



One-Day Conference

on

16th Finance Commission Report

25 February, 2026

Policy Recommendations

Organised by

Finance Department, Govt. of Telangana

In collaboration with

Centre for Economic and Social Studies (CESS), Hyderabad



POLICY RECOMMENDATIONS

Event: One-day Conference on the Deliberations of the 16th Finance Commission Report

Organisers: Centre for Economic and Social Studies (CESS), and Finance Department, Government of Telangana

Venue: Taj Deccan, Hyderabad

Date: 25th February 2026

INAUGURAL SESSION

1. Fiscal Discipline

- *Address Off-Budget Borrowings:* All off-budget borrowings where the state services the debt and principal must be included within the overall public debt of the state. The Finance Commission recommends cutting down on these practices, avoiding fresh off-budget borrowings, and ensuring existing ones are retired over time.
- *Enforce Fiscal Deficit Limits:* The 3% fiscal deficit limit for states should be maintained and accepted as a standard for fiscal consolidation.
- *Targeted Subsidies:* States should re-evaluate universal DBT schemes that lack discrimination for eligibility, as the increasing burden of these subsidies' crowds out public investment and capital expenditure.

2. Federal Institutional Reforms

- *Cess and Surcharge 'Grand Bargain':* To prevent the stagnation of funds flowing to states, a grand bargain should be struck where cesses and surcharges are included in the divisible pool, even if it results in a slight reduction in the overall devolution percentage.
- *Institutional Fit for Purpose:* The Finance Commission needs to be re-evaluated to determine if its current institutional design—conceived in a different political and economic era—is still fit for the purpose of modern fiscal management.
- *Reduction of the Concurrent List:* The Concurrent List should be reduced. Specifically, items like education should be returned to the state list, allowing the Union to incentivize states through programs rather than direct intervention.
- *Re-bundling of Large States:* India should consider a framework where large states are automatically re-bundled into smaller ones to prevent the excessive concentration of power at the national level.
- *Repairing Federal Cleavages:* There is an urgent need to repair the deepening cleavage between the Centre and the states to facilitate second-generation structural reforms in land, labour, and taxation.

3. Delimitation

- *Mixed Criteria for Delimitation:* Instead of a simplistic application of population growth, the current number of seats should be frozen based on existing criteria, while additional seats should be distributed using mixed criteria where population growth is only one of several factors.

4. Local Governance and Revenue

- *Empower Local Taxation:* States must empower urban local bodies to tax property based on reasonable market values to fund essential city infrastructure.
- *Direct Local Devolution:* Chief Ministers should exercise their constitutional power to devolve resources directly to the third tier of government (panchayats and local bodies) without waiting for central government.
- *Agricultural Income Tax:* States should consider taxing modest but diversified agricultural holdings that generate high returns, as this revenue would accrue 100% to the states.

5. State-Level Research and Development

- *Institutional Support for States:* States should commission their own research institutions to analyse specific development constraints rather than relying on national-level economic surveys that may not capture state-specific realities.
- *Global Benchmarking:* State and local governance should be benchmarked against other Asian and Latin American countries (like Indonesia or Malaysia) to understand how far India is currently out of the mainstream in terms of urban standards.

TECHNICAL SESSION - I

1. Federal Institutional Reforms

- *Coordinate Constitutional Bodies:* There is a critical need for formal coordination and consultation between the Finance Commission and the GST Council, as the latter now determines the tax rates that form the divisible pool the Commission devolves.
- *Revise the Concurrent List:* Subjects moved from the State List to the Concurrent List during the 42nd Amendment of 1976, such as education, should be reviewed and potentially returned to the states.

2. Devolution Criteria

- *Reform Cesses and Surcharges:* The Union should address the shrinking divisible pool by capping cesses and surcharges or including them in the shared revenue pool. These levies should be time-bound, exceptional, and withdrawn once their intended purpose is served.
- *Update Devolution Criteria for GST:* Devolution formulas must be updated to reflect the shift from an origin-based to a destination-based tax regime, accounting for how consumer and producer states are impacted differently under GST.

3. Fiscal Management

- *Tailored Borrowing Limits:* Borrowing arrangements should move away from uniform limits; instead, faster-growing states or those with lower debt-to-GDP ratios should be permitted a larger fiscal base.
- *Shift to GSVA:* Economic measurement should move from GSDP to Gross State Value Added (GSVA) to remove distortions caused by varying taxes and subsidies.
- *Modernise 'Capital Investment' Definitions:* The definition of capital expenditure must be updated to include intangible assets like technology and AI development, rather than focusing solely on physical infrastructure.
- *Data Transparency:* The Union must share GST data with researchers and states to enable sensible analysis of the tax regime's impact.
- *Utilise High-Frequency Data:* Economic analysis should move away from '18th-century concepts' and utilise daily transaction data and high-frequency indicators constructing development indicators.

4. Sectoral, Demographic, and Environmental Policies

- *Update Demographic Indicators:* Future distribution formulas should utilise population ageing indicators (such as the old-age dependency ratio) instead of just fertility rates to address the fiscal challenges of states like Kerala and Tamil Nadu.
- *Account for Internal Migration:* Finance Commission reports should explicitly address the fiscal implications of internal migration, which is currently an overlooked issue.
- *Social Sector Funding:* Vertical distribution must be strengthened to help states meet national policy targets for health and education.
- *Reform Centrally Sponsored Schemes (CSS):* The current method of CSS in areas that are state subjects erodes the states untied fiscal space.
- *Environmental Performance Incentives:* Devolution criteria should include performance-based incentives for improving air quality and consider the opportunity costs for states conserving non-forest resources like wetlands.

TECHNICAL SESSION - II

1. Grants-in-Aid

- *Conduct State-Specific Structural Analysis:* The Finance Commission should carry out a rigorous, individual analytical exercise for each state to assess their specific 'need of assistance' as mandated by Article 275 of the Constitution. This is particularly critical for structurally deficit states (such as North-eastern and hill states) that lack the inherent capacity to meet administrative costs without central transfers.
- *Re-evaluate the Abolition of Revenue Deficit Grants:* While some argue that removing these grants incentivizes states to 'get their houses in order' and improve tax efficiency, others warn that a 'broad-brush' removal without a mechanism to address structural gaps could lead to significant fiscal stress for states with unique economic.
- *Define and Rationalise 'Subsidies':* There is an urgent need for a uniform, country-wide definition and classification of subsidies to ensure that data is comparable across states. States should focus on distinguishing between wasteful expenditure and necessary human capital spending (like health and education).

2. Urban Local Bodies Reform

- *Strengthen State Finance Commissions (SFCs):* To move away from ad-hoc grants, SFCs must be strengthened to accurately estimate the gap between local revenues and the funds required to meet basic service level standards.
- *Refine Distribution Criteria for Local Bodies:* The Commission should move away from using population (90% weight) as the primary distribution metric for local body grants, as it unfairly benefits larger, wealthier corporations over smaller, poorer municipalities and town panchayats that require more 'hand-holding'.
- *Increase Transparency in Local Transfers:* States should adopt or reinstate the practice of publishing a 'supplement document' alongside their budgets that clearly highlights all funds transferred to local bodies to ensure recommendations are actually implemented.
- *Adapt Conditionalities to Local Needs:* Grant conditionalities (such as earmarking 50% for water and sanitation) should be flexible enough to reflect local realities; for instance, money should not be tied to services that a local body has already achieved at a 100% level.

3. Institutional and Sectoral Recommendations

- *Eliminate Discretionary Grants:* It is recommended to do away with state-specific and sector-specific grants to remove discretionary powers and ensure that all transfers are strictly formula-based and transparent.
- *Incentivise Ecological Outcomes:* Policy should reinstate or strengthen performance-based grants for air quality and climate change mitigation.
- *Address Unsustainable Salaries:* States should look internally at their own Pay Revision Commissions (PRCs) to address unsustainable salary and pension levels that are crowding out other developmental expenditures.

4. Concerns on the 16th Finance Commission Approach

- *Acknowledge Demographic Shifts:* The redistribution of grants should continue to account for rapid urbanisation (projected at 40% by 2026), but must ensure the 60:40 (rural : urban) ratio does not leave rural areas, where poverty is often more concentrated.
- *Address 'Double-Barrel' Hits:* Policy-makers must find solutions for North-eastern states that are facing a simultaneous cut in tax devolution and the removal of revenue deficit grants, which could leave them unable to manage basic services.

TECHNICAL SESSION - III

1. Federal Architecture and Statutory Transfers

- *Focus on Total Statutory Transfers:* The federal dialogue should move beyond simple tax devolution to focus on total statutory transfers, including both devolution and grants, as these funds are fungible within state budgets.
- *Establish a Minimal Guarantee Devolution:* To protect state budgets from volatility caused by central revenue shortfalls, a guaranteed minimal devolution or corpus should be established to ensure fiscal stability.
- *Lateral Federalism:* States should move toward a new federal compact that prioritizes ‘lateral federalism,’ where states cooperate horizontally to share best practices and create coalition combinations.
- *Expand into Regulatory and Monetary Federalism:* States should be given a formal role in regulatory and monetary policy discussions, as they often suffer the consequences of these central-level decisions without having an avenue for input.
- *Update Devolution for Destination-Based Taxation:* Taxation criteria must be updated to reflect the shift to a destination-based regime (GST), which fundamentally changes how consumer and producer states generate revenue.

2. Fiscal Measurement

- *The Golden Rule:* States should adopt a Golden Rule to completely eliminate revenue deficits, moving toward a roadmap where borrowed resources are used only for creating durable, wealth-creating assets rather than funding revenue expenditure.
- *Adopt Uniform GSDP Standards:* States should implement the Dholakia Committee recommendations to ensure uniformity in the estimation of GSDP and GDP across the country.
- *Utilize Market-Led Borrowing Spreads:* Rather than rigid central monitoring, the market should determine the interest rate spreads based on the actual fiscal performance of individual states.
- *Monitor Public Sector Balance Sheets:* Fiscal stress should be assessed by looking at public sector balance sheets—including power and water utilities and transport corporations—rather than relying solely on government budgets.
- *Measure Stock and Risk Accumulation:* In public sector enterprises, measurement efforts should be as rigorous in tracking accumulated risk and assets (stock) as they are in tracking the flow of funds.

- *Address Innovative Financial Engineering:* There is an urgent need to address the innovative use of off-budget liabilities and the securitization of future revenues through corporations, which often bypasses Article 293 and CAG oversight.
- *Eliminate Revenue Deficits for Stability:* States should aim to bring revenue deficits to zero to ensure macro stability, as capital expenditure drives long-term GDP growth and revenue generation more effectively than revenue-deficit expansion.

3. Expenditure Efficiency

- *Rationalise State Schemes:* States should rationalize and consolidate their numerous existing schemes to free up resources for developmental needs.
- *Shift to Outcome Efficiency:* Evaluation metrics should shift from production efficiency to expenditure and outcome efficiency.
- *Techno-economic Analysis:* High-value capital expenditure projects should undergo rigorous techno-economic and cost-benefit analysis to prevent the inefficient use of resources.
- *Link Borrowing to Measurable Reforms:* Additional borrowing space granted to states should be explicitly linked to the implementation of measurable reforms in stressed sectors.
- *Strengthen Procurement Integrity:* Rigorous techno-economic analysis and safeguards for the integrity of the procurement process must be established for all major capital expenditures.
- *Expand KLEMS Data:* The KLEMS database should be expanded beyond the current 15 states to better assess capital output and productivity at the sub-national level.

4. Emerging Obligations

- *Restructure the Power Sector:* Policy should move toward a fundamental restructuring of the power sector to address structural failures and the subsidy trap, rather than relying on simplistic privatization.
- *Strategic Disinvestment:* States should focus on disinvesting non-performing or structurally challenged enterprises rather than selling off profitable state-owned assets.
- *Incorporate Modern Challenges:* The fiscal architecture must be updated to include considerations for demographic transitions (migration), technological transformations (AI), and climate change mitigation.

- *Implement Utility Deficit Ratios:* States should consider mandating revenue-to-fiscal deficit ratios for utilities (like power and water) to ensure they operate with the same fiscal discipline expected of the state government.

FIRESIDE CHAT

1. Institutional Reform and Federal Dialogue

- *Restructuring the Finance Commission:* There is merit in appointing an eminent politician as the Chairman of the Finance Commission—specifically one who no longer holds political ambitions—provided they are economic savvy and are supported by a panel of economists.
- *Closed-Door Executive Meetings:* To move policy forward effectively, a forum should be established where the Prime Minister and Chief Ministers meet privately, away from media presence, to hold business-like discussions on a limited, specific national agenda.
- *State-Initiated National Dialogue:* Rather than waiting for centre, Chief Ministers should proactively write to the Prime Minister to convene NITI Aayog meetings and submit their own technical papers for national discussion.

2. State Structure and Governance

- *Fragmentation of Large States:* To improve governance and the quality of urban infrastructure, India should consider breaking up large states into smaller units. This is particularly vital for urban development, as the creation of new states often provides a necessary catalyst for effective land acquisition and the building of new capitals.
- *Leading on Regulatory Ease:* To attract investment, states should compete to become leaders in the reduction of unnecessary compliance burdens.

3. Economic Reforms

- *Privatisation of Power Distribution:* There is a strong recommendation for the privatisation of power distribution companies (DISCOMs) to reach a state of development (Viksit) in utility services, as evidenced by improvements in cities like Delhi.
- *Agricultural Trade and Land Use:* India should move toward a more transparent system for the conversion of agricultural land to non-agricultural use, which would benefit farmers. Additionally, the country should embrace agricultural exports more aggressively, as the capacity of Indian farmers to meet global demand is often underestimated.
- *Unified Pay and Pension Oversight:* To prevent future fiscal instability, Pay Commissions should be explicitly instructed to account for pension liabilities before making recommendations on salary increases. This ensures that current pay raises do not create unfunded burdens for future generations.

4. Fiscal Discipline

- *National Consensus on Freebies*: The central government should take an apolitical initiative to form a consensus among all states to limit competitive populism (or Revdi culture). This effort should be modelled after the successful collective agreements reached for the FRBM Act and the GST regime.
- *Market-Led Fiscal Discipline*: To ensure fiscal realism, the market should be allowed to lead the interest rate spreads based on the actual fiscal performance of individual states, rather than relying solely on central monitoring.





Centre for Economic and Social Studies (CESS), Hyderabad

The Centre for Economic and Social Studies (CESS) was established as an autonomous research Centre in 1980. The Indian Council of Social Science Research (ICSSR, Ministry of Education, Government of India) recognized it as a national institute in the year 1986 and included the Centre in its network of institutions. Conducting inter disciplinary research in analytical and applied areas of social sciences, encompassing socio-economic and other aspects of development, constitute the predominant activities of the Centre. Its sphere of research activity has expanded beyond the state of Telangana covering other areas of the country as well.

The Centre has been registered under Section 6(1) (a) of the Foreign Contribution (Regulation) Act 1976 which enables the Centre to accept contributions from the external agencies for carrying out research work. The CESS has also been approved by the Department of Scientific and Industrial Research, Ministry of Science and Technology and the Director General of Income Tax (Exemptions), Calcutta under the rule 6 of the Income Tax Rules Section 35(1) (iii) of the Income Tax Act 1961.

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