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16th Finance Commission Submits Report for 2026-31

3 March 2026

SUBJECTS COVERED

ECONOMY POLITY

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WHY IN NEWS

The **16th Finance Commission**, chaired by former NITI Aayog Vice Chairman **Arvind Panagariya**, submitted its report to the President of India on March 3, 2026, covering the award period **2026-27 to 2030-31**. Key recommendations include maintaining 41% vertical devolution and introducing GDP contribution as a new criterion in the horizontal distribution formula.

16TH FINANCE COMMISSION REPORT (2026-31)

Constitutional Basis

The **Finance Commission** is established under **Article 280** of the Indian Constitution. The President constitutes it every five years (or earlier if needed) to recommend:

- Distribution of net tax proceeds between the Union and states (vertical devolution)
- Allocation among states of the states' share (horizontal distribution)
- Grants-in-aid to states under Article 275
- Any other matter referred by the President in the interest of sound finance

The **16th Finance Commission** was constituted in **December 2023** under the chairmanship of **Arvind Panagariya** — an economist and Columbia University professor who also served as the first Vice Chairman of NITI Aayog (January 2015 – August 2017) and India's G20 Sherpa during that period.

Vertical Devolution: 41% Maintained

The Commission recommended maintaining **41% of the Union's net tax revenue** as the states' aggregate share. This is identical to the 15th Finance Commission's recommendation.

Finance Commission	Devolution %
13th FC (2010-15)	32%
14th FC (2015-20)	42% (highest ever)
15th FC (2021-26)	41% (reduced by 1% for J&K/Ladakh UTs)
16th FC (2026-31)	**41%**

The 1% reduction from 14th to 15th FC reflected the creation of **Jammu & Kashmir and Ladakh as Union Territories** in 2019 — they now receive funds from the Union budget separately, not from the divisible pool.

Horizontal Distribution: New GDP Criterion

The horizontal formula determines how the 41% devolution is split among the 28 states. The 16th FC introduced **GDP contribution (10%)** as a new criterion — rewarding states that contribute more to national economic output. The full formula:

Criterion	Weight
Income Distance (from highest per-capita income state)	45%
Population (2011 Census)	15%
Area	15%
Forest and Ecology	10%
GDP Contribution *(new)*	**10%**
Tax Effort	2.5%
Demographic Performance	2.5%

Income Distance (45%) remains the dominant criterion — it compensates poorer states by giving higher weights to those with lower per-capita GSDP compared to the richest state (currently Goa or Telangana). This ensures redistribution from richer to poorer states.

GDP Contribution (10%) benefits larger, more productive economies like Maharashtra, Karnataka, Tamil Nadu, and Gujarat. Critics argue this dilutes the redistributive purpose of fiscal federalism.

Demographic Performance (2.5%) rewards states that achieved better fertility rate targets — this benefits southern states that achieved demographic transition earlier (Tamil Nadu, Kerala, Andhra Pradesh, Telangana, Karnataka).

Grants: ₹9.47 Lakh Crore

The Commission recommended **₹9.47 lakh crore** in grants over 2026-31:

- **Local body grants** (Panchayati Raj Institutions + Urban Local Bodies): largest component
- **Disaster Risk Management grants**: for State Disaster Response Funds (SDRF)
- **Sector-specific grants**: health, education, and performance-linked grants

What Finance Commissions Do NOT Cover

Finance Commissions recommend — the Union government is not legally bound to implement recommendations. However, Article 280 reports are almost always accepted (with minor modifications). Finance Commissions do **not** cover:

- CSS (Centrally Sponsored Schemes) — these flow through separate budget allocations
- Autonomous bodies' grants
- Borrowing limits (set under FRBM Act and Article 293)

UPSC Angle — GS-2: Finance Commission is a key constitutional body — contrast with NITI Aayog (non-constitutional). The 14th FC gave maximum ever devolution (42%) — this is frequently asked. Note: "net proceeds" = total tax collection minus collection costs minus IGST refunds. Cess and surcharge are NOT part of the divisible pool (this is a major grievance of states — and a popular Mains question).

UPSC RELEVANCE

Art. 280, Finance Commission composition, 41% devolution, 16th FC chairperson (Arvind Panagariya), horizontal formula criteria.

MAINS GS-2:

Fiscal federalism — Finance Commission vs Planning Commission vs NITI Aayog; cess/surcharge exclusion from divisible pool debate; redistributive vs growth-oriented criteria conflict.

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16TH FINANCE COMMISSION — CORE DATA:

Constitutional basis: **Article 280**

Chairman: **Arvind Panagariya** (Columbia University; ex-NITI Aayog VC 2015-17)

Constituted: **December 2023**

Report submitted: **March 3, 2026**

Award period: **2026-27 to 2030-31** (5 years)

Vertical devolution: **41%** of Union net tax revenue

Grants recommended: **₹9.47 lakh crore**

HORIZONTAL FORMULA (16TH FC):

Income Distance: **45%**

Population (2011): **15%**

Area: **15%**

Forest & Ecology: **10%**

GDP Contribution *(new)*: **10%**

Tax Effort: **2.5%**

Demographic Performance: **2.5%**

DEVOLUTION HISTORY:

13th FC (2010-15): 32% | 14th FC (2015-20): **42%** (highest) | 15th FC (2021-26): 41% | **16th FC (2026-31): 41%**

Why 15th FC reduced from 42% to 41%: J&K + Ladakh became UTs in 2019 → funded from Union budget, not divisible pool

KEY CONSTITUTIONAL ARTICLES:

Art. 280: Finance Commission establishment

Art. 275: Grants-in-aid (Finance Commission recommends)

Art. 293: Borrowing by states (prior sanction of Union if state has outstanding loans)

Art. 246: Union/State/Concurrent legislative lists (Seventh Schedule)

WHAT IS NOT IN DIVISIBLE POOL:

Cess (e.g., GST Compensation Cess, Education Cess, Health & Education Cess)

Surcharge on income tax

Only pure taxes go into divisible pool — states cannot share cess/surcharge proceeds

FINANCE COMMISSIONS VS NITI AAYOG:

FC: Constitutional (Art. 280), statutory five-year body; recommendations quasi-binding

NITI Aayog: Created by executive order (2015); no fund-transfer powers; only advisory

Planning Commission (abolished 2014): Was non-constitutional; had discretionary grants power

OTHER RELEVANT FACTS:

15th FC Chairman: **N.K. Singh** (former IAS, Revenue Secretary, Finance Secretary)

14th FC Chairman: **Y.V. Reddy** (former RBI Governor)

> "Demographic Performance" criterion rewards states with TFR ≤ replacement level (2.1) — benefits southern states
>
> States' grievance: Cess + surcharge as % of gross tax revenue has risen from ~3% (2000) to ~20% (2024) — shrinking effective devolution

Sources: Drishti IAS , PIB , PRS Legislative Research

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