

## **1. Cabinet Hikes Dearness Allowance by 5%**

**Prelims: Economics- Inflation**

**Mains: GS-III- Indian Economy and Issues Relating to Planning, Mobilization of Resources, Growth, Development and Employment.**

### **Why in News?**

- ▶▶ The Union Cabinet decided to increase the Dearness Allowance (or DA) that it pays its current employees and existing pensioners by 5 percentage points.
- ▶▶ Accordingly, 50 lakh central government employees and 65 lakh pensioners will henceforth receive 17% of their basic salary as DA instead of 12%.

### **What is DA and how is it calculated?**

- ▶▶ **DA is provided by the government to its employees to cushion the impact of the rising cost of living. Inflation (or rate of increase in prices) eats away the buying power of money; hence the justification for DA.**
- ▶▶ For instance, if the annual inflation is 5%, it means that a commodity that cost Rs 100 in the first year, would cost Rs 105 in the second. If the employee has a salary that allows her to spend Rs 100 on that commodity, she will be able to buy that commodity in the first year. However, in the second year, that Rs 100 will no longer be enough for the employee to buy that commodity, which now costs Rs 105, thanks to the inflation rate. It is to compensate for this gap that the government pays DA to its employees.
- ▶▶ **To calculate DA, the government typically uses the All India Consumer Price Index-based inflation rate** as a broad marker. For greater effectiveness, the DA is revised twice a year.

### **Possible Positive Impacts on the Economy:**

- ▶▶ An increase in DA **provides additional money in the hands of government employees.** If all this additional money is spent, it **will have a positive impact on the sagging consumption demand**, which the biggest problem in the economy right now.
- ▶▶ However, the impact will depend on whether — and to what extent — employees actually spend this money. It is possible that given the prevalent sentiment of insecurity, they may choose to simply save it in their bank accounts. But given that deposit rates on short-term savings are being cut, it seems likely that people would choose to spend, rather than save.
- ▶▶ **But even if all this money is simply kept in the banks, it will help the economy by bolstering the flow of funds to the banking system.**

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### **Possible Negative Impacts on the Economy:**

- ▶▶ This money will come out of the government's coffers. And to the extent that this **will hit the resources available with the government, it will constrain economic activity.**
- ▶▶ For example, under the current circumstances, when government is finding it difficult to raise revenues, an additional outgo for DA will either push the government to borrow money from the market — thus **leaving less money to be lent to private businessmen and businesswomen** — or it will come as the cost of some other expenditure such as the spending that could have built more roads or more schools.

