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Sixteenth Finance Commission — Misses and Concerns

Context

- The Sixteenth Finance Commission (SFC) operated with considerable autonomy, drawing its mandate directly from constitutional provisions.
- It examined the two core pillars of India's fiscal federalism: **vertical devolution** (distribution between Centre and States) and **horizontal devolution** (distribution among States).
- While it preserved certain structural features of earlier commissions, it introduced important shifts affecting **fiscal balance**, **constitutional responsibility**, and the principle of **equalisation**.

Vertical Devolution: Fiscal Space and Constitutional Mandate

- **Background: The 42% Shift and Its Aftermath**
 - A major restructuring occurred under the Fourteenth Finance Commission, which raised the States' share in the divisible pool from 32% to 42%, citing the discontinuation of plan grants.
 - This was later revised to 41% after the reorganisation of Jammu and Kashmir and retained by the Fifteenth Finance Commission.

- The Sixteenth Commission maintained the 41% benchmark, granting it **semi-permanence**.
- However, the Centre expressed concerns about shrinking **fiscal space**, prompting adjustments outside the divisible pool framework.
- **The Issue of Cesses and Surcharges**
 - The Centre increasingly relied on **non-shareable cesses and surcharges**, reduced funding for centrally sponsored schemes, and declined certain grants recommended earlier.
 - Since cesses and surcharges are excluded from the divisible pool, their expansion effectively narrows the States' share of total central revenue.
 - Instead of firmly addressing this under its **constitutional mandate**, the Commission proposed a **grand bargain**: States would accept a smaller share of a larger pool if cesses were merged into regular taxes.
 - Although pragmatic, this approach did not fully reinforce the spirit of Articles 270 and 280.
- **Trends in Effective Transfers**
 - Effective transfers (tax devolution plus grants) averaged about 27–28% of the Centre's pre-transfer gross revenue during the Eleventh to Thirteenth Commissions.
 - This rose sharply to 35.6% under the Fourteenth Commission and moderated to 34.4% under the Fifteenth.
 - For 2026–27, the first year of the Sixteenth Commission's award, the ratio stands at 32.7%.
 - The projections assume 11% nominal GDP growth, higher than budget estimates, and do not fully account for revenue-reducing GST reforms of September 2025.
 - These assumptions may affect the credibility of long-term fiscal projections and signal a relative contraction in States' fiscal capacity.
- **Discontinuation of Revenue Deficit and Sector-Specific Grants**
 - The discontinuation of **revenue deficit grants** and the absence of **sector-specific grants** mark a major departure.
 - Such grants traditionally addressed **revenue gaps** and structural cost disabilities.
 - Their removal limits scope for calibrated adjustments and weakens redistributive flexibility within the system.

Horizontal Devolution: Efficiency Versus Equalisation

- **Introduction of the Contribution Criterion**
 - A new **contribution criterion** was introduced, measured through a **state's share in aggregate GSDP**.
 - While intended to reward efficiency, GSDP reflects market-driven concentration of capital and migration patterns rather than fiscal prudence.
 - High-income States benefit from structural advantages, not necessarily superior fiscal management.
- **Dual Use of GSDP and Conceptual Tensions**
 - GSDP was used in opposite ways: the **income distance** criterion favours lower per capita GSDP States, whereas the contribution criterion rewards higher GSDP States.
 - To moderate extremes, the square root of GSDP was applied.

- Even so, the same indicator simultaneously advances equity and performance, creating conceptual inconsistency between efficiency and equity objectives.

- **Dropping the Fiscal Discipline Criterion**

- The removal of the **fiscal discipline** or tax effort criterion contradicts the emphasis on performance.
- This criterion directly measured fiscal responsibility and revenue mobilization.
- Its exclusion reduces incentives for prudent financial management and shifts emphasis toward output-based indicators rather than governance quality.

Distributional Impact: Gains and Losses

- **States Experiencing Losses**

- Compared to the Fifteenth Commission, significant States such as Madhya Pradesh, Uttar Pradesh, West Bengal, Bihar, Odisha, Chhattisgarh, and Rajasthan faced reductions.
- Several smaller and north-eastern States, including Arunachal Pradesh, Meghalaya, Manipur, Nagaland, Tripura, Sikkim, and Goa also experienced losses. Gains among richer States were uneven.

- **The Case for Equalisation Grants**

- Article 275 provides for grants-in-aid addressing State-specific needs, particularly in health and education.
- Well-designed **equalisation grants** can offset disparities arising from formula changes.
- The complete withdrawal of such mechanisms limits corrective capacity and risks widening inter-State disparities.

Conclusion

- The Sixteenth Finance Commission preserved the 41% devolution benchmark but avoided assertive intervention on expanding cesses and surcharges.
- The reduction in effective transfers, optimistic growth assumptions, and discontinuation of revenue gap grants signal a cautious recalibration of fiscal federalism.
- In horizontal distribution, the adoption of a GSDP-based contribution measure introduces tension between **performance incentives** and the constitutional goal of balanced development.
- The long-term impact on **cooperative federalism**, regional equity, and sustainable public finance will unfold over time.

Sixteenth Finance Commission — Misses and Concerns FAQs

Q1. What was the key decision of the Sixteenth Finance Commission regarding vertical devolution?

Ans. The Sixteenth Finance Commission retained the States' share in the divisible pool of central taxes at 41%, continuing the benchmark set by earlier commissions.

Q2. Why are cesses and surcharges controversial in fiscal federalism?

Ans. Cesses and surcharges are controversial because they are non-shareable taxes that reduce the effective share of revenue transferred to the States.

Q3. What new criterion was introduced in horizontal devolution?

Ans. The Commission introduced a contribution criterion based on a State's share in aggregate Gross State Domestic Product (GSDP).

Q4. Which major States experienced losses under the new devolution formula?

Ans. States such as Bihar, Uttar Pradesh, and West Bengal experienced reductions in their shares compared to the previous award.

Q5. Why are equalisation grants considered important?

Ans. Equalisation grants are important because they help address inter-State disparities and ensure balanced development by supporting States with greater fiscal needs.

Source: **The Hindu**

Skill India as Herculean Challenges, Galgotian Blunders

Context

- India stands at a decisive moment in its development journey. Its **demographic dividend**, lasting until 2040, offers a rare opportunity to transform a youthful population into productive human capital.
- However, this opportunity demands systemic reform in vocational education and **skill development**.
- Despite ambitious initiatives such as the 2020 **National Education Policy**, structural weaknesses in financing, governance, and industry participation continue to limit outcomes.
- Without a shift toward a **demand-driven**, accountable, and employer-owned model, the demographic advantage risks turning into a demographic burden.

Historical Neglect of Vocational Education

- **International Comparisons**
 - Several European Union countries and China have institutionalised strong vocational systems, enrolling nearly 50% of secondary students in vocational streams.
 - In many advanced economies, vocational education receives around 2% of the education budget; in China and Germany, it reaches 11%.
 - India, by contrast, enrolls only 1.3% of its secondary students in vocational education.
 - This reflects decades of **policy neglect**, delayed focus on school education, and insufficient prioritisation of skill pathways.
 - Limited public data and **fragmented schemes** across ministries further weaken transparency and coordination.
- **Fragmented Financing and Policy Instability**
 - Skill initiatives frequently rely on annual Budget announcements, leading to **policy instability** and short-lived programmes.
 - Schemes are often celebrated one year and forgotten the next. Underutilisation of allocated funds and weak implementation reveal structural inefficiencies.

- Such inconsistency undermines long-term planning and prevents the development of a stable **skills ecosystem**.

Policy Ambition versus Ground Reality

• The National Education Policy (2020)

- The 2020 National Education Policy aims for 50% of learners to be exposed to vocational education by 2025.
- However, exposure does not guarantee integration, certification, or employability.
- A meaningful transformation requires mainstreaming vocational education within the formal system and elevating its social and economic status.

• Accountability Concerns and CAG Findings

- Audits by the Comptroller and Auditor General of India of the Pradhan Mantri Kaushal Vikas Yojana reveal persistent governance failures.
- Financial reporting delays, invalid bank accounts, and limited placement outcomes expose deep **financial impropriety** and weak accountability.
- Only about 41% of short-term trainees secured placements, highlighting the limitations of a quantity-driven approach focused on enrolment numbers rather than sustainable employment.
- The continued emphasis on short-term training without quality assurance, monitoring, and labour market alignment has yielded modest returns.
 - Institutional learning and reform have lagged behind policy ambition.

Reimagining Skill Financing: Three Reform Proposals

• Skill Loans: Shifting Power to Students

- A significant portion of public expenditure on skills could be redirected toward **skill loans** for students rather than operational funding for institutions.
- This approach would:
 - Empower students with informed choice
 - Encourage **competition** among training providers
 - Improve **quality assurance** through market discipline
 - Promote **demand-driven development**

• Skill Vouchers: Promoting Lifelong Learning

- Skill vouchers place purchasing power directly in the hands of learners.
- Since funding follows the trainee rather than the institution, providers are incentivised to deliver measurable outcomes.
- Vouchers support **lifelong learning**, targeted upskilling in **Artificial Intelligence**, digital and green sectors, and greater inclusion of women in the workforce.
- They also encourage school leavers to consider vocational pathways instead of defaulting to degree inflation.
- International experience demonstrates that voucher systems create competitive and responsive markets aligned with evolving labour demands.

- **Skill Levies: Ensuring Employer Ownership**

- A **Reimbursable Industry Contribution (RIC)** model links employer contributions to payroll and reimburses firms when training is conducted.
- This mechanism ensures **industry ownership**, stable funding insulated from political cycles, and stronger alignment with real workforce needs.
- Transitioning from an employer-engaged to an **employer-owned system** would deepen private sector responsibility and reduce excessive dependence on government funding.

The Way Forward: The Need for Real-Time Labour Market Intelligence

- Effective skills planning requires accurate and continuous labour market data. Periodic **skill gap studies** are insufficient in a rapidly evolving economy.
- A modern labour market information system should integrate anonymised data from online job platforms, use **data analytics** and AI modelling, and make aggregated insights available through the National Career Service portal.
- Real-time intelligence would align training supply with actual demand, enhance transparency, and support evidence-based policymaking.

Conclusion

- India's demographic window is narrowing. Harnessing the **demographic dividend** requires bold structural reform in vocational education and skill development.
- Sustainable financing, institutional accountability, employer ownership, and real-time **labour market intelligence** are central to transformation.
- With decisive action, India can convert its demographic advantage into **long-term economic strength** and global competitiveness. Without reform, the opportunity may pass unfulfilled.

Skill India as Herculean Challenges, Galgotian Blunders FAQs

Q1. What makes India's demographic dividend a critical opportunity?

Ans. India's demographic dividend, lasting until 2040, provides a limited window to transform its young population into productive human capital that can drive economic growth.

Q2. Why is vocational education weak in India compared to other countries?

Ans. Vocational education in India remains weak due to historical policy neglect, low enrolment rates, fragmented financing, and limited budgetary prioritisation.

Q3. What major issues were identified in the audit of PMKVY?

Ans. The audit of the Pradhan Mantri Kaushal Vikas Yojana by the Comptroller and Auditor General of India revealed financial irregularities, invalid bank accounts, and low trainee placement rates.

Q4. How can skill vouchers improve the skill development system?

Ans. Skill vouchers can improve the system by placing purchasing power in the hands of learners and encouraging competition and accountability among training providers.

Q5. Why are skill levies considered a sustainable financing solution?

Ans. Skill levies are considered sustainable because they ensure stable funding, promote employer ownership, and align skill development with industry needs.

Source: **The Hindu**

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