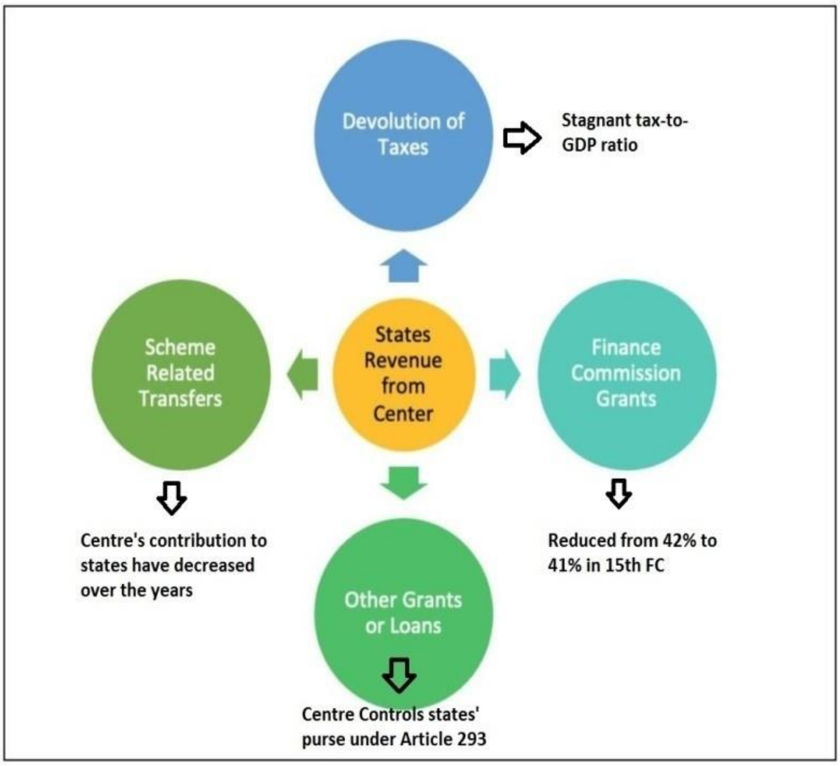
1. 16th Finance Commission Report- Economy

The 16th Finance Commission, constituted in 2023 under the chairmanship of Dr. Arvind Panagariya has had its key recommendations accepted by the Government for implementation during 2026–27 to 2030–31

Finance Commission of India is a constitutional mechanism for fiscal federalism, designed to maintain a fair, transparent, and rule-based distribution of financial resources between different tiers of government in India.

Constitutional Basis and Nature



Constitutional Authority- Established under Article 280 of the Constitution of India. Ensures constitutional balance between financial powers and responsibilities of the Union and the States.

Periodic Constitution- Constituted by the President of India every five years, or earlier if required. Each commission is numbered sequentially (e.g., 15th FC, 16th FC).

Advisory Character- Recommendations are not legally binding. However, due to constitutional sanctity and convention, they are largely accepted by the Union Government.

Composition and Expertise

Structure

1. One Chairperson
2. Four other Members

Qualification Rationale

1. Members are chosen for expertise in-
   a. Public finance
   b. Economics
   c. Administration
   d. Law
2. Ensures technically sound and politically neutral recommendations.

Core Mandate and Functions

Vertical Devolution (Centre–State Sharing)- Determines the percentage share of net tax proceeds between-

1. Union Government
2. State Governments

Addresses vertical fiscal imbalance caused by-

1. Revenue-raising powers concentrated at the Centre
2. Expenditure responsibilities largely resting with States

Horizontal Devolution (Inter-State Distribution)

Allocates states' share among individual States using objective criteria such as-

1. Population
2. Income distance
3. Area and forest cover
4. Demographic performance
5. Tax effort

Promotes **equity and balanced regional development.**

Grants-in-Aid (Article 275)- Recommends principles governing financial assistance to States from the Consolidated Fund of India.

Aimed at-

1. Bridging revenue gaps
2. Supporting special needs of States
3. Addressing structural fiscal weaknesses

Local Bodies Financing (73rd & 74th Amendments)

Suggests measures to augment State Consolidated Funds to support-

1. Panchayati Raj Institutions (PRIs)
2. Urban Local Bodies (ULBs)

Strengthens grassroots fiscal decentralisation.

Important Structural Limitation

Cesses and Surcharges

1. Levied exclusively by the Centre.
2. Not part of the divisible pool, hence not shared with States.
3. Increasing reliance on these has raised concerns over erosion of cooperative federalism.

Key Highlights of the 16th Finance Commission

Vertical Devolution- Tax Sharing

States' Share Retained at 41%

1. Same as recommended by the 15th Finance Commission.
2. Reflects continuity and stability in fiscal federalism.

"Grand Bargain" Observation

1. Though the percentage remains 41%, the effective divisible pool has shrunk.
2. Reason- Growing proportion of revenues through cesses and surcharges.
3. Recommendation-
4. Gradual integration of cesses and surcharges into the normal tax pool.
5. Enhance transparency and trust between Centre and States.

Disaster Management Grants

Inclusion of New Disasters- Heatwaves and Lightning recommended as nationally notified disasters. Enables States to access central disaster funds for climate-induced risks.

Total Allocation- ₹2,04,401 crore for five years.

Fund Distribution

1. 80% to State Disaster Response Fund (SDRF) – immediate relief
2. 20% to State Disaster Mitigation Fund (SDMF) – prevention and resilience

Significance- Aligns fiscal policy with climate change realities. Shifts focus from relief-centric to mitigation-oriented disaster management.

Grants to Local Bodies

Total Allocation- ₹7,91,493 crore for rural and urban local governments.

Two-Tier Structure- Basic Grants (80%)

1. Untied
2. Ensure basic service delivery

Performance-Based Grants (20%)

1. Linked to- Financial accountability, Service delivery improvements and Digitalisation and transparency

Urbanisation Premium- ₹10,000 crore incentive fund.

Encourages-

1. Merger of peri-urban villages
2. Creation of stronger Urban Local Bodies

Addresses challenges of unplanned urban sprawl.

Fiscal Roadmap and Discipline

State Fiscal Deficit- Recommended cap at 3% of GSDP. Reinforces FRBM discipline at the State level.

Union Fiscal Deficit- Targeted reduction to 3.5% of GDP by FY 2031. Aims at long-term macroeconomic stability.

Discontinuation of Revenue Deficit Grants

Major Policy Shift- Post-Devolution Revenue Deficit Grants discontinued.

Rationale- Avoids perpetual dependency on central transfers.

Encourages-

1. Tax base expansion
2. Improved tax administration
3. Expenditure rationalisation by States

Implication- Signals transition from support-based federalism to performance-oriented federalism.

Overall Significance- Acts as the financial backbone of cooperative federalism.

Balances-

1. Equity vs efficiency
2. Autonomy vs accountability

Increasingly addresses-

1. Climate risks
2. Urbanisation
3. Fiscal sustainability

Remains central to debates on-

1. Centralisation of revenues
2. State autonomy
3. Quality of public expenditure

Source- https-//www.newindianexpress.com/business/2026/Feb/01/fm-tables-16th-fin-commission-report-states-to-get-rs-14-trillion-next-fiscal