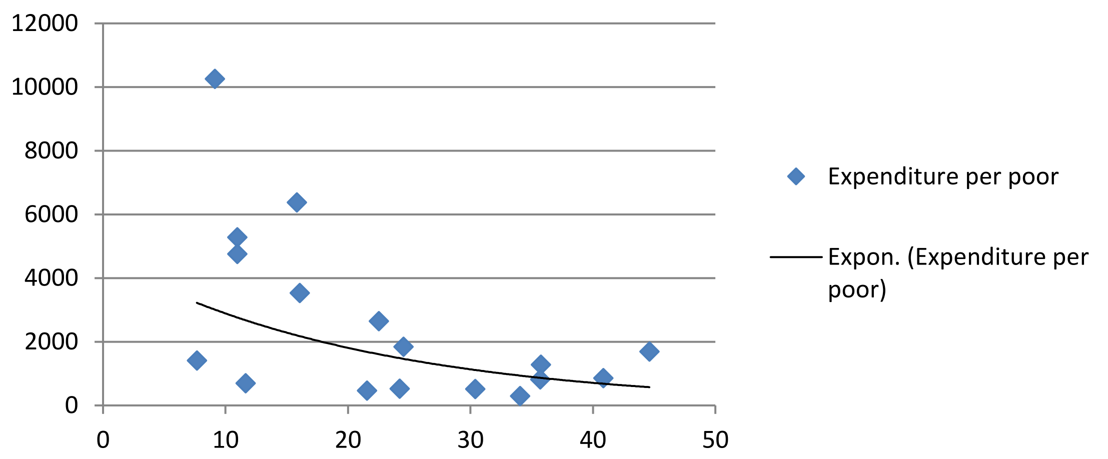
Second, the grants for the schemes are not determined on the basis of the shortfall in the prescribed standard of services. Both the total and individual State allocations are based on incremental plans prepared by the respective State governments and approved by the Committee. Inability to link the transfers with service levels makes it difficult to judge them based on achieving minimum standards. The focus is on spending money rather than ensuring services.

Third, designing the grants not linked to meet the shortfall in services from the prescribed levels results in significant misallocation. It is not necessarily the educationally backward State or the State with poor health indicators that gets more education or health grants. The telling case is of rural employment guarantee. The volume of grants depends on the ability of the bureaucracy in preparing the plans and fulfilling the formalities including furnishing of the utilization certificate. As may be seen from Graph 7, the per capita spending on rural poor is lower in States with higher rural poverty ratio!

Fourth, the uniform matching ratio across States makes it difficult for the low income States to utilize the grants allocated to them fully. In a situation in which the general purpose transfers are not able to offset the fiscal disabilities of the low income States satisfactorily, they will not have the fiscal space to provide matching requirements. In the event, Kerala, one of the most advanced States in elementary education and healthcare comparable to many advanced economies also avails the grant by making the same matching contribution while

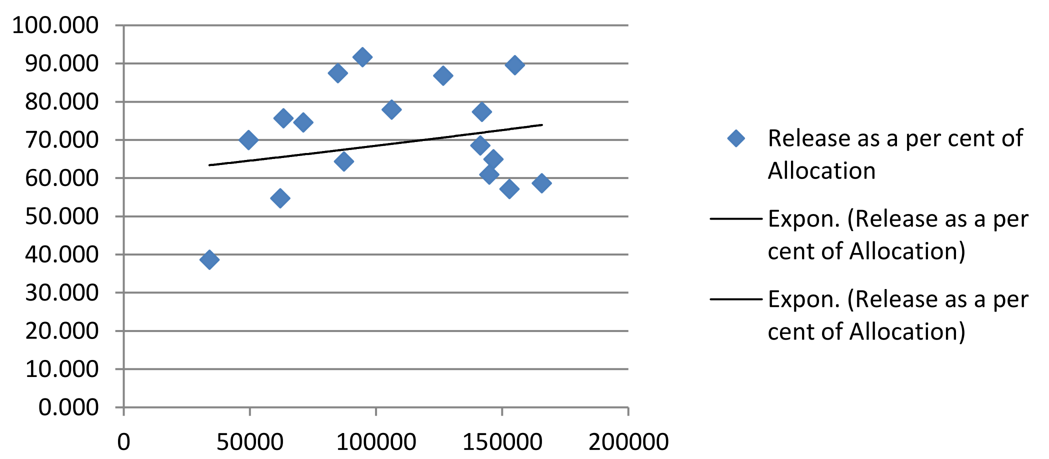
Bihar which is educationally the most backward State does not get adequate grants as it finds hard to contribute the same matching ratio. Introduction of varying matching ratio depending on the shortfall in services levels could improve the design of the grant system.

Graph 7 : Rural Poverty Expenditure per poor According to Rural Poverty Ratio



Fifth, there is considerable difference between the approved allocation and actual grants given. In 2014-15 for example, only 71 per cent of the allocated funds were disbursed in the case of rural employment guarantee scheme and the extent of difference varied between 38 per cent in Bihar, the poorest state and 91 per cent in West Bengal, a middle income state. This creates uncertainty in implementing schemes and invariably the States with greater shortfall in services levels suffer the most. A careful analysis shows that the shortfall from the approved is generally higher in the States with lower incomes.

Graph 8: Release as Per Cent of Allocation in States According to Per Capita Incomes



Sixth, the analysis of grants for healthcare shows that the states are able to substitute grants to their own spending so that the incremental spending on the services is much less than the grant amount. In the case of healthcare for example, econometric analysis relating to changes in health expenditures with changes in own revenues, general purpose transfers and specific purpose transfers shows a significant substitution of expenditures on account of specific purpose grants. (Rao and Choudhury,2012; Srinath et.al, 2017).

Seventh, approval of the schemes with various components and requirement to adhere to the originally approved composition often leads to micromanagement, proliferation of bureaucracy and inefficiency. In the case of education, for example, the States have the prepare budget and the Centre has to monitor in terms of 28 different interventions. In the case of healthcare, the Action Agenda report of the NITI Aayog referred to 2000 budget heads in which the grants are given. Although after the consolidation of the schemes, the volume of flexi funds has been increased to 10 per cent of the grant in some cases, most schemes suffer from micromanagement, inadequate allocation to different activities and wastage therefrom.

This foregoing analysis indicates that the design and implementation of both general and specific purpose transfers need to be analysed in detail. This will help in making recommendations to enhance effectiveness in equitable and incentive compatible provision of public services by the states. A detailed analysis of general purpose transfers in the form of tax devolution and Article 275 grants recommended by the Finance Commission and three important specific purpose transfers namely, SSA, NHM and MGNREGA will be undertaken in the final report to make specific recommendations on improving their effectiveness. The Finance Commission transfers are decided by the Finance Commission and the government itself does not have a say in changing the formula. However, the analysis can help in providing guidelines to the Commission while drafting its terms of reference to incorporate improvement in the formula. As regards, Centrally Sponsored Schemes are concerned, the analysis will help in improving the design and implementation of the schemes. This will also help in analysing other important schemes to ensure equalisation with incentives.

VI. Concluding Remarks:

Fiscal transfers from the Centre to States are critical in India. Unlike in many developed federations when the tax base differentials are not very significant, India has large and growing horizontal fiscal imbalances besides a high degree of vertical imbalances arising from the assignment of tax powers and expenditure responsibilities in the Constitution. Therefore, design and implementation of general and specific purpose transfers is critical in Indian federation from the viewpoint of not only ensuring horizontal equity, balanced regional development and overall stability and integrity of the federation. This becomes even more important when the fact that there are significant hindrances to mobility of population and therefore, it is necessary to take capital to the people and not wait for the people to move towards capital.

Analytically, general purpose transfers are given to offset fiscal disabilities of the States so that all the States are enabled to provide comparable levels of public services at comparable tax rates. However, given the large variations in fiscal disabilities in Indian States with per capita income in the highest income state is five times that of the lowest income State, it becomes difficult to design the general purpose transfers to fully offset the revenue and cost disabilities. Even the richest state suffers from physical and social infrastructure deficits and therefore clamours for transfers and this poses constraints on the extent of targeting and equalization through instruments like tax devolution. This brings in the importance of specific purpose transfer to ensure minimum standards of services considered meritorious or those with significant inter-state externalities.

In India, after the recent changes in the institutional architecture, all general purpose transfers are given on the recommendations of the Finance Commission. The latest is the Fourteenth Finance commission whose recommendations have been implemented since 2015-16. The second source of grants is from various Central ministries which are scheme based. There are at present 28 Centrally Sponsored Schemes and another 45 central Sector schemes for which grants are given by various Central Ministries.

The analysis of intergovernmental transfers shows that that the tax devolution and grants given on the recommendations of the Finance Commission have a strong equalizing element whereas, those given by various Central Ministries do not. Even the former is able to offset the revenue disabilities of low income states only partially. The consequence of this is that the higher income States are able to incur significantly lager per capita expenditures on all major social and economic services as well as in the aggregate. This tends to accentuate inequalities in social and economic infrastructures among the States leading to increasing divergence in developmental outcomes.

There are a number of problems with the design and implementation of specific purpose transfers. First, there are too many schemes, often each with multiple objectives resulting in the thin spread of resources and inability to design the transfer system to achieve minimum standards of specified services. Second, these are not linked to service level outcomes but tend to be incremental. Thus, the transfers are not designed to achieve the basic purpose of ensuring minimum standards of services. Third, the large number of specific purpose transfer schemes taken up for equalization results in the thin spread of resources with hardly any impact on service levels. Fourth, the grants are not linked to improving service levels and it is not necessarily the States with larger shortfall in services receiving higher grants. Thus, educationally backward states do not get larger grants for education and states with lowest health standards of not get higher per capita grants for health. The analysis shows that the states with higher concentration of the rural poor get lower per poor grants for rural employment. Fifth, there is considerable difference between the originally approved allocation and final release of funds under various schemes. In the case of rural employment the shortfall was 20 per cent in 2014-15. The variation between allocation and release are different in different states and generally, the difference is larger in the case of low income states. The inability of the centre to provide the funds allocated in the beginning of the year creates considerable uncertainty in the use of funds. Sixth, a part of the reason for the grater shortfall in low income States is perhaps the uniform matching requirements. The low fiscal space available in these states makes it difficult to provide the matching contributions to fully utilize the funds allocated to them. Seventh, requirement to seek grants under several different interventions within a scheme, results in lack of flexibility to the recipient in the use of funds. Finally, in some schemes like healthcare, the States were able to substitute grants for their own spending with the result that there has not been a commensurate increase in spending on healthcare after the grants are received.

The Central government may not be able to influence much as far as the Finance Commission's recommendations are concerned as this is an independent body making assessments of Union and state finances and recommending tax devolution and grants. However, while providing guidelines to the Commission in the Terms of Reference, it can specify the need to design the devolution system to incentivise, tax effort, and expenditure efficiency in its recommendations. However, the Centre can certainly do well to rationalise the centrally sponsoring schemes. In the case of specific purpose transfers, the Centre has to determine the design itself. Here, it is important to limit the number of schemes and fund them adequately to make a difference to service level. It is important to link them to shortfall in specified services so that the overall objective of ensuring minimum standards is achieved. The design should result in increased outlay on the aided services. There is certainly a case for having differential matching requirements with states contribution increasing as the shortfall in services reduces. The Fourteenth Finance Commission has made the recommendation that the number of transfers should be minimised and the design and implementation mechanism for each scheme should be decided by a committee comprising of Union and State government representatives and domain experts.

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APPENDIX

A1. National Health Mission

Objectives and Design:

The National Health Mission (NHM) is a specific purpose grants given to the States and Union Territories to augment their healthcare system to provide "accessible, affordable, accountable, effective and qualitative" healthcare. Initially started as the National Rural Health Mission (NRHM) by consolidating various programmes on health in 2006, the programme was expanded to address health concerns of the urban poor living in listed and unlisted slums in 2013. The chapter on health in the 12th Plan document provides a broad framework for implementation of the programme during 2012-17 and beyond.

The objective of the programme is to provide assistance to the States to ensure universal access to equitable, affordable and quality healthcare services, accountable and responsive to people's needs with effective inter-sectoral convergent action to address wider social determinants of health. The core values of the programme are to (i) safeguard the health of the poor, vulnerable and disadvantaged persons; (ii) strengthen public health systems as a basis for universal access and social protection against rising costs (iii) Build the environment of trust between the people and health service providers (iv) Empower the communities to become active participants in attaining the highest possible levels of health ad (v) improve efficiency and optimise the use of resources. These are supposed to be achieved by building integrated network of primary, secondary and a substantial part of tertiary healthcare facilities and achieve inter-sectoral coordination to address food security, nutrition, access to safe drinking water and sanitation, education of female children, occupational and environmental health determinants such as women's rights and employment, and different forms of marginalization and vulnerability. The programme proposes to incentivise the States and Union territories to undertake health sector reforms to achieve greater efficiency and equity. It also proposes to prioritise services to address the health of women and children, and the prevention and control of communicable and non-communicable diseases. Finally, it proposes to reduce the out of pocket expenditure of the households on healthcare.

The NHM support to States/UTs has five key components. (i) The National Rural Health Mission – Reproductive and Child Health (NRHM-RCH) Flexible Pool extends financial assistance to two components namely (a) Reproductive, Maternal, New-born, Child and Adolescent Services (RMNCH+A) which is a continuum care approach covering all stages of life and (b) health System Strengthening under NRHM which is meant to augment infrastructure, human resources, programme management and patient transport services. (ii) National Urban Health Mission (NUHM) provides financial assistance to effectively address the health concerns of the urban poor living in listed and unlisted slums. (iii) Control of Communicable Diseases includes programme assistance to control communicable diseases such as Tuberculosis, Vector Borne Diseases, and Leprosy in addition to Integrated Disease Surveillance Project. (iv) Control of non-communicable diseases provides financial assistance to States to meet the challenges of controlling non-communicable diseases such as Cancer, Diabetes, Cardiovascular Diseases and Stroke, National programme for Control of Blindness, National mental Health Programme, National Tobacco Control programme, and national programme for Health Care of Elderly. (v) Infrastructure maintenance is the assistance given to states to meet the salary on Family Welfare Schemes.

Financing Issues:

When the NRHM programme was initiated, it was entirely funded by the Central government. However during the 11th Plan period (2007-08 to 2011-12), the Central contribution was 85 per cent and the States were required to contribute 15 per cent. Later, during the three years of the 12th Plan (2012-13 to 2014-15), the ratio of Central and State contributions to the programme was 75:25 for the general category States and 90:10 for the Special category States. However, after the 14th Finance Commission increased the tax devolution to 42 per cent (as against 32 per cent by the previous Commission) of the divisible pool, the funding pattern was changed based on the recommendation of the NITI Aayog's Committee of Chief Ministers convened by the Chief Minister of Madhya Pradesh to 60:40 in the case of general category States and 90:10 in the case of Special Category States.

For allocating funds to individual States, the Union Ministry of Health and Family Welfare works out the resource envelops for the year and conveys it. Envelops are determined on the basis area and population weighted by and the socio-economic backwardness and health lag in the States. Ten per cent of the funds is given to the state that demonstrates that it is able to efficiently absorb the funds provided as seen from the progress in key areas of institutional reform identified in the MOU. For the NRHM –RCH Flexible pool, population weights for States are predetermined. The large Empowered Action Group (EAG) States (Madhya Pradesh, Bihar, Rajasthan and Odisha) are assigned the wright of 1.3, the two EAG States of Jharkhand and Chhattisgarh are assigned the weight of 1.5, the eight north-eastern states including Sikkim are assigned the weight of 3.2 and the small Union Territories (excluding

Delhi and Pondicherry) are assigned the weight of 3 and the remaining states are given the weight of 1. The allocation for NUHM is done on the basis of urban population and slum population by giving 50 per cent weightage to each of the two factors.

Based on the resource envelop communicated to them the states are required to prepare their annual Programme Implementation Plans (PIPs) based on the State's context and felt needs. These are appraised and approved by the National programme Coordination Committee (NPCC) chaired by the Secretary , Ministry of Health and Family Welfare and the States are required to implement the plan as approved plan.

Analysis of Transfers under NHM:

As mentioned earlier, the basic purpose of specific purpose transfers is to ensure minimum standards of healthcare throughout the country. This requires the government to define the minimum standard, work out the cost of providing this in different states and design the transfer system to ensure that every State spends the prescribed expenditures to achieve the minimum standard. However, it must be recognised that there are a number of social determinants of health and the government can only ensure expenditures. Equalising health expenditures in a state is only a necessary condition to ensuring minimum standards of healthcare for, there are a number of social determinants of health and some of them may even be outside the control of the governments. The analysis of the design and implementation of the schemes bring out a number of policy issues which need to be revisited of the programme has to be made effective. These are discussed in the following.

(i) Designing the transfer system to achieve the objective of equalising expenditures is extremely important. As mentioned above, it is important to define the standards and cost them. This implies that there should be clarity in the objectives. It is impossible to judge the effectiveness of the programme when multiple objectives are specified. Specifying too many objectives spreads the resources thinly across many activities besides increasing the difficulties in monitoring. In a shared cost programme it is important that the implementing level of government should be allowed to plan and implement the programme and allocating resources across several activities within the health sector will increase bureaucratic role without ensuring efficient resource allocation. Such a micromanagement of the programme betrays the lack of trust with the States. As reported in the Action Agenda document of the NITI Aayog, there are as many as 2000 budget heads. It would be useful to set the targets in terms of infrastructure created such as the number of health centres and sub-centres, the number of health professionals and availability of medicines as per the norms and institute an accountability system where the health system is made accountable to the people. Specifying the targets in terms of the above and providing expenditures to these would help to link the outlays to the creation of health facilities making it easy to fix accountability.

(ii) At present, the resource envelop is worked out and communicated to each State government. As pointed out above, the envelope is determined for 5 different components and a predominant part of this is determined on the basis of population weighted according to health lags and area. It is not clear how the weights indicating the health lags are determined. However, the weights assigned to the EAG states at 1.3 or 1.5 and for North-eastern and Himalayan Hill states at 3.2 as compared to the other States at 1 indicate that these are based on broad judgements rather than the actual position on health lags. In other words, it is hard to find significant and positive correlation between the grants given and the health status in the States. Kerala, the State with the best IMR gets the third highest grant allocation as well as release. This is clearly seen from Table 1 (Graph 1) where the per capita NHM grant allocation as well as release to states is shown against Infant Mortality Rate according to NFHS IV. Similarly, Uttar Pradesh, grants allocated as well as released to state with the highest IMR is much lower than many States with much lower IMR. Thus, both the allocation and release of funds to the States are not to ensure minimum standards of services.

(iii) The analysis of actual release of funds shows that the actual release of funds was lower than the original allocation in all the States. The largest shortfall was in Jharkhand followed by Andhra Pradesh and Telangana the new States. Among the low income States, besides Jharkhand, the shortfall was more than 15 per cent in Chhattisgarh and Uttar Pradesh.

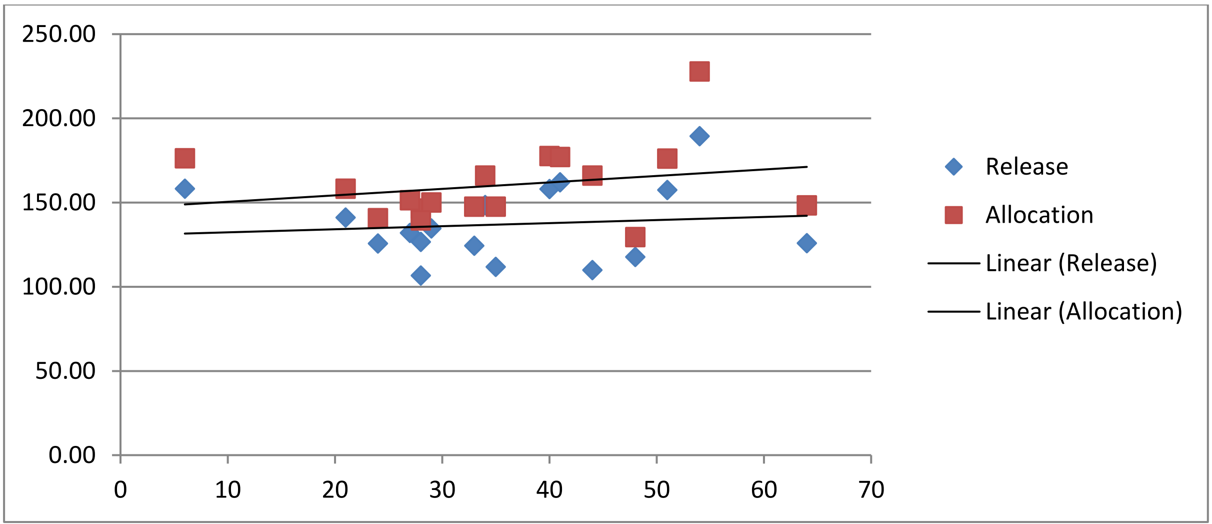
(iv) The fact that there was shortfall in the actual release from the original allocation implies that this was substantially due to the budget cut. This is revealed by the fact that the actual expenditure on NHM in 2014-15 was lower than the budget estimate by 20 per cent. Cutting the expenditure arbitrarily defeats the purpose of ensuring minimum levels of expenditure.

(v) It has been mentioned that one of the reasons for the shortfall in the actual release of expenditures from the original allocation is the inability to provide the utilisation certificates and fulfil other compliances in time. At the same time, as the Union Ministry of Health and Family Welfare wants to utilise the funds, the funds allocated to those states which do not fulfil the compliances are distributed to those that fulfil them. This defeats the purpose of equalisation. The issue must be addressed by building capacity in non-complying states and perhaps, introducing multi-year budgeting so that these States avail the funds and use them in an efficient manner to get the desired outcomes.

Table A1: Grants Allocation and Release

States	IMR	Allocation	Release	Release as a ratio of Allocation
Andhra Pradesh	35	147.52	111.81	75.8
Bihar	48	129.50	117.69	90.9
Chattisgarh	54	227.77	189.33	83.1
Gujarat	34	165.88	148.39	89.5
Haryana	33	147.48	124.25	84.3
Jharkhand	44	165.91	109.85	66.2
Karnataka	28	146.29	126.57	86.5
Kerala	6	176.30	158.18	89.7
Madhya Pradesh	51	176.00	157.36	89.4
Maharashtra	24	140.68	125.57	89.3
Odisha	40	177.53	158.00	89.0
Punjab	29	150.06	134.55	89.7
Rajasthan	41	177.06	161.93	91.5
Tamil Nadu	21	158.21	141.00	89.1
Telengana	28	139.24	106.55	76.5
Uttar Pradesh	64	148.23	125.91	84.9
West Bengal	27	151.39	131.95	87.2

Graph A1-1: Distribution of Central Grants According to Infant Mortality Ratio



(vi) The important objective of requiring the states to make matching contributions is to ensure that the funds given by the Central government for augmenting health services add to the overall health expenditures and that the states do not substitute these funds to their own spending. However, an econometric analysis of carried out in a recent study by regressing changes in expenditures on changes in NHM transfers, own revenues, general purpose transfers and priority assigned to the health sector (as shown is the share of health expenditure in total expenditure) in a fixed effects model for the period 20013-15 shows that specific purpose transfers showed that every rupee of per capita specific purpose transfers reduces the spending by the State by 0.36 paise when the impact of own revenues and general purpose transfers are accounted for (Table 2). While this is definitely an improvement over the previous estimate by Rao and Choudhury (2012), it still shows that the States do substitute some portion of transfers by cutting down non-aided portion of health expenditures and this needs to be corrected to additionality in expenditures.

Table - Regression Results – Dependent Variable: Changes in States' Own Expenditure on Health
(Dep Variable: Changes in Per capita expenditure on health- NHM)

#	Independent Variable	**Coefficient of Variation (and Standard Error)**			
		Rao and Choudhury (2012)			New Analysis
		1991-2007 (Model I)	**1991-2000 (Model II)**	**2001-2007 (Model III)**	**2012-2015 (Model IV)**
1	Changes Specific Purpose Transfers from Union Government on Health Δ (PC_CGH) it = { (PC_CGH) it - (PC_CGH) it-1 }	-0.952*** (0.074)	-0.777*** (0.114)	-1.059*** (0.109)	**-0.360*** (0.137)**
2	Changes State's Own Revenues Δ (PC_SOR) it = { (PC_SOR) it - (PC_SOR) it-1 }	0.012*** (0.003)	0.015*** (0.004)	0.1545*** (0.006)	**0.012 (0.020)**
3	Changes State's Priority for Health (as % of spending) Δ (SPH) it = { (G hi /G bi)t - (G hi /G bi) t-1 }	17.649*** (1.828)	15.03*** (2.038)	19.487*** (4.231)	**38.644*** (12.069)**
4	Changes in General Purpose Transfers (Unconditional) from Union Government Δ (PC_GPGC) it	0.019*** (0.007)	0.014 (0.011)	0.013 (0.01)	**0.017** (0.008)**
5	Constant	18.252*** (3.561)	17.17*** (3.885)	3.552 (5.035)	**58.204*** (17.542)**
6	State Specific Fixed-effects	Yes	Yes	Yes	**Yes**
7	Time Specific Fixed-effects	Yes	Yes	Yes	**Yes**
8	Number of States	14	14	14	**11**
9	Number of Observations	224	126	84	**55**
10	R-square	0.69	0.62	0.77	**0.29**

Estimated equation is: Δ (PC_OHE)it = $\alpha + \beta\ \Delta$ (PC_CGH)it + $\gamma\ \Delta$ (PC_SOR)it + $\psi\ \Delta$ (SPH)it + $\tau\ \Delta$(PC_GPGC)it + υ (State Dummies) + σ (Year Dummies) + εit

Source: Pavan Srinath et.al (2017), *Public Expenditure on Health in India 2005-06 to 2015-16*, Takshashila Institution, Bangalore.

Reform Issues:

The foregoing analysis shows that the scheme has been less than optimal in achieving the objectives it has set forth. The basic objective of ensuring a prescribed minimum stand of health services cannot be achieved with the present design and implementation mechanism. Therefore, the scheme needs to be revisited make it more effective. Important reform issues to make the scheme more effective are discussed in the following:

(i) As mentioned earlier, it is necessary to define the objective of the scheme clearly. This implies that it is necessary to avoid multiple objectives and focus on a single objective of ensuring minimum levels of health infrastructure across the country. It is necessary to avoid multiple objectives and linking transfers to several interventions. The objective should be to ensure a prescribed minimum health infrastructure for primary and secondary healthcare including physical infrastructure, health professionals and drugs. A significant portion of the tertiary healthcare and some portion of secondary healthcare must be provided by the States themselves.

(ii) Once the focus shifts to ensuring minimum standards of services, it is not necessary to have multiple interventions and give grants under a large number of budget heads. The NITI Aayog document states that there are as many as 2000 budget heads for NHM transfers. Such micromanagement and minute division of transfers hugely enhances the transaction cost and spreads the resources thinly across several interventions which will prevent making appreciable impact on the health infrastructure. When the nature of the intervention is decided by the States themselves, it is important to trust them and provide them flexibility to ensure the type of infrastructure and strengthening of services they intend to provide. According to the Constitution, Public Health is a State subject and it is appropriate to trust them and empower them to provide a mix of infrastructure as perceived them to be appropriate.

(iii) The resource envelop allocation to the states should be made purely on the basis of shortfalls in infrastructure as per the specified norms. The present system of allocating funds on the basis of area and population weighted according to health lags to a considerable extent arbitrary and does not allocate resources according to varying standards of health infrastructure. As the objective of any specific purpose transfer is to ensure minimum standards of services, it is necessary to define what is the minimum standard sought to be equalised and make allocations accordingly.

(iv) The difference between original allocation and ultimate release creates difficulties in implementing the planned activities by the recipients of the grants. The difference largely arises on account of cuts in the Central budget for the schemes or inability of the recipient state governments to fulfil the compliances including the timely provision of utilisation certificates. Simplification of the transfers in the lines indicated in (ii) above should considerably reduce the compliance requirements by the States. In addition, as some infrastructure facilities in the health sector may require longer time period to complete, multi-year budgeting may be thought of as a solution.

(v) Creation of infrastructure facilities by itself may not improve the health outcomes. It is important to institute a system of incentives and accountability. This does not fall in the realm of design of the transfer system but implementation. To a considerable extent this has to do with the system of governance in the State.

(vi) The matching requirements from the states fort NHM has been changed after the NITI Aayog Committee of Chief Ministers convened by the Chief Minister of Madhya Pradesh recommended the marching ratio between the Centre and states at 60:40 for the General Category States (GCS) and 90:10 for the Special category States. Given the large number of schemes and significant inter-state variations in the health infrastructure including human resources between the States and the need to bring up the states lagging in the services to the minimum level, it may be appropriate to design the scheme requiring varying matching requirements. The GCS may be grouped into three categories depending on their taxable capacity as high, moderate and low capacity states and the matching ratio for the states may be fixed at 50%, 40% and 30%. This way, low capacity states will find it easier to contribute their marching requirements and avail the Central transfers.

(vii) It is important to ensure that the grants given to the States add to the expenditure on healthcare and the States are not allowed to substitute their own spending by transfers. This would require adding a condition to availing the grants. This could be done either by stipulating that the expenditure excluding the transfers on health does not fall short of the projected health expenditures excluding the transfer for the year or by stipulating that the share of health expenditure in total budgetary expenditure increases by the volume of grants received.

Appendix A2: Sarva Shiksha Abhiyan

Sarva Shksha Abhiyan (SSA) is a Centrally Sponsored Scheme implemented in partnership with the States to achieve universalization in elementary education in the country. The scheme was conceptualised and introduced based on the experience gained from the erstwhile programmes namely, Operation Black Board (OBB), Shiksha Karmi Project (SKP) and District Primary Education Programme (DPEP). The National Mission for SSA was initiated in January 2001 The objectives of the scheme are to ensure universal access and retention, inclusiveness by bridging gender and social category gaps in education, enhancement in the learning levels of children. These are sought to be achieved through as many as 42 interventions such as opening of new schools, construction of schools and additional classrooms, toilets and drinking water, provisioning of teachers, periodic teacher training and academic resource support and textbooks and support for learning achievement.

The enactment of the Right of Children for free and Compulsory Education (RTE) Act in 2009 and consequent insertion of Article 21A in the Constitution states that, “the State shall provide free and compulsory education to all children in such a manner as the Stare may, by law, determine”. Thus, the Act mandates that every child in the 6-14 age group in entitled to have free and compulsory education in a neighbourhood school till the completion of elementary education. The framework for implementation of SSA has accordingly been amended in September 2010 to align with the provisions of the RTE Act. An important provision of the Act is the requirement of admitting 25 per cent of the seats in private schools for the children belonging to the weaker sections and disadvantaged groups in class 1 or pre-primary class with the government required to reimburse the fees of these children. The Act also prescribes inter alia, (i) provision for a non-admitted child to be admitted to an age appropriate class, (ii) specifies the responsibilities of different levels of government in implementation, (iii) lays down the norms and standards relating to pupil-teacher ratio, buildings, infrastructure, school-working days and teacher working hours, (iv) rational deployment of teachers to maintain the pupil-teacher ratio in every school and not just the block or the district as a whole, (v) the norms are set for pupil-teacher ratios, buildings and infrastructure, physical punishment and mental harassment of students are prohibited, prescribes screening procedure for admission of children and prohibits charging capitation fees, private tuition by teachers and running of schools without recognition, (vii) development of curriculum in consonance with the values enshrined in the Constitution and (viii) provides for 25 per cent admission of children belonging to weaker sections and disadvantaged groups in class 1 or pre-primary class and reimbursement of fees to states towards expenditure incurred by them for admission of economically weaker section (EWS) of students in private unaided schools with effect from 2014-15.

The objectives of the programme of universalising elementary education, closing the gender and social groups' gaps, and improving the quality of education is sought to be achieved through 42 interventions grouped under 8 different components. These include, access and retention, quality, gender, equity, Section 12 (1) (C) of RTE Act reimbursement of expenditure for 25 per cent of admissions in private schools), infrastructure development, programme management and other issues. This is a shared cost programme between the Central and state governments. During the period 2010-14, the sharing ratio between the centre and States was 65:35 for general category States and 90:10 for Special Category States. After 2015-16 this was changed to 60:40 in the case of general category States and 90:10 in the case of Special category States has continued.

The shares of different States and Union Territories in total grants are determined on the basis of the approved Annual Work Plan and Budget (AWP&B). Each State and Union Territory submits it AWP&B to the Project Appraisal Board Chaired by the Secretary in the Ministry of Human Resource Development as per the financial norms of the scheme, which includes the shares of the centre and states. The Central share is released in three instalments – an ad-hoc instalment, balance of 1st instalment and 2nd instalment. The release is done subject to the submission of provisional/audited utilisation certificate, state share statement, outstanding advances and pace of defraying expenditure. The release is done to the States and Union Territories on a lump sum basis for further release to State Implementing Societies.

The share of the Central government is released in three instalments in different months – ad-hoc, first and second instalments to ensure uniform flow of funds. The release is done after the required documents such as provisional/audited utilisation certificate, state share statement, outstanding advances and pace of expenditure implementation. The Central share is released to the States and the latter in turn release the funds to State Implementing Societies (SIS). The Central share is divided into General and Capital heads from which the SC, ST and General components are segregated. SISs function under the supervision of the respective State governments. They release the funds received by them to Government schools, Government aided schools and private schools identified by the State government for giving grants.

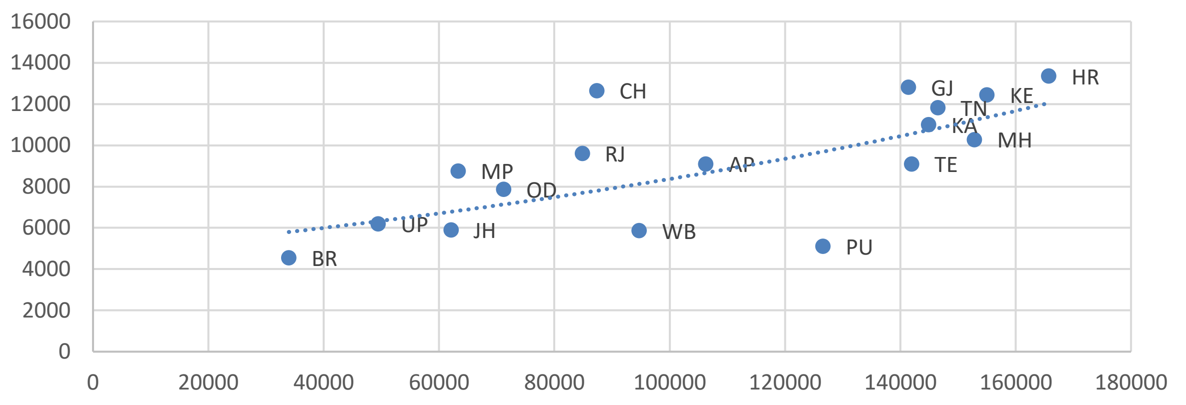
Analysis of Grants:

As mentioned earlier, there are as many as 42 interventions within the SSA with multiple objectives and the States have to prepare their plans for each of the interventions. Multiple objectives makes defining the minimum standards difficult. For example, while enrolment ratio can be defined, it is not possible to clearly define and set minimum standards for the quality of education to be achieved through the transfer system. The focus then shifts to inputs such as teacher – student ratio or physical infrastructures provided rather than learning outcomes. At the end, the Right to Education ends up with attendance at schools rather than educating the young.

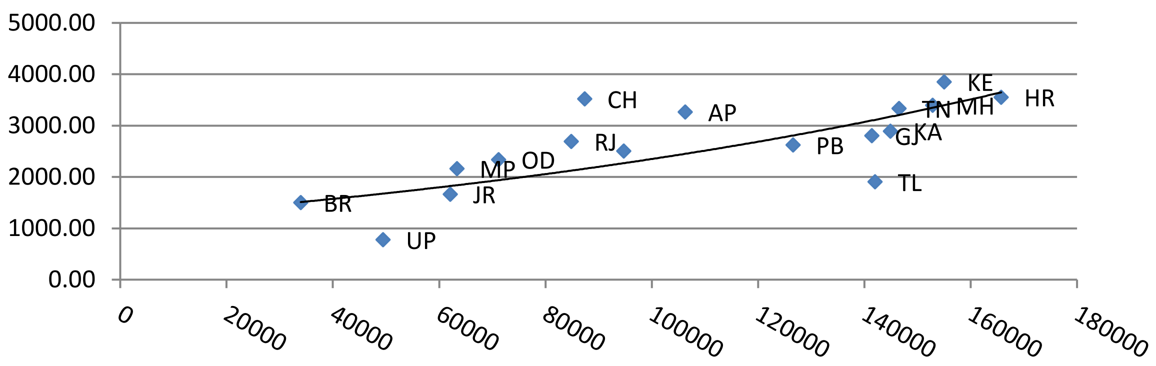
There are a number of issues of both design and implementation of the scheme. As may be seen from Graph A2-1, the expenditure per child in the school going age (6-13) in the States are positively related to per capita GSDP with a correlation coefficient of 0.688. This shows that SSA has not had a significant impact on equalising per child expenditures and the States with low revenue capacity continue to suffer from poor educational standards as comparted to their more affluent counterparts. In addition to lower expenditures, the poor implementation results in lower teacher-student ratio, employment of untrained teachers, absenteeism of teachers and inability to provide teaching accessories. Thus, the basic objective of equalising standards of elementary education gets defeated.

As mentioned earlier, the preparation of plans for SSA is done on incremental basis and not on the basis of the shortfall in standards of elementary education. In the event, the grants are given not necessarily on the basis of the deficiency in the standards of elementary education, but on the basis of the ability of the State to prepare its plans. The spread of grant per child in the age group 6-13 in the States arranged according to per capita GSDP shows virtually no relationship between the two variables (Graph A2-3). This shows that distribution of grants has not been according to the deficiency in the standards or revenue disabilities of the States. This is a matter of concern as in low income –highly populated states with higher proportion of the children in the school going age, the low per child expenditures will accentuate educational inequality.

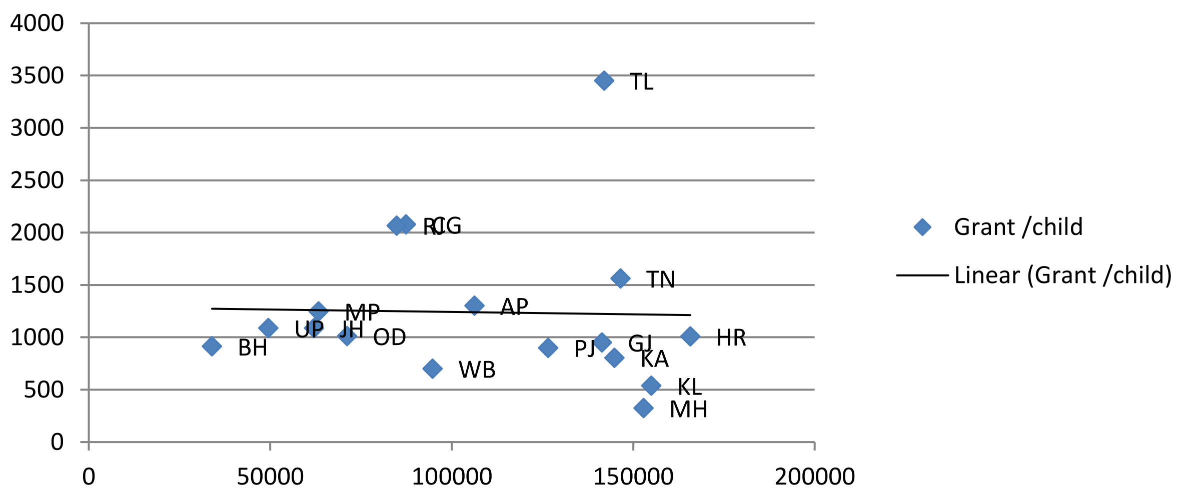
Graph A2:1 Elementary Education Expenditure Per Child in the Age Group 6-13 in States Arranged According to Per Capita GSDP



Graph A2:2 Per Capita Expenditures in Education in States Arranged According to Per Capita Incomes

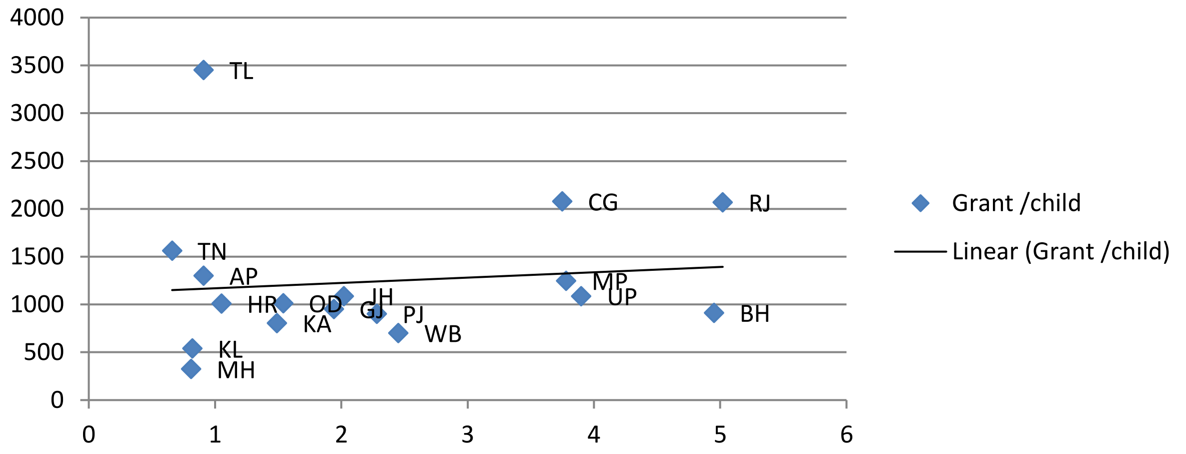


Graph A2:3 Grant /Child According to Pet Capita GSDP in States

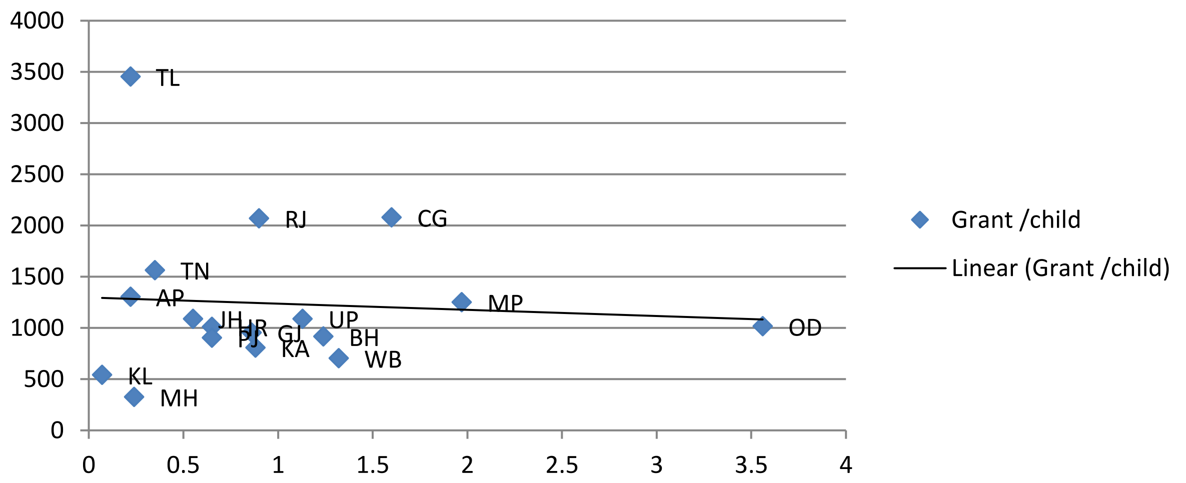


The shortcoming in the design of the grants under SSA is reinforced when we look at Graphs A2:4 and A2:5. In the first graph, the SSA grant in 2014-15 in the States are shown against the ratio of out of school children taken from the *Statistics on School Education 2011-12* published by the Ministry of Human Resource Development. If out of school is taken as a measure of educational standard, the graph shows that there is hardly any relationship between the grants given and educational standards in the States (Correlation coefficient: 0.112). Similarly, per child grant to States according to dropout ratio too shows virtually no relationship between the two variables with a correlation coefficient of (-) 0.0698. (Graph A2-5).

Graph A2:4 Grant /Child According to Ratio of Children Out of School to Total Children



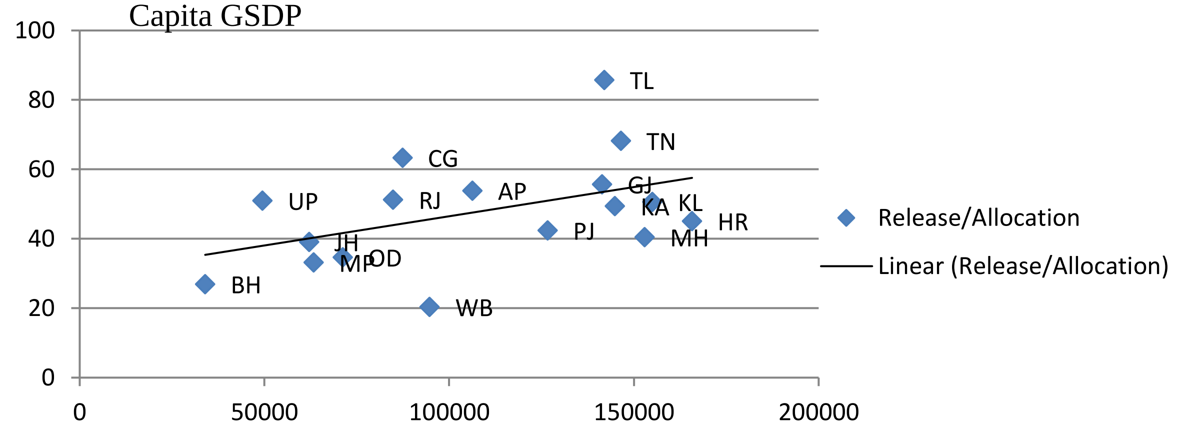
Graph A2:5 - Grant /child According to Dropout Ratio



The lack of equalization in the SSA grants is not only because of the shortcomings in the design of the grant system but also due to implementation problems. The low income States have been lagging in fulfilling the conditionalities and availing the grants allocated to them to the full. The positive relationship between the ratio of grants release to allocation with per capita GSDP shows that the higher income States are able to implement the scheme better than the less affluent States. In other words, the low income States not only are allocated lower per child grants, but also they are unable to utilise the grants allocated to them. Inability to utilise the grants results in their grants being distributed to those States which fully utilise, thus compounding the inequity. The variations in the utilization rates could be due to their inability to implement the schemes expeditiously, or inability to fulfil the conditions like timely auditing off the accounts, compilation of information on the utilization from the village level or simply, inability to provide matching resources as required in the scheme. This implies that there must be concerted efforts at building capacity to implement the schemes, have to re-examine the reporting requirements.

Considering the importance of the scheme, it may also be useful to think in terms of multi-year implementation plans to avoid losing the grants. As regards matching ratios are concerned, to encourage educationally backward states, the Central government could introduce varying matching ratio requirements depending on the extent of educational backwardness or the revenue disability. The Special category States in any case have to make lower matching contributions. Even among the general category states, it may be appropriate to classify them into three categories in terms of educational backwardness/revenue disability and have a matching ratio of 30%, 40% and 50% for the most backward, middle category and least backword category States.

Graph A2:6 -Grant Release/Grant Allocation in States According to Per Capita GSDP



After the enactment of RTE, a provision has been made to provide 25 per cent seats in private schools disadvantaged children on reimbursement of the fees by the government. While this can be a gateway to these children to avail elite education, it can also create some social problems. First only a miniscule minority of the students can get a chance to get admitted in private schools. This provides an alibi for not improving the quality of government schools. Second, given that the social background of the disadvantaged students admitted under RTE are very different from the regular students, there can be a feeling of segregation and discrimination. Furthermore, given the varying family backgrounds with the general students having access to parental guidance or paid tuitions after the school, the RTE students may find it hard to compete with the regular students. It is important that the States should work towards improving the standards in government schools by having adequate number of trained teachers, constant upgradation of their skills, enforcing their attendance and regular teaching in schools and access to teaching materials and aids.

The important issue in SSA should be to reduce educational inequalities among the States so that children are provided with access to education irrespective of the place of their residence and economic and social background. The focus will have to be not on enrolments but on learning. This requires improvements in design and implementation of the scheme and the capacity and willingness by the states to enforce compliance by the teachers. In particular, there is a need to build capacity in the lagging States. Multiple interventions with minute conditionalities only adds to the problems of implementation and bureaucratic interference. It is necessary to trust the states, handhold them where necessary, help them to build capacity to implement and provide greater flexibility in the use of funds rather than distribute funds across several interventions.

Appendix A3: Mahatma Gandhi National Rural Employment Guarantee

Salient Features of the Scheme

According to the World Bank report, Mahatma Gandhi National Rural Employment (MGNREGA) is the world's largest public works programme. This is a programme designed to ensure livelihood security by providing 100 days of guaranteed wage employment in a financial year for an adult member of every household that volunteers to undertake manual work. The programme was introduced by merging and expanding the erstwhile Sampoorna Grameena Rozgar Yojana (SGRY). It was started in 200 districts of the country in 2006 and the coverage was expanded to additional 130 districts in 2007 and the entire country in 2008.

The National Rural Employment Guarantee Act of 2005 provides the framework for the design and implementation of the scheme. The job seekers are required to obtain the job cards by applying for registration. The job card holders have to be provided with employment within 15 days from the date of application for the job failing which they are entitled to receive unemployment allowance. Contractors are not supposed to execute the works and unskilled wage should constitute 60 per cent of the work plan and the remaining 40 per cent should be incurred for material cost and skilled wages. The entire scheme has to be implemented by the Panchayats and the share of village panchayats should be at least 50 per cent. Priority in the works should be assigned to those involving natural resource regeneration and improving agricultural productivity, drought proofing and flood protection. Payment to the workers have to be made directly to their bank or post office accounts.

The salient features of the scheme are (i) this is a rights based scheme for adult members willing to do manual labour; (ii) the employment must be provided to the job card holders within 15 days of their application failing which they are entitled to receive unemployment allowance; (iii) Job card holders can receive employment entitlement is up to 100 days in a financial year depending upon their demand; (iv) the works chosen must be labour intensive with unskilled wages constituting 60 per cent of the cost; (v) Implementation of the scheme is done at decentralized levels with village panchayats required to implement 50 per cent. The entire work plan is supposed to be identified and recommended by the Gram Sabha. The Panchayat Raj Institutions have been given the primacy in planning, implementing and monitoring the scheme; (vi) The facilities such as crèche, drinking water, first aid and shade should be provided at the work sites; (vii) women beneficiaries must constitute one-third of the employment provided; (viii) There must be proactive disclosures through social audit, grievance redressal mechanisms to ensure transparency and accountability and (ix) the States are responsible for implementation and ensure that work as demanded for up to 100 days is ensured.

Under the MGNREGA the work plan is supposed to be decided on the basis on a participatory planning exercise. The responsibility for preparing the labour budget for the next financial year along with the details of unskilled labour requirement is assigned to the District Programme Coordinator and this task has to be completed by December. The entire exercise leading up to the estimation of the labour budget and identification of the work plans is done in a decentralized planning exercise. The Gram Sabhas are supposed to identify the work plan and the Gam Panchayat-wise identification of the shelf of works and estimation of employment demand is aggregated at the block level and thereafter at the district and State levels. These estimates scrutinised by the State Government are submitted to the Empowered Committee chaired by the Secretary, Rural Development of the Central government. After taking account these inputs, the Empowered Committee finalises the labour budget based on the performance of the State in terms of the employment created during the preceding four years, the planning process adopted to finalise the labour budget in the State, an appraisal of the initiatives and strategies of the State to improve delivery mechanism and assessment of the requirement of the State in terms of magnitude and intensity of rural poverty as reflected in the Socio-economic Caste Census, 2011 (SECC) estimates and frequency of the occurrence of natural calamities. The labour budget thus finalised is only indicative and not a ceiling. The states are required to cater to the actual demand for work during implementation.

The funds to the States are released normally in two tranches and there can be more than one instalment in a tranche. The amount in a tranche depends upon the approved labour budget, opening balance, pending liabilities of the previous year and overall performance. After the approval by the Empowered Committee and adoption in the budget, the State government is required to prepare district-wise, month-wise projections of labour demand. Based on this fund requirement is estimated by the NREGA Soft. The first tranche is estimated on the basis of the funds required for first six months of the financial year or 50 per cent of the labour budget of the State, whichever is lower. The first tranche is released in April and the amount is calculated on the basis of labour demand projected for the first 3 months, adjustment of unspent balances and pending liability.

The release of the first tranche is subject to the submission of (i) a certificate to the effect that accounts of all the district of the State for the financial before 2014 have been settled;

(ii) a certificate on the settlement of all audit paras under the MGNREGA; (iii) a detailed action taken report on the complaints forwarded to the State; (iv) a certificate indicating satisfactory compliance of Ministry's clarifications/suggestions/guidelines and observations from time to time; (v) a certificate to the effect that there hasn't been any mutualisation and misappropriation of funds.

The second tranche is released subject to the fulfilment of the prescribed conditions and on submission of the proposal in the prescribed format by the State. The proposal can be submitted only after the district/State utilises of 60 per cent of the available funds. If the second tranche proposal is submitted after 1st October, it is necessary to submit the audit report of the previous year. The quantum of funds released in the second tranche depends on the performance in the utilisation of the funds available.

Analysis of the Scheme

Governmental intervention in redistribution is necessary because markets do not bring about the desired state distribution of income and wealth. It is also important that while funding for such redistribution has to come predominantly from the Central government, implementation of anti-poverty intervention has to be at local levels for reasons of comparative advantage (Rao and Das-Gupta1995, Rao, 2002). There are general questions as to whether such targeted interventions are better, or assuring basic minimum levels of income to the targeted groups of population is more desirable. In this report, these issues have not gone into as the objective is to analyse the design and implementation issues in this important specific purpose transfer.

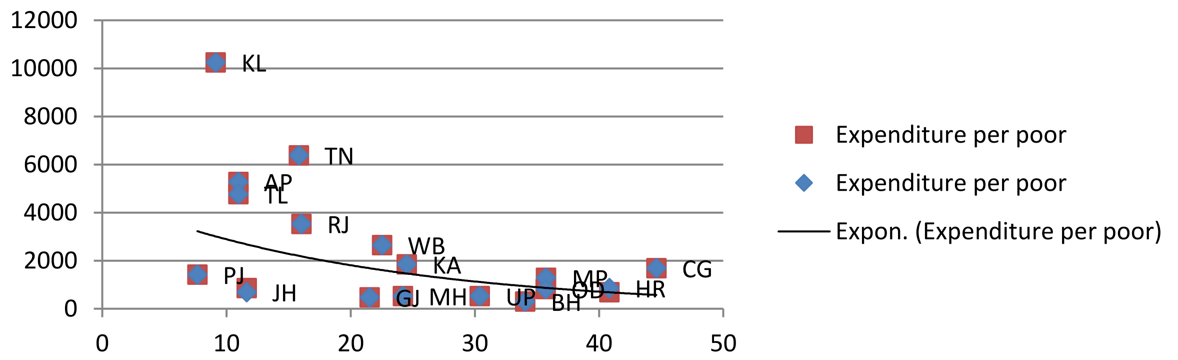
This is undoubtedly an important anti-poverty intervention. The self-selection through manual unskilled work in the scheme makes targeting the benefits of the scheme to the poor automatic. Indeed, there are challenges in implementation and possibilities of misappropriation at the grass-roots level in feudal oligarchic power structure in rural areas. There are also administrative costs and bureaucracy at various stages with potential power to seek rent. These issues of implementation have to be addressed by evolving and strengthening the systems of checks and balances including an effective social audit.

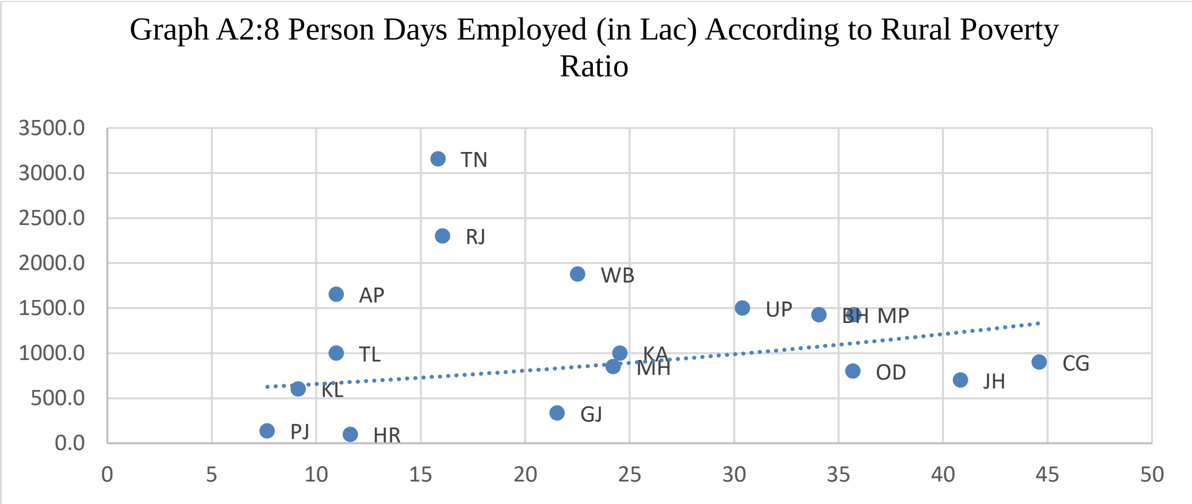
The focus of this study is design and implementation of the specific purpose transfer for generating wage employment in rural areas to minimise the hardship arising from rural poverty. Although there are multiple objectives in the scheme, the principal focus is to mitigate the distress caused by rural poverty. This would mean that the spending on MGNREGA should spread across the States such that the State with higher concentration of poverty should receive larger amounts. The analysis of per poor spending on MGNREGA across different States shows that in 2014-15, per rural poor expenditure was negatively correlated (-0.572) with the rural poverty ratio according to the Tendulkar measure (Graph 7). This shows shortcomings in the targeting of MGNREGA.

The above finding is reinforced by the pattern of person days of employment generated through MGNREGA in different States relative to their rural poverty ratio (Tendulkar measure) in 2014-15. Graph 8 which presents the analysis shows no particular pattern. It is seen that Tamil Nadu had the highest number of person days employed even though the rural poverty ratio in the state was just 15.8 per cent. In contrast, Bihar, Chhattisgarh and Jharkhand and Madhya Pradesh which had the highest rural poverty ratios had much lower person days of employment.

The above result is not surprising as, despite being a demand driven programme, the labour budget is finalised on the basis of factors such as performance of the State in creating employment during the preceding four years, the planning process adopted to finalise the labour budget, the initiatives and strategies of the State to improve delivery mechanism and assessment of the requirement of the State in terms of magnitude and intensity of rural poverty as reflected in the Socio-economic Caste Census estimates and frequency of the occurrence of natural calamities. In this list of factors, SECC poverty measure is the only factor that targets the spending on rural poverty. Besides being largely incremental, there is considerable discretion by the Empowered Committee and consequently, it is not necessarily the States with largest poverty concentration that get the highest MGNREGA grant.

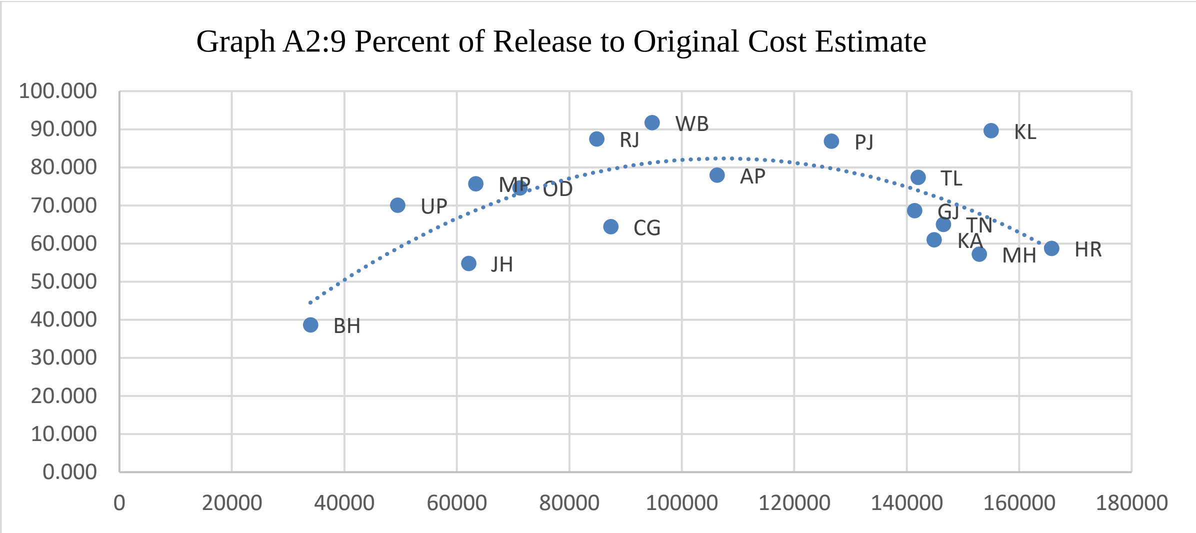
Graph A2:7 Rural Poverty Expenditure per poor According to Rural Poverty Ratio





A comparison of originally estimated cost of the programme with the final release of funds under MGNREGA in 2014-15 shows interesting results. First, although the funding for MGNREGA is claimed to be open ended, the actual release of funds in 2014-15 for the scheme were lower than the originally estimated expenditures in every State by varying magnitudes (Graph 9). This is understandable as the originally estimated cost could include the matching contribution from the States. However, the wide variations in the ratio of original cost estimate to the release shows that there could be significant difference between originally approved grants and the final grants.

The graph plotting the difference between the original cost estimate and final release of expenditures arranged according to per capita GSDP in the States brings out an interesting pattern. The ratio of grant releases by the Centre to the States with very low per capita GSDP are the lowest. The ratio increases as per capita GSDP increases and then declines at very high per capita GSDP levels. The States with low per capita GSDP have the concentration of rural poverty and the programme is much more important to them than more affluent States. At very high income levels where the rural poverty ratio is low, the States themselves may not attach much importance to the programme and utilise the funds.



The important point is that as MGNAREGA is a programme of giving wage employment to the poor, it is desirable to design the grant system based on single factor of rural poverty rather than bring in other considerations. If indeed the States do not have the capacity to design the works and implement the programme, the solution lies in developing their capacity through handholding so that the overall objective on providing assured wage employment to the rural poor is met.

One of the reasons for the low ratio of actual release of grants to the original expenditure estimate in the States with low per capita GSDP may be due to their inability to provide matching contributions. Although MGNREGA is considered as a "core of the core" programme, the States are required to make a matching contribution of 30 per cent to the Central contribution. The contribution is uniform across the general category States. As suggested in the case of NHM and SSA, it may be desirable to devise a varying system of matching ratios depending on the revenue raising capacities of the States. This would help the States with low per capita GSDP which also are those with high concentration of rural poverty to utilise the grants better.