

Finance Commission transfers and equity issue

Prelims: General Studies Paper - 1
Economic and Social Development-Sustainable Development, Poverty, Inclusion, Demographics, Social Sector Initiatives, etc.

Mains: General Studies - 3
Indian Economy and issues relating to planning, mobilization, of resources, growth, development and employment.

1. Concerns Raised by States

- States demanded a higher share (50%) of tax devolution instead of the current 41%, citing reduced fiscal space.
- States argued that since cesses and surcharges account for more than 15% of the gross tax revenue but are not shared with States, they should either be included in the divisible tax pool or limited to 8-10%.
- Fiscal stress increased due to:
 - ➔ COVID-19 impacts
 - ➔ GST reforms and rate rationalisation
 - ➔ Rising public debt
 - ➔ Expansion of Centrally Sponsored Schemes, reducing State autonomy.
- States also criticised frequent changes in devolution criteria and weightage, making future transfers unpredictable.

2. Issues with Existing Devolution Pattern

- Income-distance criterion heavily favours fiscally weaker States; many States wanted the weight of the income-distance criterion reduced and adjusted for purchasing-power differences to better reflect variations in the cost of living.
- Shares of beneficiary States (Bihar, MP, UP, West Bengal) increased from 42.5% → 51% (6th FC to 15th FC).

- The share of southern States (AP, Karnataka, Kerala, Tamil Nadu) declined from 24.8% → 15.8%.
- Despite larger transfers, public service disparities remained high:
 - ➔ Bihar health spending: ₹937/person vs Arunachal Pradesh: ₹10,148/person
 - ➔ Bihar education spending: ₹20,282/student vs Sikkim: ₹1.3 lakh/student.

3. Key Recommendations of the 16th Finance Commission

- The 16th Finance Commission (FC) accepted the Centre's view that cesses and surcharges should not be shared with States, as they are used to fund welfare and infrastructure programmes that indirectly benefit States.
- It retained the 41% vertical tax devolution to States.
- It abolished revenue-deficit grants, sector-specific grants, and State-specific grants.
- It recommended that States:
 - ➔ stop off-budget borrowings
 - ➔ include all liabilities in their budgets
 - ➔ maintain fiscal deficits below 3%.
- These measures may increase short-term fiscal pressure on States.
- New weight distribution:
 - ➔ Income distance - 42.5%
 - ➔ Population - 17.5%
 - ➔ Area - 10%
 - ➔ Forest cover - 10%
 - ➔ Demographic criterion - 10%
 - ➔ GDP contribution - 10%.
- However, instead of using actual State GSDP shares, the Finance Commission used a square-root formula to reduce differences between States and gave it only 10% weight instead of the expected 25%.

A square root transformation is a mathematical technique where you replace each value in a dataset with its square root. In simple terms, it means you take the square root of each number in your data column.

4. Outcomes and Future Concerns

- **Square-root transformation of GDP** reduced gains for economically stronger States like **Maharashtra, Tamil Nadu, Karnataka**.
- Under the **16th Finance Commission**, the share of **southern States increased slightly to around 17%**.
- At the same time, the share of the **major beneficiary States declined to below 50%**, resulting in only a **small net shift of about 1.2% in favour of southern States**.
- The balance between **equity** and **efficiency** changed only **slightly** under the **16th Finance Commission**.
- The weight given to **efficiency increased from 25% to 30%**, while **equity decreased from 75% to 70%**, but this change was **too small to significantly affect outcomes**.
- Alternative models show stronger States could receive **significantly higher transfers** if **GDP contribution** received greater weight.
- Future Finance Commissions should focus more on **fiscal capacity, outcomes, and data-driven methods** rather than non-fiscal indicators alone.

India and Australia – bridging the trade and trust barrier

Prelims: General Studies Paper - 1
Current events of national and international importance

Mains: General Studies - 2
Bilateral, regional and global groupings and agreements involving India and/or affecting India's interests.

1. India–Australia CECA: Background and Context

- India and Australia may sign a **Comprehensive Economic Cooperation Agreement (CECA)** to expand the **2022 Economic Cooperation and Trade Agreement (ECTA)**.
- Under ECTA, **Australia opened 100% of its market to India**, while India provided around **70% market access covering 91% of trade value**.

- India is accelerating trade agreements due to **global geopolitical uncertainty, tariff instability**, and the need to boost **trade and investment flows**.

2. Trade Imbalances and Key Challenges

- Since ECTA, **bilateral merchandise trade doubled** from **\$12.2 billion (FY21) to \$24.1 billion (FY25)**.
- However, benefits remain uneven as **Australian exports make up nearly two-thirds of bilateral trade**.
- In **services trade**, which has crossed **\$10 billion**, **Australia's higher education sector alone contributes nearly 60%**.
- However, the **investment pattern is reversed** - by **2024, Indian investment in Australia reached nearly \$32 billion**, compared to **Australia's cumulative FDI of about \$18 billion in India**.
- Australia seeks **equal market access**, while India wants a **more balanced trade and investment relationship**.

3. Agriculture: The Main Negotiating Challenge

- Australia identified four cooperation sectors (**clean energy, education, tourism, agribusiness**), but **agriculture remains the most sensitive issue**.
- India protects vulnerable sectors such as **dairy, wheat, rice, sugar and chickpeas** from market opening.
- Despite restrictions, **Australian agricultural exports to India rose by nearly 90%**, while **Indian agricultural exports to Australia increased only 35%**.
- The difference reflects structural realities:
 - ➔ Average Indian farm: **0.73 hectares**
 - ➔ Average Australian farm: **1,400+ hectares**
 - ➔ Agriculture contributes around **16% to India's GDP and 2.5% to Australia's**.
 - ➔ Agriculture supports **over half of India's population**, making it a **livelihood and food security issue**.

4. Way Forward: From Market Access to Complementarity

- India and Australia should focus less on tariffs and more on **mutual recognition of biosecurity and phytosanitary standards**.

- Cooperation can expand in **digital certification, quarantine systems and regulatory alignment**.
- Australia can support India through **precision farming, cold-chain infrastructure, water management and climate adaptation technologies**.
- Greater **Australian investment, technology transfer and agri-partnerships** can make the FTA based on **complementarity rather than equal market access alone**.

Why is the Indian rupee falling?

Prelims: General Studies Paper - 1
Current events of national and international importance

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Indian Economy and issues relating to planning, mobilization, of resources, growth, development and employment.

1. Context

- The Indian rupee has been **falling sharply against the US dollar**, crossing **₹96 per dollar in May 2025**, up from around **₹85 a year earlier**.
- Exchange rate is the **price of one currency in terms of another**, driven by **demand and supply**.
- Currency movement is closely linked to India's **balance of payments (BoP)** position.

Balance of Payments (BoP) is the record of all money coming into a country and going out of it through trade, services, investments, and transfers over a specific period.

2. Impact of trade deficits on the rupee

- **Exports increase rupee demand**, while imports reduce it:
 - ➔ Export earnings are converted into rupees → demand rises
 - ➔ Imports (especially oil) require rupees to be exchanged for dollars → demand falls
- When **imports exceed exports (trade deficit)**:
 - ➔ More rupees are sold for dollars than vice versa
 - ➔ This leads to **lower rupee demand and depreciation**
- India has a **persistent merchandise trade deficit**, mainly due to **high oil imports**, partly offset by:

- ➔ **Service exports (IT/software)**
- ➔ **Remittances from migrant workers**

- Despite this, the **current account remains in deficit**, weakening the rupee.

3. Capital outflows and depreciation

- The **current account deficit is financed by capital inflows** like FDI(Foreign Direct Investment), FPI(Foreign Portfolio Investment), and loans.

FDI (Foreign Direct Investment): Long-term investment where foreign investors build or expand businesses in a country, creating **stable** economic ties.

FPI (Foreign Portfolio Investment): Short-term investment where foreign investors buy stocks or bonds in financial markets, making it more **volatile and speculative**.

- **Capital outflows weaken the rupee:**
 - ➔ Investors sell rupee assets and buy dollars
 - ➔ Demand for rupee falls, pushing depreciation
- Recent sharp depreciation episodes occurred due to **trade weakness and FPI outflows**, including:
 - ➔ **2013 (54.4 → 63.8)**
 - ➔ **2018 (63.6 → 73.6)**
 - ➔ **2020 (71.5 → 76.2)**
 - ➔ **2022 (74.4 → 82.3)**
 - ➔ **Sep 2024–Feb 2025 (83.3 → 87.1)**
 - ➔ **May 2025 onward (85.2 → 96)**
- The latest phase of depreciation is linked to:
 - ➔ Foreign investors pulling out due to **geopolitical tensions**
 - ➔ **Higher US interest rates** increasing returns abroad

4. RBI role and implications

- RBI intervenes by **selling dollars from forex reserves** to stabilise the rupee.
- India's forex reserves are strong at about **USD 691 billion (March 2026)**, covering **10.8 months of imports**.

- Impacts of depreciation:
 - ➔ **Negative:** higher import costs (especially oil), inflation pressure
 - ➔ **Positive:** improves export competitiveness, though limited by supply constraints
- Key concerns:
 - ➔ Global oil price risks
 - ➔ Continued capital volatility
- Needed measures: **control speculative outflows and reduce oil import dependence.**

KEYWORDS

City Investments to Innovate, Integrate and Sustain 2.0 (CITIIS 2.0)

- The Government approved ‘**City Investments to Innovate, Integrate and Sustain 2.0 (CITIIS 2.0)**’ on **31 May 2023**.
- The programme has been designed by the **Ministry of Housing and Urban Affairs (MoHUA)** in collaboration with the **French Development Agency (AFD)**, **Kreditanstalt für Wiederaufbau (KfW)**, the **European Union (EU)**, and the **National Institute of Urban Affairs (NIUA)**.
- The initiative will be implemented over a period of **4 years**.
- **CITIIS 2.0** comprises **three key components**:
- **Component 1:** Provision of **financial and technical assistance** to **up to 18 Smart Cities** for implementing projects based on the **circular economy**, with a special emphasis on **Integrated Waste Management**.
- **Component 2:** Support to **all States and Union Territories (UTs)** in undertaking **climate action initiatives**.
- **Component 3:** **National-level interventions** aimed at facilitating the **scaling up of sustainable practices** across **cities and towns** throughout the country.

Bose Einstein Condensate (BEC)

- A BEC is the fifth state of matter formed when a gas of **bosons is cooled extremely close to absolute zero (0 K or -273.15°C)**, causing particles to behave as a single quantum system instead of individual atoms.
- Predicted by **Satyendra Nath Bose (1924)** and extended by **Albert Einstein (1925)** for atoms following Bose-Einstein statistics.
- Achieved in **1995** using ultra-cold rubidium gas by **Eric Cornell and Carl Wieman**, later independently by **Wolfgang Ketterle**, leading to the 2001 Nobel Prize.
- At this state, atoms occupy the **same lowest energy level**, behaving like a single “super-atom” with observable quantum effects at macroscopic scale.
- Used mainly in **quantum research, precision measurement, atomic clocks, sensors, and quantum computing studies**; also studied in space experiments for microgravity effects.

Places In News

Amer Fort, Jaipur



- **Amer Fort** is a **large palace-fort complex** located on a **small hill**.

- It was built using **yellow and pink sandstone** along with **white marble** and is divided into **four sections**, each with its own **courtyard**.
- It was once the **royal residence of the rulers of Amer** and is now a **UNESCO World Heritage Site** and a major tourist attraction.
- The fort was commissioned by **Maharaja Man Singh I in 1592**.
- The main entrance, **Suraj Pol**, leads to **Jaleb Chowk**, a courtyard that earlier served as an **army parade ground** and a place to display **war victories**.
- The **Diwan-e-Aam (Hall of Public Audience)** was where the ruler heard the concerns and aspirations of the people.
- Other important attractions include **Jas Mandir**, the **Zenana (women's quarters)**, the **royal garden**, and the **Palace of Man Singh**.

