

Finance Commissions and their Distribution Criteria: Strengthening Fiscal Federalism in India

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ABSTRACT

This paper analyses the evolving role of the Finance Commission of India in strengthening fiscal federalism through its changing distribution criteria and institutional reforms. Drawing upon Finance Commission reports from the Tenth to the Fifteenth cycles, the study evaluates the transition from compensatory, population-based formulas to evidence-driven, performance-oriented frameworks incorporating income distance, ecological sustainability, and demographic indicators. Using a thematic content analysis of multiple commissions, supported by secondary data on tax devolution and fiscal capacity disparities, the paper highlights how constitutional mandates, intergovernmental bargaining, and political economy considerations have shaped resource-sharing mechanisms over time. The analysis identifies persistent challenges vertical and horizontal imbalances, debates over population norms, GST-induced revenue vulnerabilities, and conditional grants—and argues for a multidimensional, equity-sustainability-governance framework for future Finance Commissions. The paper proposes integrating emerging determinants such as climate resilience, human development, digital governance capacity, and gender equity to deepen inclusivity and enhance fiscal accountability. The findings underscore that the Finance Commission's evolution represents not only technical change but also a shift toward cooperative and participatory intergovernmental fiscal relations, integral to India's long-term developmental transformation.

Keywords: Finance Commission distribution criteria, Tax devolution, Vertical & horizontal imbalances, Grants and transfers

JEL Classification Code: H77, H71, H73, H72

I. Introduction

Fiscal federalism represents a central pillar of India's constitutional design, structuring the allocation of responsibilities, expenditures, and revenue-raising authority between the Union and the States. As a large, heterogeneous democratic federation, India requires institutional mechanisms to mediate intergovernmental fiscal imbalances while ensuring transparency, equity, efficiency, and regional development. Among India's fiscal institutions, the Finance Commission set up under Article 280 holds a distinctive role as the primary authority that recommends vertical and horizontal devolution, grants-in-aid, and the principles for distributing central resources across States.

Since its inception in 1951, the Finance Commission has undergone significant transformation, reflecting shifts in economic conditions, demographic dynamics, governance models, and the broader political economy (Stockhammer & Ramskogler, 2009). The early Commissions focused on compensatory transfers aimed at correcting fiscal imbalances and ensuring minimum service delivery across States. Over time, however, as economic liberalisation, decentralisation reforms, and sustainability imperatives gained prominence, the Commission incorporated more nuanced parameters such as income distance, fiscal discipline, forest cover, demographic performance, and ecological sustainability signaling the move toward a more evidence-based and performance-driven devolution framework (Chakraborty, Gupta, & Singh, 2018).

Despite these advances, the Indian fiscal landscape continues to face structural challenges. Vertical fiscal imbalances remain high, exacerbated by the Centre's revenue dominance and State-level expenditure commitments. Horizontal disparities persist due to unequal economic capacities, demographic pressures, and uneven human development achievements. The introduction of GST has reshaped Centre-State fiscal dynamics but also generated fresh tensions around compensation, tax buoyancy, and collaborative decision-making in the GST Council. These evolving dynamics necessitate a systematic re-examination of the Finance Commission's criteria to ensure that fiscal devolution aligns with growth, sustainability, inclusiveness, and cooperative federalism.

This study undertakes such a re-examination by critically assessing the evolution of distribution criteria of successive Finance Commissions, analysing their rationale, implications, and limitations, and proposing forward-looking reforms grounded in principles of equity, efficiency, and sustainable development.

II. Literature Review

This section reviews key national and international studies that help explain the evolution of fiscal federalism and the role of the Finance Commission. The literature highlights how Centre–

State financial relations have changed over time and identifies the emerging trends shaping the Finance Commission's distribution criteria.

Theoretical Foundations of Fiscal Federalism

The conceptual roots of fiscal federalism lie in the classical frameworks developed by Musgrave (1959) and Oates (1972). Musgrave's functional theory identifies three core roles of the public sector allocation, redistribution, and stabilization. According to this framework, the Union government is better positioned to manage redistribution and macroeconomic stabilization, whereas subnational governments are relatively more efficient in providing local public goods due to their proximity to citizens' preferences.

Oates' Decentralization Theorem further clarifies that decentralized provision of public goods enhances allocative efficiency when preferences are heterogeneous across regions (Oates, 1972). Later contributions emphasized the importance of intergovernmental fiscal transfers to correct both vertical and horizontal imbalances (Bird & Smart, 2002). These transfers, when guided by transparent and rule-based criteria, can improve fiscal accountability, promote efficient resource allocation, and strengthen cooperative federalism (Boadway & Shah, 2009). Collectively, the theoretical literature underscores the need for institutional mechanisms—like Finance Commissions that balance equity and efficiency while accommodating regional diversity.

International Perspectives on Fiscal Transfers

Globally, intergovernmental fiscal transfers are used to address fiscal disparities, ensure regional equity, and strengthen multi-tier governance. Studies on federations such as Canada, Australia, Germany, and Brazil reveal several consistent patterns: Horizontal equalization mechanisms are central in reducing regional inequalities (Bird & Vaillancourt, 2006). Performance-linked grants are increasingly used to incentivize fiscal discipline and governance reforms. Environmental and demographic variables are gaining prominence as countries integrate sustainability and aging-related fiscal risks into transfer formulas. Rule-based frameworks enhance credibility and reduce politically motivated transfers. These international trends resonate with India's own reforms, particularly the inclusion of ecological criteria (14th and 15th FC) and demographic performance indicators (15th FC).

Evolution of Fiscal Federal Institutions in India

Scholarly work on India's federalism underscores its inherently dynamic, adaptive, and politically negotiated character. Rao and Singh (2006) argue that India's quasi-federal constitutional design, characterized by a strong Centre, necessitates robust institutional mechanisms to balance state autonomy with national coordination. Over time, institutions such

as the Planning Commission, NITI Aayog, the Finance Commission, and the GST Council have played a pivotal role in shaping Centre–State fiscal relations. The Planning Commission era (1950–2014) was marked by centralized planning and discretionary plan transfers, which often resulted in inefficiencies and regional disparities (Bagchi, 2001). The establishment of NITI Aayog in 2015 signaled a shift towards cooperative and competitive federalism, emphasizing evidence-based policymaking (Ahluwalia, 2019), though its advisory nature and lack of statutory authority limit its influence (Chakrabarty & Kandpal, 2024). In contrast, the Finance Commission—though constituted under Article 280—functions as a key institutional mechanism for rule-based and predictable revenue sharing. Its recommendations have evolved from an early redistributive approach to incorporating fiscal discipline incentives (11th–13th FCs), and more recently, ecological and demographic considerations (14th–15th FCs) (Rangarajan & Srivastava, 2004). The introduction of the GST Council in 2017 further institutionalized fiscal coordination by harmonizing indirect taxes, although questions persist regarding revenue buoyancy and compensation mechanisms (Joseph&Kumary, 2023). Together, these transitions highlight the critical interplay among institutions in shaping India’s federal fiscal architecture.

Empirical Studies on Finance Commissions and Distribution Criteria

Scholars have extensively analysed the evolving role of the Finance Commission, noting its gradual shift from equity-based distribution to more performance-oriented frameworks. Early works by Chelliah (1996) and Bagchi (2003) highlight the emphasis on horizontal equity, while Chakraborty. (2024) document the rise of performance-linked incentives in recent commissions. Boadway and Shah (2009) stress the need for transparency and rule-based criteria, and Oates (1999) argues that effective equalization enhances fiscal responsibility and developmental outcomes. Recent empirical studies further underscore the inclusion of forest cover for ecological justice, demographic performance for addressing population dynamics, and tax effort for strengthening accountability. Despite these advances, concerns persist regarding inadequate compensation mechanisms, volatility in GST revenues, debates over the use of 2011 population data, conditionality attached to grants, and limited empowerment of local governments. Collectively, these issues point toward the need for deeper conceptual reform in the distribution criteria adopted by the Finance Commission.

Emerging Themes in the Literature

Contemporary scholarship reveals three major trends in the evolution of Finance Commission criteria. First, the focus has expanded from traditional equity-based considerations to multidimensional criteria incorporating ecological sustainability, demographic dynamics, governance quality, and performance indicators. Second, there is increasing recognition of development-linked indicators such as human development, gender equity, climate resilience,

and social infrastructure as essential components of fiscal devolution. Third, scholars emphasize the need for adaptive and flexible fiscal frameworks, as rapid economic transitions, shifting demographic patterns, and rising environmental vulnerabilities demand dynamic, forward-looking mechanisms for resource allocation.

Identified Research Gap

Although the literature offers valuable insights into fiscal federalism and the Finance Commission's evolution, several research gaps remain. There is limited systematic analysis of how distribution criteria have changed over different Commissions, and their link with measurable development outcomes is not well established. The literature also lacks an integrated framework combining equity, efficiency, sustainability, and governance quality. Emerging indicators such as gender parity, climate resilience, and digital governance are under-studied, and comparative assessments across different phases of Finance Commissions are minimal. This study aims to address these gaps through a structured analytical approach.

III. Plan of the Study

This section provides a brief outline of the study's objectives, data sources, and methodological approach. It explains how the research will be conducted and the basis on which the analysis will be carried out, thereby offering a clear framework for the study.

Objectives of the Study

The objectives of this study are fourfold. First, it seeks to trace the evolution of the Finance Commission's distribution criteria from the Tenth to the Fifteenth Commission, highlighting the shifts in approach and underlying policy logic. Second, it aims to evaluate the rationale and impact of the key criteria on fiscal balance and the functioning of cooperative federalism. Third, the study examines emerging dimensions such as ecological sustainability, demographic performance, and governance quality that increasingly shape contemporary fiscal devolution. Final, objective is to propose a balanced framework that integrates equity, efficiency, and sustainability to guide the design of future Finance Commission recommendations.

Methodology

This study adopts a qualitative-descriptive and comparative analytical research design. The primary focus is on evaluating the evolution of the Finance Commission's distribution criteria across successive cycles, with emphasis on the Tenth to Fifteenth Finance Commissions. While the study is mainly qualitative, it integrates relevant quantitative data (e.g., weightage patterns, share of state devolution, ecological and demographic indicators) through secondary data sources

to support comparative insights. The methodology employed in this study is organised around three analytical pillars. First, a documentary and content analysis approach is adopted, involving the systematic review and thematic coding of Finance Commission reports to identify recurring patterns, shifts in criteria, and underlying normative principles. Second, a comparative framework analysis is utilised to examine inter-Commission variations in distribution criteria, assigned weightages, and the broader fiscal philosophy guiding each Commission's recommendations. Third, the study undertakes a contextual interpretation that links the evolution of distribution criteria with the economic, political, and demographic transitions shaping India's fiscal landscape. Together, these methodological components provide a comprehensive and multidimensional understanding of the Finance Commission's evolving role in India's fiscal federal architecture.

Data Sources

This research is based entirely on secondary data, ensuring high reliability by drawing from authoritative and verified sources. Core primary documents include Finance Commission Reports (10th–15th), Union Budget statements with devolution data, RBI's State Finances Reports, NITI Aayog publications, and GST Council reports with compensation records. These are complemented by a wide range of secondary sources such as foundational texts on fiscal federalism (Musgrave, Oates, Boadway & Shah), peer-reviewed journal articles, working papers, the Economic Survey of India, and analytical studies by institutions like the IDFC Institute and NIPFP. Environmental, demographic, and fiscal capacity datasets used in Finance Commission assessments further strengthen the evidence base. Together, this triangulation of sources enhances the validity, depth, and robustness of the study's conclusions.

Data Collection Process

Data collection followed a structured three-stage process. First, official Finance Commission reports for each cycle were compiled. Second, detailed tables were created to capture the weightage of criteria, devolution percentages, grants-in-aid patterns, and state-wise allocations. Third, major thematic shifts such as the introduction of forest cover and demographic performance were extracted for qualitative assessment. A coding sheet was then developed to categorise the criteria into equity-based, efficiency-oriented, sustainability/ecological, and governance-linked indicators. This systematic classification enabled structured comparison and facilitated comprehensive thematic analysis.

Analytical Framework

The study adopts a Hybrid Analytical Framework that integrates descriptive, comparative, and normative approaches. Descriptive trend analysis is used to trace patterns in horizontal

distribution criteria, vertical devolution shares, and shifting weightages across Finance Commissions. Comparative criteria evaluation enables cross-commission assessment of transitions from population-based formulas to multidimensional frameworks, the growing prominence of performance-linked indicators, and the incorporation of ecological considerations. The normative evaluation applies principles of equity, efficiency, fiscal autonomy, sustainability, and cooperative federalism to examine whether the evolving criteria adequately reflect India's federal priorities and long-term development goals.

Scope and Delimitations

The scope of this study covers the evaluation of distribution formulae adopted by the 10th–15th Finance Commissions, the assessment of policy recommendations and underlying empirical rationale, and the analysis of emerging themes with implications for the forthcoming 16th Finance Commission. The study deliberately excludes econometric modelling of state-specific outcomes, primary field surveys, detailed examination of political negotiations shaping recommendations, and granular state-level fiscal performance analysis. These boundaries were intentionally set to maintain analytical clarity and ensure a focused, conceptually grounded examination of Finance Commission criteria and their evolution.

Reliability and Validity Considerations

Reliability is ensured through cross-verification of all numerical information using multiple credible sources and by relying on official documents as the foundation of the analysis. Validity is strengthened through systematic triangulation of economic, demographic, and ecological datasets, the application of established theoretical frameworks to interpret the findings, and the use of a consistent comparative approach across Finance Commission cycles. Since the study uses only publicly available secondary data and official documents, there are no ethical concerns related to privacy or confidentiality. Citations have been included to acknowledge relevant literature and frameworks.

IV. Evolution of the Finance Commission's Distribution Criteria:

A Comparative Analytical Assessment

The Finance Commission's distribution framework has evolved substantially over the decades, reflecting shifting developmental priorities, economic reforms, demographic changes, and governance expectations. This section provides a structured analysis of the transition from a predominantly need-based, equity-oriented approach to an evidence-driven, multidimensional, and performance-oriented system of fiscal devolution. For analytical clarity, the evolution is examined across three phases: the foundational and redistributive period (1st–9th FC), the

formalisation of weighted criteria (10th–13th FC), and the incorporation of sustainability and demographic reforms (14th–15th FC). The discussion concludes by outlining emerging directions likely to shape the approach of the 16th Finance Commission (Zahir, 2020).

Phase I: Foundational and Redistributive Orientation (1st–9th Finance Commissions)

In the early post-independence decades, the Finance Commission’s primary objective was to promote regional equity and reduce horizontal fiscal imbalances. Distribution criteria focused on population (based on the 1971 Census), per capita income, fiscal need, minimum needs of states, and compensation for revenue deficiencies. This phase was characterized by a redistributive and compensatory approach without formal weightages, relying largely on qualitative assessments rather than quantitative rankings. The emphasis was on ensuring minimum standards of public services across states, with limited scope for performance-based incentives. Analytically, this reflects the broader priorities of nation-building, balanced regional development, redistribution toward backward states, and a gap-filling approach. However, the absence of clear, transparent, and quantifiable criteria reduced predictability and made the outcomes more susceptible to negotiations (Nithin & Roy, 2016).

Phase II: Formalisation of Weighted and Performance-Based Criteria (10th–13th Finance Commissions)

The Tenth Finance Commission (1995–2000) marked a significant turning point by introducing systematic weightages to clearly defined, quantifiable criteria. This shift formalized the allocation process and signaled a move toward greater transparency, predictability, and evidence-based decision-making in the distribution of central resources to states Mohan, R. (2019).

Table 1: Major Criteria Introduced by the Finance Commissions: Purpose and Analytical Significance

Criterion	Purpose	Analytical Significance
Income Distance	Equity	Favours poorer states; reduces horizontal imbalance
Population	Need	Ensures demographic relevance
Area	Cost of service delivery	Recognises geographical constraints
Tax Effort	Efficiency	Encourages own revenue mobilisation
Fiscal Discipline	Accountability	Aligns with FRBM reforms

Source: Compiled from *Reports of the Eleventh to Fifteenth Finance Commissions*, Ministry of Finance, Government of India; *Economic Survey (various issues)*; and *RBI, State Finances: A Study of Budgets (various years)*.

Key Features of 10th–13th FCs

The introduction of weightage systems during this phase enhanced clarity and strengthened the objectivity of allocation. The emphasis on fiscal discipline aligned with the broader economic reforms of the 1990s and early 2000s, while incentives for tax effort encouraged states to enhance their own revenue mobilisation. Grants also began to be linked with governance reforms, such as local body strengthening and FRBM compliance (Rao, Sen, & Jena, 2008). Analytically, this period reflects a liberalisation-driven shift from purely redistributive fairness to greater accountability and efficiency, from qualitative judgments to quantitative scoring, and from discretionary decision-making to predictable, rule-based transfers. The overall design increasingly sought to balance equity with efficiency Oommen, M. A. (2010).

Phase III: Multidimensional, Sustainable, and Demographic Criteria (14th–15th Finance Commissions)

The Fourteenth and Fifteenth Finance Commissions mark the most comprehensive and transformative stages in the evolution of distribution criteria. The 14th Finance Commission (2015–2020) introduced significant innovations, including raising the states’ share in the divisible pool to 42%, incorporating forest cover as an ecological indicator (7.5%), continuing substantial weightage for income distance, and retaining the 1971 population while using 2011 data as a reference. These reforms recognized ecological sustainability and rewarded conservation efforts, particularly benefiting states with high forest cover and constrained revenue capacity such as those in the Northeast and Chhattisgarh. By expanding states’ share, the 14th FC also strengthened fiscal autonomy and provided greater flexibility in public expenditure (D’Souza, 2015).

"The comparative shift in horizontal distribution criteria across the 14th and 15th Finance Commissions is summarised in Table 2."

Table 2: Horizontal Devolution Criteria (14th vs 15th Finance Commission)

Criteria	14th FC (2015–20)	15th FC (2021–26)
Income Distance	50%	45%
Population (1971)	17.5%	-
Population (2011)	10%	15%
Area	15%	15%
Forest/Ecology	7.5%	10%
Demographic Performance	-	12.5%
Tax/Fiscal Effort	-	2.5%

Source: Compiled from *Report of the Fourteenth Finance Commission (2015–20)* and *Report of the Fifteenth Finance Commission (2021–26)*, Ministry of Finance, Government of India.

15th Finance Commission (2020–2025)

The Fifteenth Finance Commission introduced key innovations, including the incorporation of demographic performance (12.5%), enhanced weight for forest and ecology (10%), renewed emphasis on tax effort and governance quality, and performance grants linked to power and agricultural reforms, disaster management, and health outcomes. These shifts signify a structural transition toward multidimensional development, rewarding states with effective population control measures, strengthening ecological justice, and elevating governance quality and performance benchmarks (Bhutani & Mishra, 2022). Taken together, the 14th and 15th Finance Commissions illustrate a clear progression from equity to a combined focus on equity, efficiency, and ultimately sustainability. This multidimensional framework aligns with global trends emphasizing climate justice, demographic balance, and accountable governance.

Critical Comparative Insights Across Phases

The evolution of Finance Commission criteria reflects increasing complexity and depth, with early commissions relying on only a few parameters while the 14th and 15th Commissions incorporated a broader set of 4-6 indicators, signaling a shift toward holistic fiscal design. This expansion aligns more closely with contemporary developmental priorities through the inclusion of forest cover, demographic performance, ecological considerations, and governance-linked incentives, demonstrating responsiveness to India’s changing socioeconomic landscape (Wasdani, 2016). Transparency has improved through clearly weighted criteria, enabling states to anticipate outcomes and adjust policies accordingly. Yet, federal tensions persist, including disagreements over the use of 2011 population data, challenges related to GST compensation, conditional grants affecting state autonomy, and demands for special treatment by specific states. Additionally, despite constitutional provisions under the 73rd and 74th Amendments, the empowerment of local governments remains limited; while the 15th Finance Commission allocated substantial resources to local bodies, accountability structures and administrative capacity continue to require strengthening (Pareek & Panda, 2021). *Table 3 summarizes the three-phase evolution of Finance Commission priorities across decades.*

Table 3: Evolution of the Role and Focus of the Finance Commissions in India

Phase	Characteristics	Focus
Phase I (1st–9th FC)	Gap-filling, normative expenditure	Equity
Phase II (10th–13th FC)	Weighted criteria; transparency	Efficiency
Phase III (14th–15th FC)	Ecology & demography linked	Sustainability

Source: Compiled from various *Reports of Finance Commissions of India* (1st to 15th), Ministry of Finance, Government of India; and supported by analysis in *Economic Survey (various issues)* and *RBI, State Finances: A Study of Budgets (various years)*.

Emerging Directions for the 16th Finance Commission

The ongoing 16th Finance Commission is likely to integrate emerging priorities such as climate finance including disaster resilience, carbon sinks, and vulnerability indices digital governance readiness, income inequality and poverty indicators, gender equity, sustainability-linked incentives, and GST rationalisation measures. These additions point toward an adaptive, forward-looking, and evidence-based approach to fiscal devolution. Overall, the evolution of distribution criteria reflects a maturing fiscal architecture shaped by democratic governance, economic reforms, and development imperatives. The trajectory of the Finance Commission demonstrates India's progression from basic equity to accountable efficiency and, more recently, to sustainable inclusivity (Debroy & Sinha, 2024). This multidimensional approach aligns fiscal federalism with pressing contemporary challenges, including climate change, demographic transitions, technological transformation, and the pursuit of inclusive growth. *Table 4 presents the temporal evolution of vertical devolution, illustrating the increasing share of states' entitlement in central taxes across successive Finance Commissions.*

Table 4: Evolution of Vertical Devolution: Share of States in Central Taxes (10th to 15th Finance Commissions)

Finance Commission	Period	States' Share (%)
10th FC	1995–2000	29.0
11th FC	2000–2005	29.5
12th FC	2005–2010	30.5
13th FC	2010–2015	32.0
14th FC	2015–2020	42.0
15th FC	2021–2026	41.0

Source: Compiled from *Reports of the Tenth to Fifteenth Finance Commissions*, Ministry of Finance, Government of India; and *Economic Survey of India (various issues)*, Ministry of Finance, Government of India.

V. Issues, Challenges, and Critical Evaluation of Finance Commission Distribution Criteria

This section presents a comprehensive critique of the existing Finance Commission framework, identifying structural, operational, and conceptual limitations that continue to shape India's fiscal federal landscape. Persistent vertical fiscal imbalances remain a core challenge, as States shoulder extensive expenditure responsibilities especially in health, education, infrastructure, and law and order—while relying heavily on central transfers due to limited revenue autonomy. Horizontal inequalities also endure despite redistributive mechanisms, with wealthier States benefiting from higher revenue buoyancy and poorer States remaining dependent, reflecting deep

structural disparities. Operational issues further complicate the landscape: the adoption of 2011 population figures sparked regional tensions, governance efficiencies receive insufficient recognition, and conditional grants often constrain State flexibility. Post-GST reforms have introduced revenue uncertainty, reduced tax autonomy, and exposed States to fiscal stress following the end of GST compensation. **Ecological and demographic issues still continue. Although giving weight to forest cover is a positive step, the financial loss faced by states with large forests is still not fully recognised. Similarly, the demographic indicators used in the formula need to be more balanced and transparent** (Das & Mishra, 2008).

Local governments continue to face fiscal vulnerability due to weak devolution, uneven practices across States, and conditional grants that limit genuine decentralization. Additionally, data limitations, non-standardized classifications, and the absence of real-time monitoring systems weaken evidence-based decision-making and undermine accountability (Sahu, Mahamallik, & Mahapatra, 2024). Conceptually, the Finance Commission must navigate tensions between equity and efficiency, redistribution and autonomy, and static versus dynamic criteria. While the institution has significantly contributed to cooperative federalism, these structural and philosophical challenges call for a more adaptive, transparent, and reform-oriented approach to fiscal transfers in India (Varalakshmi & Yoganandham, 2024). *Table 5 consolidates the major structural and operational challenges that continue to shape India’s fiscal federal landscape.*

Table 5: Key Dimensions and Challenges in India’s Fiscal Federal Architecture

Dimension	Challenges
Vertical Imbalance	Centre controls revenue; States bear expenditure load
Horizontal Equity	Wide disparities; uneven buoyancy
GST Structure	Reduced autonomy; compensation uncertainty
Local Financing	Weak bases; uneven accounting
Ecology/Demography	Uneven benefit; contentious criteria
Data/Monitoring	Lack of transparency; weak tracking

Source: Compiled from *Reports of the Fourteenth and Fifteenth Finance Commissions*, Ministry of Finance, Government of India; *Economic Survey of India (various issues)*; and *RBI, State Finances: A Study of Budgets (various years)*.

While Table 5 highlights the key structural and operational challenges that constrain India’s fiscal federal architecture, these systemic issues manifest unevenly across States. Differences in revenue capacity, fiscal effort, and dependence on central transfers reveal the practical implications of vertical and horizontal imbalances identified earlier. States with stronger own-revenue bases and diversified economies are better positioned to exercise fiscal autonomy, whereas fiscally weaker and demographically burdened States remain heavily reliant on central

devolution (Pandey, 2024). This inter-State variation in fiscal strength and dependency is illustrated in **Table 6**, which presents comparative indicators of tax effort, income levels, and transfer dependency across major States in India.

Table 6 – State-wise Fiscal Capacity and Development Disparities in India

State	Own Tax Revenue/GSDP (%)	Per Capita GSDP (₹)	Dependency on Transfers (%)
Maharashtra	7.2	287000	28
Tamil Nadu	6.6	241000	32
Karnataka	7.0	315000	30
Gujarat	6.8	275000	33
Uttar Pradesh	4.3	95000	52
Madhya Pradesh	4.7	123000	48
Chhattisgarh	5.1	121000	46
Bihar	3.2	54000	65
Assam	4.1	98000	58
Jharkhand	4.5	105000	55

Source: Compiled from *Reserve Bank of India, State Finances: A Study of Budgets (various years); Economic Survey of India (2023–24)*, Ministry of Finance, Government of India; and *Finance Commission Reports (14th & 15th)*.

VI. Way Forward and Policy Recommendations

India’s fiscal federal architecture is undergoing a transformative phase shaped by demographic changes, climate vulnerabilities, rapid technological advancements, and evolving institutional dynamics, necessitating a forward-looking and multidimensional approach to fiscal devolution (Reddy, 2015). A reimagined framework should rest on four pillars: equity, efficiency, sustainability, and inclusivity—balancing fiscal capacity with performance incentives, ecological priorities, and human development indicators. States must be supported through greater revenue autonomy, strengthened GST administration, and rationalised Centrally Sponsored Schemes to reduce fragmentation and empower region-specific planning (Chernof & Warshawsky, 2014). Local governments should be bolstered through predictable untied grants, capacity building, and performance-linked funding to enhance service delivery at the grassroots. Integrating digital governance is critical, including a national real-time fiscal data dashboard, unified treasury systems, and open-source data sharing to improve transparency, research, and accountability. Grants-in-aid should give states both flexible funds and specific support for areas like climate resilience, health, education, and social development. States that improve women’s participation in the workforce, reduce learning gaps, and make progress on SDG goals should be rewarded.

Strengthening cooperative federalism requires regular Union–State fiscal dialogue, an independent Fiscal Council for evidence-based oversight, and clear mechanisms for resolving intergovernmental disputes. To improve predictability, devolution cycles must be stabilized and States guided by medium-term fiscal frameworks, realistic revenue projections, and a sustainable post-GST compensation mechanism (Chalam & Mishra, 1997). Overall, the Finance Commission must align its constitutional mandate with emerging developmental imperatives by creating a distribution system that is equitable, efficient, inclusive, sustainable, predictable, and transparent (Oommen, 2010). Such reforms will strengthen India’s fiscal architecture and promote balanced, resilient, and future-ready development across states.

Table 7: Summaries Recommended Policy Innovations Aligned with the Proposed Multidimensional Reform Framework.

Policy Area	Recommended Reforms
Horizontal Criteria	Add HDI, gender parity, climate indicators
Vertical Devolution	Stabilise revenue; incentivise compliance
Local Governance	Increase untied grants, build capacity
Digital Fiscal Architecture	National dashboard; real-time reporting
Climate Resilience	Green grants, risk indexing
Federalism	Dialogue mechanisms; fiscal council

Source: Compiled from *Reports of the Fourteenth and Fifteenth Finance Commissions*, Ministry of Finance, Government of India; *Economic Survey of India (2023–24)*; *RBI, State Finances: A Study of Budgets (various years)*; and policy discussions in *NITI Aayog Working Papers on Fiscal Federalism (2021–23)*.

VII. Conclusion, Policy Implications, and Future Research Directions

The evolution of the Finance Commission’s distribution criteria reflects the broader transformation of India’s fiscal federalism from a primarily redistributive and compensatory framework to a multidimensional one emphasizing performance, sustainability, and development alignment. Earlier Commissions primarily sought to correct fiscal imbalances and ensure the provision of basic services, while later Commissions, particularly the Fourteenth and Fifteenth, introduced transparent, weighted, and evidence-based parameters that accounted for ecological sustainability, demographic performance, and governance quality. Despite these progressive shifts, persistent challenges remain such as disputes over population norms, revenue uncertainty following the introduction of GST, inadequate fiscal empowerment of local governments, and the absence of reliable and standardized data systems. From a policy standpoint, this analysis underscores the importance of designing a balanced fiscal framework that simultaneously promotes equity, efficiency, ecological resilience, and social inclusion. Giving States more financial freedom, providing regular and stable funds to local bodies, and using digital tools like

real-time dashboards can greatly improve transparency, accountability, and coordination in India's fiscal system.

Future research should move beyond descriptive analysis to empirical assessments that measure how evolving distribution criteria influence State capacities, fiscal performance, and developmental outcomes. Promising research directions include: Examining the impact of tax devolution through time-series or econometric analysis; Investigating inter-State inequality using panel data techniques; Modelling GST revenue behaviour through elasticity and buoyancy analysis; Studying local government finances via in-depth case studies; and Exploring climate-fiscal linkages through risk modelling and vulnerability mapping. Further exploration of GST revenue dynamics and the climate-fiscal interface is essential for developing resilient and adaptive fiscal mechanisms. Ultimately, strengthening the institutional architecture of the Finance Commission and aligning its approach with evolving socio-economic and environmental realities will reinforce cooperative federalism and contribute to a more equitable, sustainable, and future-ready fiscal framework for India.

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