

Gist of EPW November Week 1, 2020

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An Inconsequential Stimulus

Context:

The article analyzes the fiscal stimulus announced by the union government to revive the economy which has been impacted due to the COVID-19 pandemic.

Background:

- Recently, the central government made a set of announcements, which is also acclaimed as a fiscal stimulus.
- The announcements include measures to restore the level of consumer demand and inject more capital into the economy.

Leave Travel Concession (LTC):

- The stimulus introduced leave travel concession (LTC) cash voucher scheme, a special festival advance scheme (which has certain strict conditions), the annual bonus for the 30.6 lakh public sector & central government employees besides a decent increase in the capital expenditure and interest-free loans to the states for the funding of projects.
- While the bonus payments do not involve any conditions, there are certain conditions attached to the LTC voucher and festival advances.
- These announcements have alleviated the fears of employees regarding the disbursement of bonus payments after the decision of the government to freeze the dearness allowances till June 2021.
- The major objective of the LTC voucher scheme is to accelerate the revenue collection of GST for both the center and the states as there has been a severe impact on the revenues due to the outbreak of the pandemic.
- The central government employees are entitled to LTC and leave encashment of 10 days for travel twice in a block of four years. But due to COVID-19, employees were not in a position to avail of LTC in the current block of 2018-21.
- With this announcement, the central government employees would have an option to avail the cash equivalent of the entitled LTC fare and leave encashment as they become eligible to purchase goods and services in lieu of the tax-exempt portion of the LTC.

- An employee, opting for this scheme, will be required to buy goods or services worth 3 times the fare and 1 time the leave encashment – before 31st March 2021.
- The items bought should be those attracting GST of 12% or more. Only digital transactions are allowed, GST Invoice must be produced.
- In order to avail the full leave encashment payment and tax-free travel fare amount, the employees would have to obtain a voucher indicating the GST number and the amount of GST paid.
- Besides, the government has temporarily brought back the festival advance scheme.
 - As part of this advance scheme, central government employees and officers will get an interest-free festival advance of Rs 10,000.
 - The repayment of this advance will have to be made in 10 installments.
 - These employees will get pre-loaded Rupay Cards of the advance value which they can utilize for digital payments up to March 31, 2021.

Concerns:

- These measures to accelerate consumption expenditure have been designed in such a manner that they put the minimum additional cost to the exchequer and are focused on nudging the central government employees to spend more.
- Nevertheless, it is opined that these schemes are too small in size to create any remarkable impact on consumer demand.
- However, there is a doubt whether these measures will increase consumption in the economy.
- To enhance consumer demand, the government should have taken measures to transfer cash to people who do not have an assured income.
- Instead, the government chose to nudge employees to spend, who have remained relatively unaffected by job loss. These employees may choose savings over spending because of uncertain economic conditions.

Other measures taken by the government:

- Apart from the budgetary provision of spending 13 lakh crore in the financial year 2020-21, the finance minister has also announced that the government would spend `25,000 crores towards capital expenditure on roads, defense infrastructure, water supply, and urban development by March 2021.
- Further, the union government has decided to give 12000 crore rupees as interest-free loans to states for capital expenditure.
- These states have been categorized into three categories.
 - Group 1: Northeastern states (1,600 crores) and Uttarakhand and Himachal Pradesh (900 crores).
 - Group 2 states will get 7,500 crores. The amount will be shared as per the devolution criteria of the finance commission.
 - Group 3 states will get 2000 crores for which they have to meet three out of four fiscal targets set by the government under the Atma Nirbhar package.
- These funds can be used for new or ongoing projects and have to be spent by 31st March 2021.

Conclusion:

- To push growth, there is a need for stronger stimulus.
- The earlier fiscal stimulus given by the government was about 1% of the GDP.
- After adding the current demand stimulus, the total fiscal stimulus will add up to 1.2% of GDP.
- This fiscal stimulus is very less as compared to the contraction in the economy. It is insufficient for the revival of the economy which had slowed down even before the COVID crisis.
- The loans given to states are relatively small and may not give a boost to capital expenditure.
- The government approach can be summed up as sporadic and fiscally conservative.
- With a shortfall in revenue and proceeds from disinvestment, the government is reluctant to provide large counter-cyclical fiscal stimulus to revive the economy.

Fifteenth Finance Commission Award for 2020–21

Implications for the States

Context:

The article analyses the recommendations of the [15th Finance Commission](#) for the year 2020-21.

Background:

- Recently, the Fifteenth Finance Commission submitted its final report for 2020-21 which provides a clear understanding of the approach of the Commission towards union-state fiscal relationships.
- The report was pending on 31st December 2019 due to many reasons and then it was decided to submit two reports for the period 2020-21 and for the five-year period 2021–22 to 2025–26.
- The report for the former period has been submitted and the report for the latter is expected to be presented in early November 2020.
- Now, the Fifteenth Finance Commission award will be covering a tenure of six years instead of five years.

Unusual extension in Commission's term

The extension in the term of the commission is unusual but this may have happened due to the following reasons:

- First, the most critical uncertainty has been generated due to a decline in the savings and investment rates, rising unemployment, a rise in the doubtful assets of the banks, and a fall in the sources of revenue to finance development expenditure, particularly in the social sector at both central and state levels.
- Second, the depressed revenue from goods and services (GST) and lack of efficient infrastructure of information technology for a smooth transition of GST revenues, has created more uncertainty.

- Third, the reorganization of Jammu & Kashmir and Ladakh into two separate union territories has led the commission to think about its development strategy separately which required detailed examination and extra time.
- Fourth, the commission was also provided with additional work of examining whether a separate non-lapsable fund can be created for defense and internal security in its terms of reference (ToR).
- Lastly, the report of the commission was also affected by the model code of conduct of elections due to the [Lok Sabha](#) elections in May 2019.

Vertical Devolution

- With regards to vertical devolution, it is necessary to recall the ToR of the Fifteenth Finance Commission which has led to apprehensiveness amongst states regarding vertical devolution and accompanying fiscal autonomy.
- The commission has kept the vertical devolution at 41% of the divisible pool of union taxes. It means that there is no change in the vertical share.
- The 1% reduction in the devolution is due to the separate status of J & K and Ladakh as full-fledged union territories.
- It is to be noted that the higher tax devolution recommended by the Fourteenth Finance Commission has been neutralized by the new cesses and surcharges.
- In recent years, there has been a tremendous increase in the share of cess and surcharges and it has crossed 12% of gross tax revenue.
- The Fourteenth Finance Commission has assigned a 42% share of states, but states are receiving only approximately 34% of the gross tax revenue. It is a major matter of concern among states.
- However, the collection through cess and surcharges is not an appropriate measure to provide resources to the states and the commission has also not made any remarkable recommendations in the context of increasing the vertical share of taxes to the states.

Reduction in corporate tax rates and its repercussions:

- At this juncture, let us recall the reduction in corporate tax rates by the central government in September 2019 to revive the economy from a low growth period of six years.
- The base corporate tax for existing companies was reduced to 22% from 30%, and to 15% from 25% for new manufacturing firms incorporated after 1 October 2019, and for those starting operations before 31 March 2023.
- However, no deductions and rebates are provided to the companies opting for new lower tax rates.
- The reduction in corporate tax rates has led to declining revenue of both the central as well as the state government, as evidenced by the budget paper of 2020-21.
- The central government has managed to compensate for the cut by asking for a higher dividend from the [RBI](#) but, states were compelled to cut their capital spending to a greater extent.

Separate non-lapsable fund for defense:

- Another remarkable feature of the recommendations of the Fifteenth Finance Commission for 2020-21 is that it has not mentioned anything about creating a separate non-lapsable fund for the defense, which was made mandatory by the additional ToR.
- It is to be noted here that if the separate fund is created for defense, it is going to undermine the share of resources to the states.
- Hence, the commission has maintained a balanced view in the first report and it is also expected that this view will continue in the main report, otherwise, states will have to suffer in terms of resources.

Devolution between the states:

- If we look at the inter-state distribution, it is evident that the Fifteenth Finance Commission has followed the measures of previous commissions in its first report.
- The dominant indicator under the formula is equity with 45% weightage, followed by population (15%), area (15%), demographic performance (12.5%), forest and ecology (10%), and tax effort (2.5%) weightage.
- Demographic performance indicator which is defined as the inverse of the total fertility rate scaled to the 1971 population, is the prominent feature of the horizontal devolution formula.
- This acts as a mechanism under which a state is rewarded for successfully implementing the family planning policy and also maintaining/decreasing the loss of shares because of using the 2011 population in place of the 1971 population in the past.
- Like the fourteenth finance commission, the fifteenth finance commission has balanced the fiscal need—population, area, and forest—at around 40% of the weight and fiscal capacity—income distance, tax effort—at around 47.5% weight.
- The commission has included the demographic performance in its devolution formula rather than putting it into the category of grants.
- The commission has rewarded states for their contributions to “global public good” like conservation of forests as done by earlier finance commissions. The finance commission has factored in the opportunity costs of preserving forests and water bodies.
- On comparing the recommendations of the 14th and the 15th finance commission, horizontal allocations have declined for eight states namely Andhra Pradesh, Assam, Haryana, Karnataka, Kerala, Odisha, Telangana, and Uttar Pradesh.
- Although the decline has been marginal for some states, Karnataka, Kerala, and Telangana have seen a major decline.

The FRBM Framework

- The borrowing by states is still under the 3% of the gross state domestic product (GSDP) limit as mandated by the fiscal responsibility acts (FRAs).
- The commission as such has not made any recommendations about the [Fiscal Responsibility and Budget Management Act, 2013 \(FRBM\)](#)/FRAs, it has indicated that it will propose a new framework for FRBM, which will further constrain the borrowing capacity of states.

- It is expected from the commission to propose a symmetric framework for states and centre with respect to borrowing. This is because the central government in the union budget 2020-21 has widened the fiscal deficit by invoking the escape clause. States cannot do so as their borrowing powers are tightly controlled by the centre.
- States have been fiscally prudent as the combined fiscal deficit of states in 2018-19 is expected to be 2.61% of all states' GSDP. However, with declining revenue and economic slowdown, it is becoming increasingly difficult for states to finance development expenditure.
- The commission should provide an implementable framework such that the hard budgetary constraints become the joint responsibility of both states and centre.
- Under given circumstances of a sharp dip in GDP growth, states should be allowed to adopt expansionary and more redistributive fiscal policies.
- A global consensus is developing over relaxing mandatory ceilings on fiscal deficit and debt-to-GDP ratios. This is because monetary policy has been marginally successful in reviving economic growth even a decade after the 2008 crisis.
- In India also, under current circumstances, there is a strong case for fiscal stimulus. To facilitate economic growth, there is a need to invest in specific sectors. With large foreign exchange reserves and a low current account deficit, the government can go for such fiscal stimulus.
- Thus, the central government should increase spending and facilitate states to do so.
- Hence, it is not the right time for the finance commission to make the existing framework of FRBM more stringent. Instead, it should go for a more liberalized framework.

Grants:

- One of the terms of reference of the finance commission was to review the continuance of revenue deficit grants, which is used to cover the shortfall in the assessed post-devolution deficit of states.
- If revenue deficit grants are discontinued then it would result in worsening of imbalances in the flow of resources to the states.
- However, considering its importance, the commission has recommended revenue deficit grants worth ₹74,340 crores to 14 states.
- Also, for three states namely Karnataka, Mizoram, and Telangana, the commission recommended special grants to cover the absolute shortfall in 2020–21 from the total amount of tax devolution and revenue deficit grants in 2019–20. However, the central government has asked the commission to review it again. This move undermines the credibility of the finance commission.
- In a deviation from the Fourteenth Finance Commission, the Fifteenth Finance Commission has recommended several grants with attached conditionalities such as grants for nutrition. However, it has been observed that, under attached conditions, utilisation rates of grants have been quite low.
- For states, tax devolution is the primary mode of resource transfer. For example, under the Fourteenth Finance Commission award, 91% of resource transfers recommended by the commission were in the form of tax devolution. Conditional grants will reduce resource distribution through tax devolution.
- Hence, the Commission should refrain from recommending conditional grants except those which are constitutionally mandated. This will protect the fiscal autonomy of states.

- With respect to local governments, there has been a marginal increase of 8.07% in grants as compared to 2019–20. Rs. 90,000 crores have been granted to local governments and an additional Rs.4,400 crore to metropolitan areas for improving the air quality, particularly in winter.
- Of the funds allocated for local bodies (other than million-plus urban agglomerations), 50% has been tied as funds for sanitation and maintenance of open defecation status, the supply of drinking water, rainwater harvesting, and water recycling.
- Tied funds will create problems for local planning in states such as Kerala, where local governments are involved in the preparation of annual plans. Hence, there should be greater flexibility in the utilization of funds.
- The finance commission has recommended providing grants to the higher tier of rural local governments, which is commendable. However, a 40% increase in the share of urban local governments is surprising, given urban local governments have their own resources which is much more when compared to rural local governments.

The outcome of recommendations in the Budget 2020–21:

- The aggregate transfer which includes both tax devolution and grants is about 7.5% of the GDP.
- There is a significant deviation between the revised estimates of 2019–20 and the actual 2018–19. Hence, transfer in 2020–21 depends on the revenue of the central government and budget forecast.
- If there would be volatility in the flow of grants, this would constrain fiscal space for key sectors such as health and education.
- Availability of the resources to states depends on the recommendations of the finance commission which will be submitted in November 2020.
- It is expected that aggregate transfer to states will decline from 7.88% of GDP in 2017–18 to 7.50% in 2020–21 (Budget estimates).

Conclusion:

- The first report of the fifteenth finance commission has nullified many apprehensions related to the terms of reference.
- It can be hoped that a similar approach will be taken in the second report. The finance commission has to include the impact of COVID-19 in its second report.
- The Fifteenth Finance Commission needs to consider the requirement of higher spending by central and state governments and should make recommendations accordingly.

‘Foundational Agreements’ and Self-reliance

Context:

- The article analyses the impact of the Basic Exchange and Cooperation Agreement (BECA), signed between India and the USA.

Background:

- India and the US have finally signed the Basic Exchange and Cooperation Agreement (BECA), which happens to be the last of the three “Foundational Military Agreements”.
- The other two agreements are the Logistics Exchange Memorandum of Agreement (LEMOA) signed in 2016 and the Communications Compatibility and Security Agreement (COMCASA) in 2018.

For more on BECA and other agreements between India and the US, check the article [India – US relations](#).

Analysis of BECA:

- BECA will facilitate interoperability and ease of operations between the militaries of two countries.
- China is certainly a factor that has strengthened defense ties between India and the US but more importantly, changing global order guided by technological and geopolitical changes have facilitated this cooperation between the two countries.
- BECA will facilitate the smooth transfer of geospatial data and critical information to India’s war equipment such as drones and missiles that will enhance their precision and kill probabilities. Data from the Indian side will also move into the US network for further processing and dissemination.
- Although the data transfer will happen bi-directionally, the analysis of data will be exclusively done by a US-managed command and control (C&C) center. The command and control (C&C) center of the US is capable of integrating information to assess threats, pair weapons with targets, and also provide for a machine to machine interface.
- However, interoperability will be possible only in those systems which are designed and selected by the Pentagon. For example, [BrahMos](#) supersonic cruise missile, which is indigenously built, has to be fitted with an interface to ensure interoperability.
- BECA has made it necessary that India’s future weapon systems should be Pentagon certified and approved. Weapons from other sources will not be useful in the US-controlled setup.

BECA and the fourth Industrial Revolution:

- The fourth industrial revolution is disrupting not only the civilian world but also warfare strategies.
 - In the near future, machines will control other machines and humans will have minimal say in the decision making.
- In this context, the Pentagon is converting itself into a “data-centric organization.” Its focus is on combining operations of all domains involving all arms of the armed forces not only of the US but also of its partners.
- These are being developed to have inter-service, intra-service and inter-partner integration and interoperability, to dominate the battlefield, in the age of (artificial intelligence) AI guided warfare systems.
- According to Pentagon’s first “enterprise data” strategy, “Data is the ammunition in the Digital Modernization Strategy and is increasingly central to warfighter advantage on and off the battlefield.”
 - The strategy draws attention to data management and governance.

Future of India’s weapons systems:

- The main objective of these agreements is to ensure hassle-free interoperability between the Indian and US military without much government clearances.
 - This makes procurement of items by the Department of Military Affairs in the Ministry of Defence smoother at the price settled between the Pentagon and its chosen military contractor.
 - For example, under the LEMOA agreement which was signed in 2016, the Indian Army purchased 11,000 sets of winter clothing from the US army directly.
- The question is whether such agreements will make Indian armed forces more dependent on the Pentagon than on the Indian government for their operational and non-operational needs?
- Overdependence on the US may make our armed forces complacent and hamper the development of indigenous weapon systems.
 - This seems to be true because we are trying to enhance our capabilities in developing old age weapon systems (development of aircraft carriers, tanks, and nuclear submarines) and on the other hand, the new-age weapon systems (development of autonomous surface, air, and underwater vehicles that can be operated as swarms), are being developed by Russia, China, and the West.

Conclusion:

- It should be acknowledged that the national military is being globalized at an unprecedented rate. The US is trying to win over its allies before its competitors try to influence them.
- India's support is necessary for the US to maintain its imperial control over the world. That is why India-US relationship will remain a priority for the US for the next one hundred years.

The Language of Compensation

Context:

- The article discusses the idea of compensation to farmers in case they incur a loss due to natural calamities.

The idea of compensation:

- In India, the frequent occurrence of Natural disasters, such as floods, cyclones, and torrential rains have led to severe destruction of lives and property.
- Hence, it is a natural cause for the victims to demand compensation for the losses incurred due to a natural disaster.
- Two distinct words- demand and appeal, have been used while claiming the compensation.

'Demand' as a form of compensation:

- The word demand has been often used in the campaign for compensation, by the opposition and the leaders of the farmers' movement.

- However in the case of natural calamity, if demand is used as a singular reference to compensation, it narrows down the idea of compensation.
- It is under two conditions, 'demand' can be equivalent to compensation.
- First, with respect to social relations which is based on the idea of private property.
- This provides the grounds for compensation to acquire the value of the entitlement.
- It is the private ownership of land by farmers that forms the basis of the agreement between the crop insurance companies and farmers.
 - In case of any crop loss, the farmer can demand compensation in a legal manner.
 - Thus, compensation as an entitlement can be defended against the violator of the agreement.
 - The one who violates the agreement becomes the wrongdoer. Even farmers can become wrongdoers at least in a theoretical manner. However, when there is an agreement between a crop insurance company and a farmer, it is the former, who is treated as the violator and becomes the wrongdoer.
 - Hence, in case a disaster strikes, farmers can demand compensation from insurance companies and if the company fails to adhere, farmers can ask the state to compensate.
 - This is why farmers protest when there is a delay in compensation by insurance companies or when they refuse to pay compensation to farmers.
- The second condition in which demand is equivalent to compensation is the contractual obligation which arises from the agreement between the farmers and insurance companies. The contractual obligation provides validity to the claims made by the aggrieved party.
 - In other words, the claims of compensation become valid whenever the contract is violated by either of the parties.
- Thus, 'demand' becomes a force of assertion rather than persuasion. It converts the claims for compensation into entitlement and makes the claims of compensation as a matter of right.
 - Demand for compensation as a matter of right assumes that the contract can be legally enforced.
 - In this manner, the contract makes a particular insurance company or the government responsible to pay compensation.
- Thus, it is the mutual agreement and its violation that allows for the use of the word demand for compensation.
- For instance, if a particular insurance company fails to compensate, farmers have the right to demand compensation as per the agreement.
- Thus Responsibility assumes legal nature. The insurance company is bound to adhere to the agreement and compensate farmers in a sincere and efficient manner.
- This contractual obligation helps to compensate for the losses incurred by farmers during natural disasters.

'Appeal' as a form of compensation:

- Making an appeal for compensation, on the other hand, is based on moral persuasion. It makes the government morally responsible to help disaster victims immediately.

- In absence of any formal agreement or say those who have not insured their crops cannot put the demand for compensation. In such cases, only the moral language of appeal can work.
- In such circumstances, the government's responsibility becomes moral rather than legal. The government relies on its moral capacity to compensate for the loss.
- In the same manner, the victim's claim for compensation is based on moral rationality. That is why the expression, "The wrong is done by nature and not by the state," forms part of this moral understanding.
- Hence, in such cases, the compensation is claimed in the form of a moral appeal to the government, and the government is expected to take necessary actions immediately.

Conclusion:

- Thus interpreting claims of compensation of every victim as demand will lead to an inaccurate understanding of compensation.

