16th Finance Commission's Warning On Rising Fiscal Risks

February 3, 2026 • vajiramandravi.com

Fiscal Risks Latest News

- The 16th Finance Commission has cautioned states against the rapid expansion of large, unconditional cash transfer schemes, which now account for over 20% of total state subsidy spending.

Understanding Cash Transfers in India

- Cash transfers have increasingly become a preferred welfare instrument in India's public finance framework.
- These transfers involve direct monetary payments to beneficiaries, usually deposited into bank accounts using the Jan Dhan-Aadhaar-Mobile (JAM) trinity.
- They are broadly classified into **conditional** and **unconditional** transfers. While conditional transfers are linked to outcomes such as education or health, unconditional cash transfers impose no performance or usage conditions.
- Historically, unconditional transfers in India were limited to social security pensions and farmer income support schemes.

- However, over the past decade, especially after improvements in digital delivery systems, states have expanded cash-based welfare to wider population groups.
- This shift has altered the composition of state subsidies, raising questions about long-term fiscal sustainability.

Trends in State Subsidies and Cash Transfers

- According to the 16th Finance Commission, large-group unconditional cash transfer schemes now constitute **20.2% of total state subsidy expenditure** in the 2025-26 Budget Estimates, a sharp rise from **just 3% in 2018–19**.
- This indicates a structural shift in how states allocate welfare spending.
- The Commission notes that while pensions and farmer support accounted for nearly **84% of unconditional cash transfers in 2018-19**, their share has fallen significantly.
- By 2025-26, large-group schemes alone account for **47.4% of all unconditional transfers**, overtaking traditional categories.
- This reflects a growing preference for politically visible, broad-based cash schemes over targeted or merit-based subsidies.

State-Level Patterns and Key Schemes

- The Commission highlighted **Maharashtra, Odisha, and Jharkhand** as states that have witnessed the steepest rise in such spending over the past two years.
- Major schemes include:
  - **Majhi Ladki Bahin Yojana (Maharashtra)**: Rs. 1,500 per month to eligible women.
  - **Gruha Lakshmi (Karnataka)**: Rs. 2,000 per month to women heads of households.
  - **Lakshmir Bhandar (West Bengal)**: Monthly transfers to women beneficiaries across social categories.
- In Maharashtra, spending on large-group cash transfers rose from **0.6% of total revenue expenditure in 2023-24 to 6.2% in 2025-26**, while Jharkhand saw an increase from **0.8% to 13%** over the same period.
- Odisha recorded a jump from **nil to 5.1%**. These sharp increases indicate a rapid fiscal expansion rather than a gradual policy transition.

Fiscal Concerns Raised by the 16th Finance Commission

- The Finance Commission has warned that the unchecked expansion of unconditional cash transfers can destabilise state finances in the long run.
- Such schemes impose a recurring fiscal burden and reduce flexibility in budgetary allocations.
- The Commission observed that many of these transfers are poorly targeted, expanding into large beneficiary bases that dilute their redistributive effectiveness.
- A major concern is the crowding out of capital expenditure. Rising revenue spending on cash transfers limits states’ ability to invest in infrastructure, education, and health, which are critical for long-term growth.
- The Commission also cautioned against financing these schemes through off-budget borrowings, guarantees, or revenue assignments, calling such practices fiscally imprudent due to reduced transparency in public

accounts.

Recommendations for Reform

- To address these risks, the 16th Finance Commission has recommended:
    - **Periodic and rigorous review of subsidy schemes**.
    - **Rationalisation of beneficiary bases** to ensure support reaches the most vulnerable.
    - **Introduction of sunset or exit clauses**, especially for non-merit and general unconditional transfers.
    - Discontinuation of **off-budget financing mechanisms** for welfare schemes.
- The Commission emphasised that welfare policies must align with fiscal responsibility and deficit reduction goals, rather than becoming permanent entitlements without review.

Source: IE
