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A Case Study of Pay Commission in India

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ABSTRACT:-

Since India's Independence, seven pay commissions have been set up on a regular basis to review and make recommendations on the work and pay structure of all civil and armed forces. The primary objective of the Pay Commission is to ensure salary hikes, maximum employee benefit and protect the rights of an employee.

Keywords:-Revenue-Vicious cycle-Sector-Impact

Introduction

Governments however are constrained by their limited budgets. The composition of public expenditure and their source of financing can have effect on the employment levels, inflation and future growth prospects. The cause of the crisis in the 1990s was imprudent behavior of the government. Since then public expenditure management has become an important objective of the Government of India (GOI). The expenditure items can be broadly classified as revenue and capital expenditure. Revenue expenditure does not create assets or reduce liabilities. Capital expenditure on the other hand by creating assets improves the long run potential of the country. In case of India the share of revenue expenditure has comparatively been higher than capital expenditure. This pattern of the government has been constantly criticized on account of the resulting fiscal imbalances and the substitution of expenditure towards less productive purposes instead of capital formation (Bose and Bhanumurthy, 2013; Goyal and Sharma, 2015). It is being argued that current spending might not improve the long run growth prospects of an economy but capital expenditure with focus on human capital, infrastructure; and science and technology can have sizeable effect (Diamond, 1989; Barro;1991, 1997; Barro and Sala-i-Martin, 1995; Romer, 1994). The role of dedicated bureaucracy in providing good leadership and governance in a highly populated country like India is invaluable. Without greasing the wheels of its administrative machinery, the functioning of the government might become highly inefficient. Efficiency wage theory dictates that to get efficient and competentworkers, a firm should provide wage which is more than the market-clearing wage in order to increase their productivity or efficiency (Akerlof, 1982; Akerlof and Yellen, 1986). Although, paying high wages to everyone is not possible but wages can be raised to a level which allows the government employees to maintain a decent standard of living (7th Central Pay Commission). The changing global outlook in the 21st century and the evolving consumer driven nature of the economy has led to vast differentials in salaries of skilled workers in private sector as compared to the public sector (Glinskaya and Lokshin, 2005; Singh et. al, 2015). Regular pay structure revisions are critical to attract better talent to public service. The size of the public wage bill is typically an important issue of economic policy. The government at times have limited resources and might be keen on reducing the wage bill burden. One option could be to allow the inflation to erode the real wages. However, these cut in real salaries do not go unnoticed and leads to discouragement and creation of an inefficient workforce (Chew, 1993). Clearly, governments are caught in a vicious cycle. The provision of higher wages can leave government with too little resources for other activities. And, the strategy to keep low wages might result in a de-skilled and poorly paid workforce (Chew, 1993). The society suffers. Social sector services need to be more professional and delivery oriented. The problem is compounded when the salary increases for skilled personnel in private sector at a faster pace. There is a trade-off between compensation and productivity. The solution could be to implement compensation reforms in a manner that the incentives of the employees are not distorted (IMF, 2016). It is true that there is no market for output of the public sector. It might be difficult to come up with a method to estimate the vales of these services. The solution in this case will be to compensate the public sector employees at a rate which is comparable (if not equal) to that for equivalent skills which are marketed in the private sector (Campo et. al, 1997). To provide the employees sustainable wages and to nudge the competent and talented workers in the government sector, the Government of India has set up various Pay Commissions from time to time.

Concern Area

Developing economies are keen on achieving rapid economic development. Even the developed economies are consistently looking for continuous improvement in the standard of living of their people. It is widely acknowledged that expenditure and economic growth are correlated. But, there are always constraints and opportunity costs while making optimal use of the resources. Private sector is not in the capacity to make huge investments,

especially for social activities, because of their objective of profit maximization and the ever persistent uncertainty. Although, the government also faces a number of budget constraints, economic development is to a great extent dependent on public expenditure, especially during the initial stages when the economy is taking-off. The expenditure incurred by the government could cater to different needs, sectors and sections of the economy. To elaborate, infrastructure is a handicap which can impede growth. By building rails and roads, the government improves the connectivity across various regions and helps the business to flourish. Similarly, the governments have welfare concerns for the population. It incurs expenditure on schemes for people on lower economic plane and allots higher funds for backward areas to promote balanced regional growth. Expenditure is also incurred to provide basic amenities to ever increasing population such as education, housing facilities and security. In developing countries, inflationary pressures are always destabilizing, the government provides subsidies and rations food to alleviate them. Subsidies are also provided for the production of goods which have the potential to generate foreign exchange. Public expenditure has the potential to make a difference through multiple channels. For example, investment in health and education can lead to formation of human capital formation which implies improvement in productivity of the workers and can lead to higher economic growth. Similarly, the expenditure incurred on agriculture or industry could create backward and forward linkages. This in turn can lead to creation of employment opportunities. To understand how the public expenditure could create multiplier effect and to what extent, it will be helpful to understand the various categories of expenditure incurred by the Government of India. Revenue expenditure has a recurring nature and undertaken on yearly basis. Capital expenditure is the investment in durable type assets. Further, revenue expenditure is categorized as expenditure on: General services, Social Services, Economic Services, Grants in Aid and Contributions; and Aid Materials and Equipments. Capitalexpenditure is divided between Capital Expenditure/Outlay and Loan/advances and includes General services, Social Services, Other Services and loans.

Research Objective

- To document the impact of Fifth Pay Commission and Sixth Pay Commission onfiscal accounts of the Centre and the State governments.
- To analyze the effects of Pay Commissions on fiscal accounts of the Centre and the State governments using historical growth rates and recent trends in fiscal variables.
- To develop a summary of the Central and State government Pay Commission
- Recommendations with focus on changes in salaries and pensions.
- To analyze the moderation in other items of revenue expenditure and capita expenditure due to pay commission.
- To estimate the multiplier impact of increase in components of government spending such as salary, pension and remaining revenue expenditure on private consumption and GDP.

Revenue Profile

The revenue profile of the Centre has its own significance as pay and allowance and pension burden is financed using the revenues generated by the government. Also, the Centre has to share the taxes with the States as mandated by the constitution. Therefore, it is the responsibility of the Centre to manage the revenue in such a manner that it is able to meet the committed liabilities without jeopardizing its fiscal space. Salary is treated as consumption expenditure and it would not be sensible on the part of the government to meet these liabilities by borrowing and increasing its debt burden. The instruments used by the Central Government to generate revenues are direct taxes, indirect taxes and non-taxes. There are capital receipts as well which comprises of recoveries of loans provided to State and foreign governments, Public Sector Enterprises and Union territories as well as receipts from disinvestment. But these receipts do not come in the ambit of revenue receipts. Table 4.2 below presents the composition of the Central Government's revenue receipt and the growth rate. Interestingly, the composition of the total revenue being generated from different sources has shifted considerably over the period 1995-96 to 2015-16. Direct taxes net of share meant for States, indirect taxes and non-tax revenues were approximately around 20 per cent, 54.2 per cent and 25.6 per cent in 1995-96. The combined share of direct and indirect taxes was around 75 per cent and has increased consistently and is around 80 per cent today. However, over time the share of indirect taxes has been coming down while direct taxes have been increasing. The share of non-tax revenue have shown a decline during the years when the recommendations of the 6th Pay Commission were implemented. Also, the rate of growth of revenues being generated from direct and indirect taxes are lower during these years. The rate of growth of direct taxes was 7.1 per cent in 1997-98, 7.2 per and 9.5 per cent in 2008-09 and 2009-10. The growth in indirect taxes for these years is 0.3, -6.2 and -5.3 per cent respectively. The rate of growth of direct taxes and indirect taxes has been particularly high in years preceding the 6th Pay Commission. The growth rate in direct taxes was 40.6 per cent in 2006-07 and 36.4 per cent in 2007-08, while indirect taxes were 21.3 per cent and 14.6 per cent. Notably, tax breaks were provided during this time to counter the slowdown in India.

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