

THE 16TH FINANCE COMMISSION RECOMMENDATIONS AND THEIR IMPACT ON THE SUSTAINABILITY OF KERALA'S DEVELOPMENT TRAJECTORY

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1. Introduction

The recommendations of the 16th Finance Commission, tabled in Parliament on 1 February 2026, regarding devolution of central taxes to the States are reflected in the Union Budget presented on the same day. The Finance Commission recommended the transfer of central tax revenue through three main channels, which will remain in effect for a five-year period, between 2026-27 to 2030-31. First, the divisible pool of tax revenues (excluding cesses, surcharges, taxes accruing to the Union Territories and the cost of collection) is to be shared between the Central and the States based on the recommendations of the Finance Commission. Second, the Finance Commission recommends specific grants to supplement the Consolidated Funds of the States. Third, the Centre provides discretionary grants to States, mainly through the Centrally Sponsored Schemes (CSS).

As usual, before finalising its report, the Commission conducted a series of discussions with States Government and other stakeholders regarding their demands and grievances. Kerala had raised the concern that the State did not receive the due share because of issues related to the criteria and the weight assigned to them by the previous Finance Commissions. Hence, Kerala discussed held discussions with experts and policy makers prior to presenting State's demands before the 16th Finance Commission. In this context, it is pertinent to examine the recommendations of Finance Commission and their impact on sustaining the development trajectory of Kerala.

The rest of the paper is organized as follows. The second section examines the criteria used by the 16th Finance Commission for the devolution of funds. The third section analyses the horizontal devolution of Funds under the 16th Finance Commission. The fourth section discusses the details of distribution of grants to local bodies. The fifth section examines effectiveness of Kerala's efforts in securing its due share from the 16th Finance Commission. The final section presents the concluding remarks.

2. Criterion and Weightage for Horizontal Devolution of Funds

The 16th Finance Commission made certain additions to and deletions from the criteria used by the 15th Commission and introduced certain changes in their weightages. Based on these modifications, the Commission adopted six criteria for the horizontal devolution of central taxes: population, demographic performance (fertility rate), area, forest, Per capita GSDP distance, and contribution to GDP. The criteria and their corresponding weightages in the 15th and the 16th Finance Commissions are provided in Table 1.

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Table 1. Criteria and their corresponding weightages for horizontal devolution (%) of central taxes among states

Sl No	Criterion	Weightage	
		15 th commission	16 th commission
1	Population (2011)	15.0	17.5
2.	Demographic performance (fertility rate)	12.5	10
3	Area	15.0	10
4	Forest	10.0	10
5	Per capita GSDP distance	45.0	42.5
6	Contribution to GDP	-	10
7	Tax and fiscal efforts	12.5	-

Source: Report of the 15th and 16th Finance Commission

Population as per the 2011 census has been used as one of the criteria for the devolution of funds. The weight assigned to population has been increased from 15 percent to 17.5 percent. Demographic performance (fertility rate) is second criteria used for the devolution of funds. The 16th FC has redefined this criterion to account for population growth between 1971 and 2011, instead of relying on change in Total Fertility Rate (TFR), which was introduced by the 15th commission to award States for controlling population growth. The weight assigned to demographic performance has been reduced by the 16th Commission from 12.5 percent to 10 percent. Areas is the third criterion used by the Commission for the devolution of funds, in which the share of a State's area in the total area of the twenty-eight States is taken as the basis for distribution. The weight assigned to area has been reduced form 15 percent to 10 percent.

Forest is another criterion used by the 16th Finance Commission for the devolution of funds, with an assigned weight of 10 percent, the same as in the 15th Commission. Per capita GSDP distance is the fifth criterion used by the 16th Finance Commission. It is defined as the difference between the per capita GSDP of a State and the average per capita GSDP of the top three large States with the highest per capita GSDP. Per capita GSDP of each State has been computed as the average for the period 2018-19 and 2023-24, excluding the pandemic year of 2020-21. The weight assigned to income distance has been reduced from 45 percent to 42.5 percent. Tax and fiscal efforts, which was used one of the criteria used by the 15th Commission, has been replaced by the contribution to national GDP. The weight assigned to contribution of GDP is 10 percent. (16th Finance Commission, 2026).

3. Horizontal Devolution of Funds under the 16th commission

The commission has allocated the shares of the twenty-eight States from the divisible pool on the basis of the above criteria and their respective weightages. Among the non- North Eastern States, eight fall under the high per capita GSDP category, seven under the middle per capita GSDP category and three under the low per capita GSDP category. Although population is one of the most important criteria used for the devolution of funds, several States do not appear to have received their due share in proportion to their population. In the report, the

Finance Commission examined the rationality of the devolution by comparing each State's share in devolution with its population share based on the 2011 Census. If a State's share in devolution coincides with its share in population, it implies that the State receives a per capita devolution equal to the per capita aggregate devolved amount. If the ratio is less than one, the State receives a smaller per capita devolution than the per capita aggregate devolved amount. If the ratio is more than one, the State receives a larger per capita devolution than per capita aggregate devolved amount (16 FC P 160). The ratio of share in devolution to share in population is given in Table 2.

It is observed from the table that the eight States in high per capita GSDP group accounted for 33.71 percent of the population in 2011, but have received only 24.71 percent of the share recommended by the 16th Finance Commission, which is only slightly higher than their share under the previous Commission (23.04 percent). The three States in the low per capita GSDP group together accounted for 28.29 percent of the population in 2011, but received 30.92 percent of the devolution under the 16th Finance Commission, which is lower than the 15th commission share (35.20 percent). The seven States in the middle per capita GSDP group accounted for 31.7 percent of the population in 2011 have received 34.43 percent of the share recommended by the 16th Finance Commission, which is slightly lower than their share in previous commission (35.20). The North-Eastern States (NES) jointly received significantly higher share of the devolution (10.5 percent) compared to their population share (5.28) under the 15 Finance Commission, but received a slightly lower share from 16th finance commission, (9.945 percent). The 16th Finance Commission acknowledge this fact and stated that 'among the eight high per capita-GSDP Non-NEH States, Goa was the only one to receive a larger share in devolution than its share in population under all five FCs' (16th FC, P.160).

Among the eight high per capita-GSDP non-NE States, Goa was the only state to receive a larger share in devolution than its share in population under all the Finance Commission (FCs) considered in this study. In per capita terms, it received more than three times the overall devolution under the FC-14 and FC-15. On the other hand, Telangana, Karnataka and Kerala recorded a sharp decline in their relative per capita devolutions under the FC-15 compared to the FC-14. The relative per capita shares of Haryana remained unchanged, Tamil Nadu showed a marginal change, while those of Gujarat and Maharashtra recorded a modest rise (16 FC P 160). Further analysis indicates that, except for Goa, all States in the high per capita GSDP group received a slightly better devolution share from 16th Finance Commission. The relative per capita share of Kerala increased from 0.69 under the 15th Commission to 0.85 under the 16th Finance Commission. Among the middle per capita GSDP states, Andhra Pradesh and Punjab have improved their relative per capita share compared to previous Commission. Similarly, among the low per capita GSDP states, Jharkhand showed an improvement in its relative per capita share under the 16th finance Commission.

Table 2. Ratio of share in devolution to share in population

State	Pop share	FC share			Share in devolution to share in population		
	2011	FC14	FC 15	FC 16	FC14	FC 15	FC 16
High per capita GSDP							
Goa	0.12	0.38	0.39	0.365	3.17	3.25	3.04
Telangana	2.94	2.44	2.1	2.174	0.83	0.71	0.74
Karnataka	5.13	4.71	3.65	4.131	0.92	0.71	0.81
Haryana	2.13	1.08	1.09	1.361	0.51	0.51	0.64
Tamil Nadu	6.06	4.02	4.08	4.097	0.66	0.67	0.68
Gujarat	5.08	3.08	3.48	3.755	0.61	0.69	0.74
Maharashtra	9.44	5.52	6.32	6.441	0.58	0.67	0.68
Kerala	2.81	2.5	1.93	2.382	0.89	0.69	0.85
Sub total	33.71	23.73	23.04	24.71	0.70	0.68	0.73
Middle per capita GSDP							
Andhra Pradesh	4.16	4.31	4.05	4.217	1.04	0.97	1.01
Punjab	2.33	1.58	1.81	1.996	0.68	0.78	0.86
Rajasthan	5.76	5.5	6.03	5.926	0.95	1.05	1.03
Odisha	3.53	4.64	4.53	4.42	1.31	1.28	1.25
West Bengal	7.67	7.32	7.52	7.215	0.95	0.98	0.94
Chhattisgarh	2.15	3.08	3.41	3.304	1.43	1.59	1.54
Madhya Pradesh	6.1	7.55	7.85	7.347	1.24	1.29	1.20
Sub total	31.7	33.98	35.2	34.43	1.07	1.11	1.09
Low per capita GSDP							
Jharkhand	2.77	3.14	3.31	3.357	1.13	1.19	1.21
Uttar Pradesh	16.78	17.96	17.94	17.62	1.07	1.07	1.05
Bihar	8.74	9.67	10.06	9.948	1.11	1.15	1.14
Sub total	28.29	30.77	31.31	30.92	1.09	1.11	1.09
Jammu Kashmir	1.05	1.55	1.85	0	1.48	1.76	0.00
Total(Non -NES)	94.75	90.33	89.55	90.05	0.95	0.95	0.95
North Eastern States							
Arunachal Pradesh	0.12	1.37	1.76	1.354	11.42	14.67	11.28
Assam	2.62	3.31	3.13	3.258	1.26	1.19	1.24
Himachal Pradesh	0.58	0.71	0.83	0.914	1.22	1.43	1.58
Manipur	0.24	0.62	0.72	0.626	2.58	3.00	2.61
Meghalaya	0.25	0.64	0.77	0.631	2.56	3.08	2.52
Mizoram	0.09	0.46	0.5	0.564	5.11	5.56	6.27
Nagaland	0.17	0.5	0.57	0.481	2.94	3.35	2.83
Sikkim	0.05	0.37	0.39	0.335	7.40	7.80	6.70
Tripura	0.31	0.64	0.71	0.641	2.06	2.29	2.07
Uttarakhand	0.85	1.05	1.12	1.141	1.24	1.32	1.34
Total (NES)	5.28	9.67	10.5	9.945	1.83	1.99	1.88
Total	100	100	100	100			

Source: Report of the 16th Finance Commission, Table 8.5, Table 8.6, Table 8.9

4. Grants-in-aid

Grants in aid constitute the second channel through which the central tax revenues are distributed among the States based on the recommendations of the Financial Commission. The 16th Financial Commission has recommended grants-in-aid amounting to Rs 9.95 lakh crore to local bodies for the five-year period, 2026-31. These grants mainly consists mainly of (i) grants for urban and rural local bodies, and (ii) grants for disaster management. The 16th FC has discontinued the revenue deficit grants, (ii) sector-specific grants, and (iii) state-specific grants recommended by the 15th FC. The details of the distribution of grants -in –aid recommended by the 16th Finance Commission under different categories are given in Table 3.

Table 3: Grants-in-aid for 2026-31 (Rs crore)

Sl no	Grants	Amount Rs. crore
1	Local governments	
1.1	Rural local bodies	4,35,236
	Basic Grant	3,48,188
	Performance Grant	87,048
1.2	Urban local bodies	356257
	Basic Grant	2,32,125
	Performance Grant	58,032
	Special Infrastructure Component	56100
	Urbanization premium	10000
	Sub total	7,91,493
2	Disaster Grants	2, 04,401
	Total	9, 95,804

Source: Report of the 16th Finance Commission, P. 214 and P.245.

Out of the total grants, Rs 4.35 lakh crore has been recommended for rural local bodies, and Rs 3.56 lakh crore for urban local bodies. Out of this Rs.356257 crore Rs. 56100 has been recommended for Special Infrastructure Component and Rs. 10000 has been recommended for Urbanization premium. A total amount of ₹2, 04,401 crore has been allocated to the State Disaster Relief Fund (SDRF) and State Disaster Management Fund (SDMF) for the period 2026-27 to 2030-31, with specific norms for the cost-sharing pattern between the Centre and States. State-wise distribution of grants-in-aid for the period 2026-31 are given in Table 4.

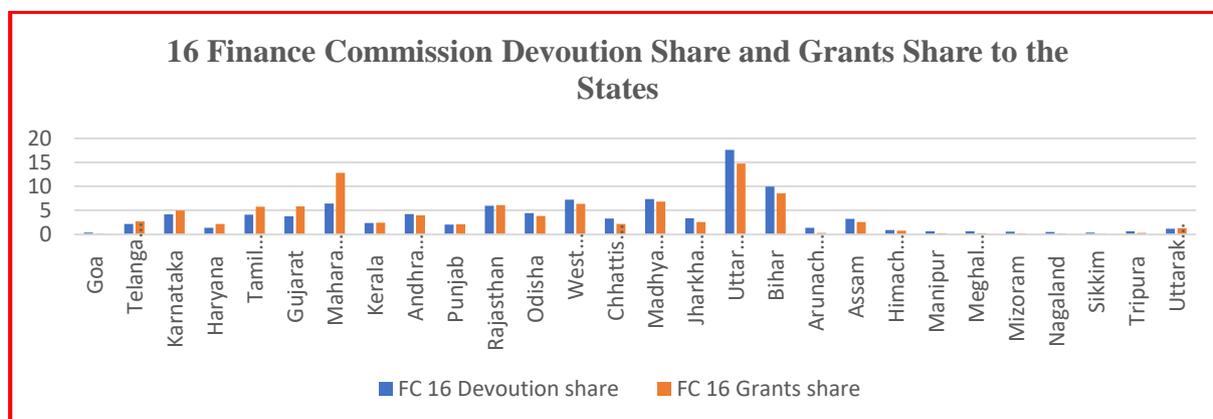


Figure 1 Devolution share and grant share of the states

A comparison of the devolution share and the grant share is presented in figure 1. It is observed that the grant shares of some States with high devolution shares are also relatively high, as is evident from Table 4. Maharashtra, Rajasthan, Madhya Pradesh, Uttar Pradesh and Bihar are among the states that have received a significantly large amount of grants. However, several high per-capita SDGP States have received a lower grant share than their population share. Telangana, Karnataka, Tamilnada, and Kerala are examples of states in this category. Further details on the relationship between population share, devolution share and grant share are provided in Table 5.

Table 4: State-wise details of grants-in-aid for 2026-31 (in Rs crore)

States	Rural Local Body Grants	Urban Local Body Grants	Disaster Grants	Total Grants	Grants share %
Andhra P.	16,627	12,158	684	36,951	3.97
ArunachalP.	1,698	233	5,825	2,615	0.28
Assam	14,580	3,249	18,153	23,654	2.54
Bihar	51,923	9,169	3,308	79,245	8.52
Chhattisgarh	11,664	4,990	149	19,962	2.15
Goa	174	726	11,278	1,049	0.11
Gujarat	18,802	23,764	3,896	53,844	5.9
Haryana	8,270	7,834	2,980	20,000	2.15
Himachal P.	3,744	435	3,741	7,159	0.77
Jharkhand	14,231	6,093	8,559	24,065	2.59
Karnataka	18,889	18,483	2,580	45,931	4.94
Kerala	3,308	16,683	15,596	22,571	2.43
Madhya P.	32,033	16,016	39,492	63,645	6.85
Maharashtra	32,817	46,803	288	1,19,112	12.81
Manipur	1,262	609	485	2,159	0.23
Meghalaya	1,479	377	315	2,341	0.25
Mizoram	567	377	453	1,259	0.14
Nagaland	697	667	11,866	1,817	0.20
Odisha	18,715	5,078	3,303	35,659	3.84
Punjab	8,486	7,834	12,281	19,623	2.11
Rajasthan	31,467	12,680	505	56,428	6.07
Sikkim	218	203	11,314	926	0.10
Tamil Nadu	16,930	25,069	3,699	53,313	5.73
Telangana	9,968	11,548	395	25,215	2.71
Tripura	1,176	1,016	20,428	2,587	0.28
Uttar Pradesh	83,261	33,543	5,504	1,37,232	14.76
Uttarakhand	4,047	2,497	9,158	12,048	1.30
West Bengal	28,203	22,023	2,04,401	59,384	6.39
Total	4,35,236	2,90,157	2,04,401	9,29,794	100

Source: Report of the 16th Finance Commission, Table 10.6, Table 10.7, Table 11.2

Table 5 Share in devolution and Grants to share in population share from 16th FC .

States	Pop share	Share in		Share in devolution to share in population	Share in grant to share in population
	2011	Devolution	Grants		
Goa	0.12	0.365	0.11	3.04	0.94
Telangana	2.94	2.174	2.71	0.74	0.92
Karnataka	5.13	4.131	4.94	0.81	0.96
Haryana	2.13	1.361	2.15	0.64	1.01
Tamil Nadu	6.06	4.097	5.73	0.68	0.95
Gujarat	5.08	3.755	5.79	0.74	1.14
Maharashtra	9.44	6.441	12.81	0.68	1.36
Kerala	2.81	2.382	2.43	0.85	0.86
Sub total	33.71	24.706	36.68	0.73	1.09
Middle per capita GSDP					
Andhra Pradesh	4.16	4.217	3.97	1.01	0.96
Punjab	2.33	1.996	2.11	0.86	0.91
Rajasthan	5.76	5.926	6.07	1.03	1.05
Odisha	3.53	4.42	3.84	1.25	1.09
West Bengal	7.67	7.215	6.39	0.94	0.83
Chhattisgarh	2.15	3.304	2.15	1.54	1.00
Madhya Pradesh	6.1	7.347	6.85	1.20	1.12
Sub total	31.7	34.425	31.37	1.09	0.99
Low per capita GSDP					
Jharkhand	0.12	3.357	2.59	27.98	21.57
Uttar Pradesh	16.78	17.619	14.76	1.05	0.88
Bihar	8.74	9.948	8.52	1.14	0.98
Sub total	28.29	30.924	25.87	1.09	0.91
Total(Non -NES)	93.7	90.05	93.92		
North Eastern States					
Arunachal Pradesh	0.12	1.354	0.28	11.28	2.34
Assam	2.62	3.258	2.54	1.24	0.97
Himachal Pradesh	0.58	0.914	0.77	1.58	1.33
Manipur	0.24	0.626	0.23	2.61	0.97
Meghalaya	0.25	0.631	0.25	2.52	1.01
Mizoram	0.09	0.564	0.14	6.27	1.50
Nagaland	0.17	0.481	0.20	2.83	1.15
Sikkim	0.05	0.335	0.10	6.70	1.99
Tripura	0.31	0.641	0.28	2.07	0.90
Uttarakhand	0.85	1.141	1.30	1.34	1.52
Total (NES)	5.28	9.945	6.08	1.88	1.15
Total	100	100	100		

Source: Report of the 16th Finance Commission

The devolution share, grant share, and population share based on 2011 Census, along with ratios of share in devolution to share in population and share in grants to share in population, are provided in Table 5. Further, the table provides information on non-North-Eastern States and the North-Eastern States, along with the sub-categories of non-North-Eastern states (high per capita GSDP, Middle per capita GSDP and low Per capita GSDP).

Overall, the high per capita GSDP group received 36.68 per cent of the total grants, compared to its 24.706 percent devolution share. Within this group, Maharashtra and Gujarat are seen to have received a higher share relative to their devolution share. Kerala, which belongs to this group, however, received only a marginal increase in its grant share compared to its devolution share. Further, the relative per capita devolution share and grant share of Kerala are almost equal, at 0.85 and 0.86 respectively. The total grant share of the middle and lower per-capita GSDP group is lower than their corresponding devolution share.

5. Kerala's Attempt to secure better share from the Commission

Kerala is one of the seven high per capita GSDP States that received a lower per capita devolution than the per capita amount devolved in aggregate under the 14th and 15th Finance Commission. It is argued that the use of the 2011 population as one of the criteria for determining the share of the States in the divisible pool tends to favour the States with larger population growth, while disadvantaging States like Kerala that have successfully implemented family planning measures. It is also contended that Kerala's relatively lower devolution share is a consequence of its higher level of development, particularly in terms of population control and improvements in health, education, and life expectancy. Recognizing these limitations, Kerala held a series of series discussions among experts and policy makers to identify an alternative approach to present before the 16th Finance Commission so as to secure a better devolution and grant share devolution and grants.

Kerala has specialised more in human capital formation than in the production of tradable or saleable commodities. More than 2.2 million Keralites migrated to 183 countries around the world, contributing significantly to the country's foreign exchange reserves. Total remittance from Malayalees in 2023 are estimated Rs 2.16 lakh crore , the highest for any State in the country (GIFT 2025). Unfortunately, this is not criterion for the devolution for the central revenue and hence Kerala is not rewarded for this contribution.

The use of the 2011 population as one of the criteria for determining the share of the States in the divisible pool is a disadvantaging to the like Kerala, which have successfully implemented family planning measures. At the same time, Kerala faces another challenge in the form of a raising proportion of elderly population, an issue that was not adequately taken into account by the previous Finance Commissions. It is therefore argued the earlier advantage of slower population growth has now been replaced by concerns associated with an ageing population, as observed in the experience of Europe, Japan and China. Hence, Kerala decided

to present this issue before the 16th Finance Commission for consideration. Kerala proposed the inclusion of a need-based component linked to the elderly population, suggesting that demographic performance should be evaluated on the basis of the share of elderly population or share of old - age dependency ratio either as a compensatory factor or as a performance criterion.

In addition, Kerala demanded the continuation of the post-devolution revenue deficit grant, arguing that such support is necessary due to its high expenditure on social sectors such as health and education. Citing increased vulnerability to climate-related disasters, the state has sought higher allocation to the state Disaster Response Fund (SDRF).

Concluding Remarks

The recommendations of the 16th Finance Commission, tabled in Parliament on 1 February 2026, relate to the devolution of central taxes to the States. The Commission has introduced certain changes in the criteria and weight assigned to them, which will remain in effect for a five-year period from 2026-27 to 2030-31. However, there is no change in the existing 41 percent share of the divisible pool of central taxes allocated to the States. As in the case of the previous two Commissions, the 16th Commission has used the 2011 Census population as one of the criteria for the horizontal devolution of funds among the States. In addition, the Commission has recommended the provision of specific grants to supplement the Consolidated Funds of the States.

Kerala derived a certain advantages from the 16th Finance Commission through the revision of the weightages assigned to some of the criteria and the introduction of a new criterion in the devolution formula. The increase in weight assigned to population from 15 percent to 17.5 percent has been beneficial to Kerala. Similarly, the reduction in the weight assigned to demographic performance from 12.5 percentage to 10 percent also worked in favour of the State. The weight given to the area of the State has been reduced from 15 percent under the 15th Finance Commission to 10 percent under the 16th Finance Commission. The weight assigned to income distance has also been reduced from 45 percent in the 15th Finance Commission to 42.5 percent in the 16th Finance Commission.

Further, the introduction of Gross Domestic Product (GDP) contribution as a new criterion by the 16th Finance Commission has significantly helped to increase the State's share in central tax devolution. As a result of these changes, Kerala's share has risen from 1.93 percent under the 15th Finance Commission to 2.382 percent under the 16th Finance Commission. Overall, Kerala's position has improved significantly. However, the State received a smaller amount per capita devolution and grant than the per capita aggregate devolved amount. This constraints sustaining state's current development trajectory.

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