Chapter 1.1

Introduction

Constitution of the Sixth Central Pay Commission

1.1.1 The Government constituted the Sixth Central Pay Commission vide Resolution No. 5/2/2006-E.III(A) dated October 5, 2006.

Terms of Reference

1.1.2 The Terms of Reference of the Commission are as under :

A. *To examine the principles, the date of effect thereof that should govern the structure of pay, allowances and other facilities/benefits whether in cash or in kind to the following categories of employees:-*

1. *Central Government employees – industrial and non-industrial.*
2. *Personnel belonging to the All India Services.*
3. *Personnel belonging to the Defence Forces.*
4. *Personnel of the Union Territories.*
5. *Officers and employees of the Indian Audit and Accounts Department; and*
6. *Members of the regulatory bodies (excluding the RBI) set up under Acts of Parliament.**

B. *To transform the Central Government Organisations into modern, professional and citizen-friendly entities that are dedicated to the service of the people.*

C. *To work out a comprehensive pay package for the categories of Central Government employees mentioned at (A) above that is suitably linked to promoting efficiency, productivity and economy through rationalization of structures, organizations, systems and processes within the Government, with a view to leveraging economy, accountability, responsibility, transparency, assimilation of technology and discipline.*

D. *To harmonize the functioning of the Central Government Organisations with the demands of the emerging global economic scenario. This would also take in account, among other relevant factors, the totality of benefits available to the employees, need of rationalization and simplification, thereof, the prevailing pay structure and retirement benefits available under the Central Public Sector Undertakings, the economic conditions in the country, the need to observe fiscal prudence in the management of the economy, the resources of the Central*

Government and the demands thereon on account of economic and social development, defence, national security and the global economic scenario, and the impact upon the finances of the States if the recommendations are adopted by the States.

E. *To examine the principles which should govern the structure of pension, death-cum-retirement gratuity, family pension and other terminal or recurring benefits having financial implications to the present and former Central Government employees appointed before January 1, 2004.*

F. *To make recommendations with respect to the general principles, financial parameters and conditions which should govern payment of bonus and the desirability and feasibility of introducing Productivity Linked Incentive Scheme in place of the existing ad hoc bonus scheme in various Departments and to recommend specific formulae for determining the productivity index and other related parameters.*

G. *To examine desirability and the need to sanction any interim relief till the time the recommendations of the Commission are made and accepted by the Government.*

*As substituted by Ministry of Finance Resolution No.5/2/20006-E.III (A) dated the 7th December, 2006.

Additional Term of Reference

1.1.3 Through a subsequent Resolution No.5/2/2006-E.III.(A) dated 8th August, 2007, the terms of reference were enlarged to include the officers and employees of the Supreme Court.

Background

1.1.4 The Fifth Pay Commission had recommended that pay revision should, in future, be entrusted to a permanent Pay Commission drawing its authority from a constitutional provision and whose recommendations, made annually, should have a binding character. The Commission, as an alternative, suggested that dearness allowance should be converted into dearness pay every time the cost of living rises by 50% over the base level. In their opinion, DA would normally increase by 50% in a period of 5 years and that this relief could be combined with a decennial exercise of pay revision through a Pay Commission, meeting partially the demands of Central Government employees for a more frequent revision of salaries on the analogy of public sector employees. The Fifth CPC recommended constitution of the next Pay Commission by 2003 so that its report was available by 2006. Although the Government did not appoint the next Pay Commission in 2003, it allowed merger of 50% of dearness allowance with pay with effect from 1/4/2004.

Composition of the Commission

1.1.5 Sixth Central Pay Commission comprised a Chairman and 3 Members as under :

1	Chairman	Justice B.N.Srikrishna
2	Member	Prof. Ravindra Dholakia
3	Member	Mr. J. S. Mathur
4	Member-Secretary	Smt. Sushama Nath

Unfortunately, one of the distinguished Members, Shri J.S. Mathur passed away in February, 2008. The Commission would like to place on record its gratitude for the immense and substantive contribution made in the Report by Shri J.S. Mathur.

Special features of Terms of Reference

1.1.6 Terms of Reference of the Sixth Central Pay Commission are somewhat different from those of the earlier Central Pay Commissions. Clause 2 (B) of the Terms of Reference envisages transforming the Central Government organizations into modern, professional and citizen friendly entities that are dedicated to the service of the people. While the earlier Commissions were required to examine the work methods and work environment and to suggest rationalization and simplifications therein with a view to promoting efficiency and optimizing the size, it is for the first time that a Central Pay Commission has been asked to look into the measures that would improve the delivery mechanisms which have a direct bearing on the services provided by various Government agencies to the common citizens. Further, Clause 2 (D) of the Terms of Reference makes it incumbent upon the Commission to harmonize the functioning of the Central Government Organizations with the demands of the emerging global economic scenario.

1.1.7 The Sixth Central Pay Commission, therefore, had not only to evolve a proper pay package for the Government employees but also to make recommendations rationalizing the governmental structure with a view to improving the delivery mechanisms for providing better services to the common man. In addition, linking the pay packages with simplification of systems and processes within the Government, greater delegation with emphasis on accountability, responsibility and assimilation of technology, etc. have been the Commission's guiding philosophy.

Measures adopted to achieve desired objectives

1.1.8 The Commission, in this Report, plans to achieve these objectives through reduction of layers within the Governmental structure so that decision making and delivery is expedited. In the process, a number of superfluous levels have been removed. This simplification is also reflected in the entire scheme of pay scales being substituted by a system of running pay bands, where the existing 35 pay scales have been replaced by 4 running pay bands (excluding -1S) containing 20 grades. Additionally, the posts of Cabinet Secretary/equivalent and Secretary to Government of India/equivalent have been placed in distinct pay scales. A system that primarily lays emphasis on delivery and end results and which continuously rewards performance has been put in place by incorporating features like Performance Related Incentive Scheme (PRIS) and variable increments in the basic scheme of pay scales. By incorporating systemic changes in the existing procedure of appointments, efforts have been made to ensure a young and dynamic bureaucracy, with a result oriented approach, where the best persons available are selected for holding specific posts. While proposing these changes, the Commission has also kept in view the capacity of the Government to pay and the principle that every rupee spent on allowances, facilities and salaries of Government employees has to translate into a specific measure for public good. The Commission, at the very outset, would like to underline the fact that this Report is a holistic document and has to be treated as an organic whole since all the major recommendations contained therein are inextricably inter-twined. Accordingly, any modification in the scheme of recommendations can severely affect the outcome this Report sets out to achieve. **The Government, therefore, would be well advised to consider implementing all the major recommendations contained in the Report as a package.**

Methodology

1.1.9 The Terms of Reference permitted the Commission to devise its own procedure. To elicit the views of various stakeholders, the Commission issued a public notice inviting all interested persons, including members of the public, peoples' representatives, consumer associations, staff associations, State/UT Governments, ministries/ departments to send their views on the subject by 31st December 2006. Consequent to an addition in the terms of reference, Unions/Associations of officers and employees of the Supreme Court of India were requested to submit their memoranda to the Commission before 31st August 2007. A questionnaire was also prepared to facilitate responses from Individuals/Groups on the items of specific interest to the Commission with facility for online response. The analysis of responses to the questionnaire is given at the end of the Volume carrying Annex to the Report. To elicit the views of various States on the financial impact that the likely recommendations of this Commission would have on them, a questionnaire in this regard was also sent to the State Governments. Since the Terms of Reference of the Commission included Regulatory Bodies, information on regulatory bodies set up under Acts of Parliament was also sought from the concerned Ministries/Departments. Following studies on specific subjects of importance were carried out by expert bodies on behalf of the Commission:-

- Study on Feasibility of Performance Related Incentive (PRI)
- Study for Estimating the Compensation Package for Government Employees and the Cost to the Government
- Study on Terminal Benefits of the Central Government Employees

(Full text of the Reports of these Studies is at the website of Sixth CPC http://www.india.gov.in/govt/paycommission.php)

From January 16, 2007, the Commission initiated meetings with various stakeholders to personally hear their views and demands on related issues. Meetings were held in various parts of the country to facilitate stakeholders staying in distant areas to present their views personally before the Commission and also to ensure larger representation. During these meetings, the Commission also got the benefit of hearing the views of Secretaries to Government of India, Heads of Department and other eminent persons. The Commission held these meetings in Mumbai, New Delhi, Kolkata, Port Blair, Guwahati, Chennai, Puducherry, Ahmedabad, Gandhinagar, Bangalore, Srinagar, Kargil, Leh and Hyderabad. During these hearings, a considerable number of documents were handed over to the Commission. The list of Unions/Federations/Associations/ eminent persons heard by the Commission is at Annex 1.1.1.

Visits

1.1.10 The Commission visited several establishments in different parts of the country to get a first hand impression about the functioning and the conditions of service prevailing there. During these visits, the Commission also interacted with a large number of field level functionaries.

Working of the Commission

1.1.11 The Sixth Central Pay Commission was given a period of 18 months to submit the Report. The Commission initiated its work immediately after the date of its Notification on 5th October, 2006. The Commission adopted a totally delayered approach where no hierarchical levels were allowed to exist and all functionaries could freely discuss the concerned issues with any one in the Commission irrespective of their hierarchy. This approach facilitated expeditious decision making and the Commission was able to finish its task well within the stipulated time-frame with a very small complement of staff. To keep the staff requirement at minimum, only multi-skilled functionaries were taken and no Group D staff employed. The Members and the officials of the Commission were not provided individual secretarial assistance or peons. Although 48 posts were sanctioned, the Commission filled only 17 posts. This has to be viewed vis-à-vis the strength of earlier Pay Commissions where the Fifth CPC had a total sanctioned strength of 141 posts (out of which 135 posts were filled) and the Fourth CPC had 209 posts. The Commission was able to achieve its target with a very small staff complement because the work processes in the Commission were re-oriented to have a result-oriented approach with emphasis on output rather than processes. Due to these work practices, the Commission was able to complete its work utilizing less than 60% of the allocated budget. In the Commission's opinion, a similar policy needs to be adopted in all Government offices, which would increase efficiency and improve the end user satisfaction.

Chapter 1.2

Philosophy & the guiding principles

Introduction

1.2.1 The Government constituted the Sixth CPC at a time of fast and accelerating economic development, emerging trade and commercial practices, increasing globalization of trade and industry with greater emphasis on increasing investment flows and transfer of technology. Indian economy is rapidly getting integrated with the rest of the world. In the economic and financial sectors, the earlier era of protectionism where the Government largely played the role of a monopolistic supplier or of a restrictor or controller, has changed. The principal role of the Government presently is perceived to be that of a facilitator and regulator in the various economic activities. An imperative and urgent need exists to harmonize the functioning of the Central Government Organisations with the demands of the emerging global economic scenario. In the social/ developmental sectors, especially in the fields of food security, elementary education, primary health care, and rural/urban development, the functioning of Government Organizations has to be improved to make them more professional, cost-efficient, citizen-friendly and delivery oriented. The Commission is the first Central Pay Commission to be constituted in this century of rapid technological advances and after coming into force of the Right To Information (RTI) and Fiscal Responsibility and Budget Management (FRBM) Acts. The Government machinery has to learn to adapt to these changes and to leverage knowledge and technology for better performance under stricter fiscal discipline and better delivery mechanisms. The Terms of Reference of the Commission suitably reflect this changed imperative.

Performance Related Incentive Scheme (PRIS)

1.2.2 The Commission has recommended several innovative features to ensure better delivery systems in the Government with emphasis on end user satisfaction which is the primary criterion for judging the efficiency of an organization. Introduction of Performance Related Incentive Scheme (PRIS) is a step in this direction. This is not a new concept. Many of the earlier Central Pay Commissions as well as various expert committees constituted in the past have recommended performance related incentives in one form or the other. In this Report, however, the Commission has tried to devise a workable and practical model by which the concept can be implemented in the Government. The PRIS recommended by this Commission envisages a pecuniary component, over and above the salary, for higher performance that would be judged by improved delivery to the end user by an external independent agency. This scheme of PRIS has been recommended to be implemented in all ministries/departments/organisations of the Central Government in a phased manner. Performance Related Incentive Scheme (PRIS) should also work as a substitute for bonus (whether linked to productivity or ad-hoc), honorarium and over time allowance.

Fitment benefit

1.2.3 The efforts of the Commission have been to devise a suitable pay package which will not only provide enough incentive to retain the brightest officers but also attract the best to join it in future. The quantum of fitment has been decided, accordingly. At the time of Fifth Central Pay Commission, fitment of 20% of the pre-revised basic pay was recommended. This was subsequently raised by the Government to 40%. The Commission is recommending a new structure of running pay bands and grade pay. In the structure, grade pay has been normally taken at 40% of the maximum of the pre-revised pay scale. Grade pay is, therefore, in the nature of fitment benefit. The pay in the running pay band, as on 1/1/2006, has been computed by adding the basic pay and dearness allowance at the rate of 74% that would have been payable on the existing Fifth CPC pay scales w.e.f. 1/1/2006 had merger of dearness allowance equal to 50% of the basic pay not been allowed from 1/4/2004.

Minimum salary

1.2.4 For fixing minimum salary, the Commission has mainly been guided by various factors like ensuring fair wages keeping in view the capacity of the Government to pay, the inflationary impact of such increase on the economy in general and on the State Governments, various autonomous bodies and other organizations which follow the Central Government pattern of pay, and the fact that the minimum salary in Government can only be available at the entry level when an employee is single or married with a nuclear family. The consumption units for computing the minimum salary have been taken as three, which, in our view, reflects the factual reality. A fair comparison based on principles of equity and social justice, also makes it imperative to take into account the economic conditions of large sections of the community that are less privileged than Government employees and several of whom live below the poverty line.

Salaries in higher grades

1.2.5 The issue of fixing salaries in higher grades is more complex. Most of the employees, in the memoranda submitted to the Commission, and during the oral evidence, desired a linkage with the salaries in the public sector enterprises as well as the private sector on the ground that a broad parity needs to be ensured between the salaries in Central Government and in the public sector enterprises. A view has also been expressed that there is excessive job security enshrined in Article 311 of the Constitution and that cumbersome rules act as a hindrance to easy exit of Government employees. The Commission has given deep thought to all these arguments. It is undeniable that Government jobs provide unparalleled job security, pension benefits, work-life balance and status. The capacity of the Government to pay is limited. Further, the Government also provides a vast array of non-monetary benefits that can and should be monetized in order to correctly assess the actual compensation package available to the employees. Quantification of these benefits has other advantages as well. The aspirants for each category of Government job would know beforehand precisely what total package to expect and, could decide for themselves whether the Government job is sufficiently attractive vis-à-vis jobs in other sectors. This is all the more necessary because the salary packages offered in the private sector are on the basis of the cost to the company. In the Government, existence of multiplicity of allowances, coupled with a certain degree of uncertainty regarding their admissibility, considerably discounts the attractiveness of Government job in strict monetary terms. Secondly, this quantification will enable Government, Parliament and the public to have a clear, comprehensive and accurate picture of the total expenditure being incurred on Government employees, both civil and military, since non-monetary perquisites scattered over many budgetary heads, mask the true picture of the expenditure incurred on the employees. The Commission has taken various steps to assess the monetary value of such benefits. A study was also commissioned in this regard. An estimate of the total compensation package available to employees in different sectors has, for the first time, been attempted/computed upfront so that employees get a better idea of the benefits they receive and what these benefits cost the Government. It would also help in crystallizing, in monetary terms, the cost to society of delivery of the service that the employee is providing.

Contractual appointments for fixed tenures

1.2.6 The Commission is recommending introduction of contractual appointments for selected posts, particularly those requiring high professional skills. Under this, suitable persons from outside can be inducted in the Government. The existing employees, at their option, can also negotiate a consolidated amount for a specific tenure in a particular post provided they leave the service. Such employees will not be entitled to any other benefit. After the expiry of the tenure, the concerned employee may renegotiate the contract or leave. This will allow salaries that are broadly comparable to the private sector with similar terms of engagement to be paid in the Government. The concerned department/organization would not be given any extra budget on this account and should ensure commensurate savings elsewhere to absorb the extra expenditure incurred. The Commission is of the view that this will not only enable the opting employees to get remuneration comparable with the private sector but will also improve the work culture in the Government because continued employment of such employees will depend solely on their performance just like in the private sector. Another benefit that is expected to accrue will be infusion of fresh talent while simultaneously enabling the Government employees to leave the Government without following cumbersome procedure that applies in case of permanent Government employees. This will enable the Government to pay a higher and need-driven remuneration depending on the particular expertise of the concerned employee which will also stall the efflux of such employees to the private sector at a time when Government needs their experience. The scheme will be very useful for various technical and scientific categories that can opt for higher remuneration under a contractual appointment on tenure basis in the Government.

Running pay bands

1.2.7 A major departure from the earlier Pay Commissions has been made in respect of pay scales. For the first time, the Commission is recommending running pay bands for civilian employees as well as for the Defence Forces. The Fourth Central Pay Commission had recommended running pay bands for Defence Forces that were implemented. The Fifth CPC, however, recommended specific pay scales for civilians as well as Defence Forces personnel. A conscious departure has been made in recommending running pay bands because of the inherent advantages of such pay scales.

1.2.8 Since the individual pay scales have a limited span, it often leads to stagnation. To ease stagnation, promotional avenues have to be created even though no functional justification for higher posts may exist. Creation of additional posts in higher grades through cadre reviews, etc. does not always achieve the desired results in terms of improved career progression. Movement from one pay scale to another frequently leads to problems in pay fixation like a senior drawing lower salary vis-à-vis a junior. Running pay bands will address all these problems and also remove many of the pay scale related anomalies.

1.2.9 Distinct running pay bands have been recommended for Government employees belonging to groups A, B and C. Employees in group D are to be retrained and upgraded to the lowest grade in pay band for group C. Within Group A, an additional separate running pay band has been prescribed for posts in the scale of Rs.18400-22400 and in higher administrative grade. This is because a common pool for all such posts that are not already encadred in any of the organized AIS/Group A services including posts under the Central Staffing Scheme has been recommended to which suitable officers of all services would be eligible for selection, based on their performance and merit. The common pool will ensure availability of the best talent for crucial posts in the highest grades. The interests of the officers who are not selected will not be harmed as they will still be eligible for promotions to the encadred posts within their individual services. Distinct scales have been recommended for the posts of Secretary and Cabinet Secretary, because these posts are occupied by heads of specific departments/ministries and the head of the bureaucracy respectively. As such, a distinction needs to be maintained for the pay scales attached to these posts.

Date of Effect

1.2.10 The revised pay structure has been devised to take effect from 1.1.2006. This will meet the demand of a majority of the employees and their associations. It is also in consonance with the observation made by the Fifth CPC that the next Pay Commission's pay scales should be made effective from such date. Recommendations relating to allowances and other issues should, however, take effect prospectively from the date these recommendations are accepted by the Government as was done while implementing the recommendations of the Fifth CPC.

Career progression

1.2.11 The pay structure has been so devised as to provide a decent entry grade and smooth career progression without any stagnation. The existing Assured Career Progression Scheme which provides two time-bound promotions in a span of 24 years has also been retained in a modified manner. Running pay bands and Modified Assured Career Progression Scheme will ensure smooth progression for 24 years. Even after 24 years, running pay bands will ensure that no one stagnates.

Changes in pension rules to facilitate early exit/ contractual appointment

1.2.12 The Commission has also recommended modifications in the CCS (Pension) Rules, 1972 that will enable payment of pension at the rate of 50% of the average emoluments/ last pay drawn without any reference to the qualifying service of 33 years for full pension. This will enable Government employees to leave the service at a relatively young age, in case they feel that they have more opportunities outside, or to opt for contractual appointment for specified posts within the Government. Simultaneously, the Government will be able to tap the best available expertise from within or outside the Government for senior positions. **Shift from career based to post based selection in the higher echelons of Government has been recommended in order to get the best domain based expertise**. For Groups B and C, a fast track promotion mechanism has been recommended by means of Limited Departmental Competitive Examination that is proposed to be introduced in most of the levels in Groups B and C.

Cadre Reviews

1.2.13 The Commission received many memoranda from various associations, organizations and individuals seeking review of specific cadres. The Commission is aware that the last Pay Commission had reorganized and rationalized many individual cadres. These reviews, however, frequently disturbed the established relativities. Further, most of these reviews have been sought on the ground of alleviating the existing stagnation. The Commission is of the view that cadre review cannot be used as a tool for easing stagnation. The Commission has incorporated other provisions in the Report that will address the problem of stagnation and delink promotions from career progression. Accordingly, as a matter of policy, this Commission has refrained from undertaking specific cadre reviews that in any case need to be carried out within an institutional framework. An established procedure for conducting cadre reviews exists in the Government. This would now need to be reviewed in the light of the recommendations made in this Report. **It, however, has to be emphasized that, apart from non-functional upgradation of some posts on personal basis in consonance with certain recommendations made in the Report, creation of additional posts in Senior Administrative Grade/equivalent/ higher grades in future has to be strictly on functional considerations and such posts should invariably be created outside the cadre to be filled by method of open selection separately being recommended in the Report.**

Allowances and benefits

1.2.14 The demands in this regard invariably sought increase in the quantum of various allowances available to the employees. The Commission has done a rationalization of the allowances. Some allowances like CCA have been proposed to be abolished and compensated elsewhere. The Commission has also attempted quantification of various benefits including allowances so as to compute the cost per employee to the Government and also to assess if these benefits could be made available to the employees in a more beneficial manner. The recommendations have been made accordingly.

Pension

1.2.15 Recommendations have been made to simplify the procedure for computation of pension. As mentioned earlier, the Commission has recommended delinking the payment of full pension on completing 33 years of qualifying service. Higher rates of pension have been recommended for retirees on attaining the age of 80, 85, 90, 95 and 100 years. A revised commutation factor for commuting pension has also been suggested taking into account the prevailing mortality rates, interest rates and fact that the commuted portion is restorable after 15 years.

Women employees

1.2.16 The Commission is conscious of the need to provide better facilities for women employees. Benefits like staggered working hours, special leave for child care, enhanced maternity leave of 180 days, better accommodation facilities in form of working women's hostels have been recommended specifically for women employees.

Persons with disabilities

1.2.17 The Commission has taken note of the problems faced by Government employees with disabilities and recommended various measures to alleviate the same. Enhanced number of casual leave, special aids and appliances for facilitating office work, higher interest subsidy for automobile loans, liberal flexi hours, extra allowance for disabled women employees to take care of young child till the time the child attains the age of two years, higher rate of transport allowance, better prosthetic aids and a proper grievance redressal machinery has been recommended for these employees.

Upgradation of certain categories

1.2.18 The Commission has recommended upgradation of certain specific categories like Nurses, Teachers, Constabulary and Postmen keeping in view the important functions being discharged by these categories. Parity between field offices and secretariat has been proposed as, in Commission's view, equal emphasis has to be given to the field offices in order to ensure better delivery.

Anomalies

1.2.19 Most of the memoranda sent to the Commission by Government organisations, employees or their associations highlighted various anomalies with reference to the pay scales, allowances or status. These anomalies in majority of cases were caused by upgradations of specific individual posts or grant of certain allowance by the earlier Central Pay Commissions or the Government. In some cases the upgradations had to be extended to comply with specific directions of various Courts. The Commission has taken note of these anomalies.

Anomalies in pay scales

1.2.20 Insofar as anomalies relating to the pay scales are concerned, a large number of these anomalies would be automatically settled by introduction of the proposed scheme of running pay bands. Where considered necessary, the Commission has also recommended upgradations of individual posts in order to remove these anomalies. The Commission has, however, taken care to minimize the number of recommendations for such upgradations and the same have been restricted to the cases that were covered by any of the following conditions: -

a) Where the promotion post had come to lie in a lower scale vis-à-vis any of the feeder posts.

b) Where the promotion and feeder posts existed in an identical scale and the level of duties /responsibilities and qualifications attached to these posts were manifestly distinct precluding their merger.

c) Where, (i) a distinct and established relativity had existed between different posts; (ii) the posts were otherwise comparable on the basis of the functions, nature of the job, qualifications prescribed, level of responsibility attached; and (iii) such relativity was disturbed at the time of or after the implementation of the recommendations of the last Central Pay Commission.

d) Where identical or analogous posts discharging similar functions had been placed in two or more distinct pay scales.

e) Where the functions, nature of the job, qualifications prescribed and level of responsibility attached to the post justified a higher pay scale without causing any distortion or imbalance in any of the established relativities

All the individual upgradations recommended by the Commission shall, in no case, take effect before 1.1.2006. This is because the Commission has no intention of rectifying these

anomalies right from the time of their inception and is of the view that interest of justice will be served if these anomalies are rectified for the present and the future.

Anomalies in allowances

1.2.21 The Commission received demands from almost all the central paramilitary and security organizations, scientific institutions and other services seeking grant of special allowance keeping in view the onerous nature of duties performed by them. It was the common argument of all that their respective organizations were performing a special job and deserved to be granted a special allowance. **The Commission is of the view that grant of special allowance for performing the assigned duties in respect of any organisation is not justified because the same is taken care of by the salary attached to the posts.** The Government has, in the past, extended special allowances in various forms to certain posts in different organisations which, in their opinion, deserved to be paid such an allowance. The Commission is maintaining status quo in respect of these allowances extended by the Government in the past. Insofar as further extension of any allowance on this account is concerned, the principle which should be followed is that **more onerous duties should result in a relatively higher pay scale being attached to the post rather than any special allowance.** A mechanism exists for evaluating the duties attached to different posts in an organization which should be used to assess the appropriateness of the existing pay scale (proposed to be substituted by grade pay and pay band) rather than granting a special allowance for performing the normal duties. **Performance of duties beyond the normal call should, in the revised scheme of things, result in a higher performance related incentive.** The specific problems faced by defence forces personnel (viz. army, navy and air force) on account of rigours of military life are, however, proposed to be compensated by an additional element of pay termed Military Service Pay (MSP).

1.2.22 The Commission has recommended substantial increase in the rates of many allowances like Transport allowance, TA/DA, Education Allowance, etc. to make them realistic. Apart from this, rationalization of allowances like HRA has also been proposed. The fixed allowances have been made inflation proof.

Administrative reforms

1.2.23 The Administrative Reforms Commission is presently functional. It has already made certain interim recommendations. The Fifth CPC had also made numerous recommendations in this regard. Thereafter, the Government had also constituted the Expenditure Reforms Commission. While the issue of increasing productivity, efficiency and a result oriented approach with greater emphasis on end user satisfaction rather than on mere procedures has been addressed in the Report, the Commission has refrained from making comprehensive recommendations on the issue of organizational reforms. Recommendations given by expert bodies in the past like Expenditure Reforms Commission have been reiterated, wherever the Commission is of the view that the same are essential for better delivery and removing the flab from the Government. Some observations regarding corporatization of certain service ministries/departments have also been made.

Defence Forces

1.2.24 The Commission has recommended parity between various posts in the Defence Forces and civilian employees. Establishing such parity was necessary for another major recommendation contained in the Report concerning lateral movement of the Defence Forces personnel to Central Para Military Forces (CPMFs), other Central Police Organizations and defence civilian organisations. Such lateral movement would not only result in large savings for the Government but will also help in providing continuous employment to the various grades of Defence Forces personnel and make available a trained and disciplined force for the use of the nation. This will also have numerous other benefits, which have been discussed in detail in Chapter 2.4 of the Report. The pay scales for the Defence Forces have been devised accordingly. As mentioned earlier, the Commission has also recommended a separate element of pay called Military Service Pay for the Defence Forces keeping in view the difficulties specific to the military life. The Military Service Pay is to be treated as pay for all purposes (excluding increments) but will not be available once Defence Forces personnel shift to the CPMFs, etc. The concept has been discussed in detail in Chapter 2.3 relating to pay scales of Defence Forces personnel.

Implementation of recommendations

1.2.25 The Report has been kept concise as the Commission is of the view that lengthy and elaborate documents tend to get ignored as well as are liable to be quoted out of context. Most of the demands made before the Commission have been addressed by recommending systemic changes. Such demands have not been individually referred to in the Report. The number of recommendations made by the Commission is also limited. All the recommendations are inter-connected and need to be treated as an organic whole. Partial implementation of these recommendations will destroy the underlying spirit, break the common thread and bring in several anomalies and inconsistencies. **The Report would, therefore, need to be treated in a holistic manner and the recommendations considered as a package.**

Chapter 1.3

The General Economic Situation & Financial Resources of the Central and State Governments

Terms of reference

1.3.1 The Terms of Reference of the Commission required that the recommendations had to be made taking into account various factors like the economic conditions in the country, the need to observe fiscal prudence in the management of the economy, the resources of the Central Government and the demands thereon on account of economic and social development, defence, national security and the global economic scenario as well as the impact upon the finances of the States, if the recommendations are adopted by them.

Trends in Economic Growth

1.3.2 The recent years between the last Pay Commission and now have witnessed a ratcheting up of growth. The overall macroeconomic situation has improved greatly with tangible progress towards fiscal consolidation and a strong balance of payments position. Gross Domestic Product (GDP) at factor cost at 1999-2000 constant prices has increased from Rs.18.7 lakh crore in 2000-01 to Rs.28.6 lakh crore in 2006-07, a 52.9 percent increase in seven years. The annual growth rate of GDP has also shown a general increase, from that of 5.8 percent per annum in 2001-02 to a level of 9.6 percent in 2006-07.

1.3.3 The Index of Industrial Production has increased approximately 2.7 times, from a level of 91.6 in 1990-91 to 247.1 in 2006-07 while the Index of Agricultural Production with base 1981-82, which stood at 166 in 2000-01, has increased modestly to 197.1 in 2006-07. There has been a steady increase in the annual growth rate of industrial production. This impressive growth in the industrial sector is propelled by the robust growth in manufacturing, which occupies the major share of the industrial production. The fastest growing sector has been Services. Between 2002-03 and 2006-07, 68.6 percent of the overall average growth in GDP has been attributed to growth in services. Trade, hotels, transport and communication became the leading sector by growing at double digits since 2003-04. Agriculture has shown wide fluctuations in its growth. In the first five years since 2001-02, its annual average growth has been of the order of 3 percent. It increased to 6 percent in 2005-06 and then dipped to 3.8 percent in 2006-07. The low growth in agriculture has wide ramifications in terms of price instability due to snowballing effect of supply side constraints in essential commodities, and in terms of the "inclusiveness of the growth process". Industrial growth, however, has revived since 2001-02. The real growth rates in industry that stood at 2.7 percent in 2001-02 accelerated to 11 percent in 2006-07.

Gross domestic capital formation and savings

1.3.4 The gross domestic capital formation has increased from a level of 26.3 percent of GDP at current market prices in 1990-91 to 35.9 percent in 2006-07. This buoyancy in the rate of investment in the economy in recent years is reflective of the high degree of business optimism. Gross domestic savings as a proportion of GDP at current market prices has been increasing since 2000-01 with savings rate rising from 23.5 percent in 2000-01 to 34.8 percent in 2006-07, mainly attributable to savings in the public sector and private corporate sector.

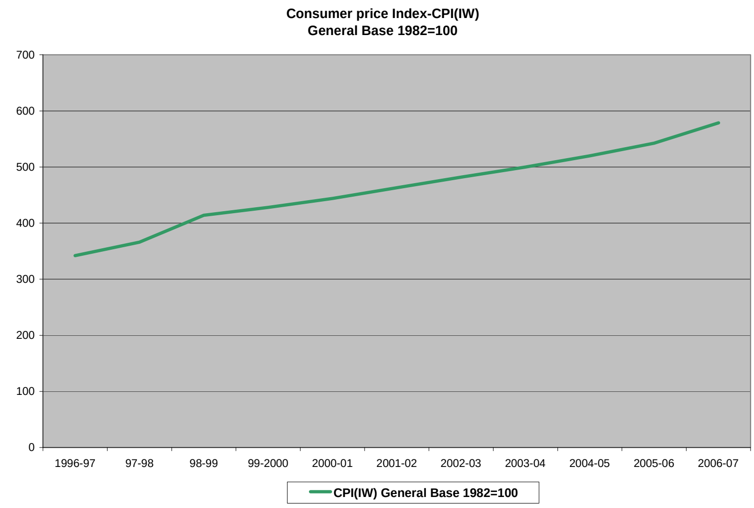
External sector

1.3.5 Exports have increased by 182 percent from a level of US $ 45.5 billion in 2001 to US$ 128.1 billion in 2006-07. The trade deficit increased from approx. US$ 12 billion in 2000-01 to about US$ 63 billion in 2006-07. While external debt has been increasing in absolute terms, it has decreased as a proportion of the Gross Domestic Product (GDP) from a level of 20.4 percent in end March 2003 to 17.9 percent in end March 2007.

Trends in Prices

1.3.6 The General Wholesale price index (WPI) (52 weeks average) increased 1.6 times between 1995-96 to 2005-06 while the price index for manufactures increased by 1.4 times and that of agriculture 1.6 times. Between 1996-97 and 2000-01, the general inflation averaged 5.1 percent. Acceleration in inflation post 2006 was caused by acceleration in inflation in primary commodities and continued high escalation in price of the commodities in fuel group due to hardening of global prices.

1.3.7 The Consumer Price Index (CPI) with Base 1982, increased from a level of 342 in 1996-97 to 579 in 2006-07.



1.3.8 The primary commodity specific nature of inflation translated into a higher level of inflation when measured in terms of the CPI as compared to WPI. This was mainly due to three reasons:-

i) Higher weightage of food group in the consumption basket,

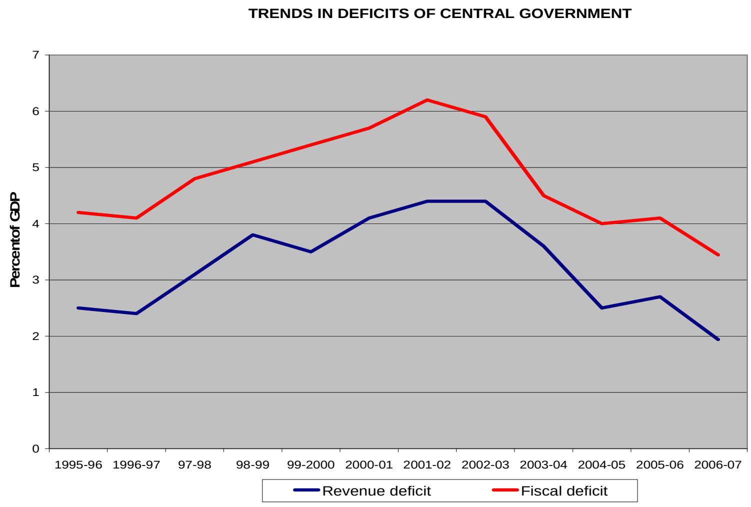
ii) Higher rate of inflation in the various items included in food group, and

iii) Differences in composition of the basket for compilation of the two indices.

Fiscal Performance of the Centre

1.3.9 The revenue deficit of the Central Government stood at 2.5 percent of GDP in 1995-96. This increased to 3.8 percent of GDP in 1998-99. The increase was largely attributable to increased expenditure on salaries and pensions consequent upon implementation of the Fifth Central Pay Commission recommendations. The revenue deficit peaked at 4.4 percent in 2001-02. Fiscal deficit also increased as a percentage of GDP from 4.2 percent in 1995-96 to 6.2 percent in 2001-02.

1.3.10 Revenue deficit as percentage of fiscal deficit increased sharply from 59 percent in 1995-96 to 80 percent in 2003-04 implying that borrowings were being increasingly used to fund current expenditure and only 20 percent of the borrowings were directed towards asset creation. It reflected the un-sustainability of the fiscal situation and the increasing risk of falling into a debt trap. This fiscal imbalance was identified as the root cause of the twin problems of inflation and the difficult balance of payments position. The chart below shows the trends in revenue deficit and fiscal deficit of Central Government.



Fiscal Reforms and Budget Management Act (FRBMA)

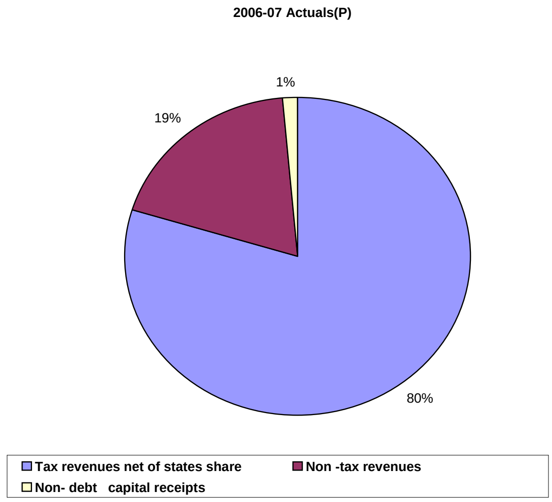
1.3.11 In the backdrop of the tight fiscal situation, the FRBMA was enacted on August 26th, 2003 and the Act and Rules were notified to come into effect from 5th July 2004. The FRBMA provided a defined mandate for medium term fiscal management.

1.3.12 The Rules under FRBMA stipulate that the revenue deficit be reduced by an amount equivalent to half percent or more of the estimated GDP at the end of each financial year and be eliminated by 31st March 2009. Fiscal deficit is to be reduced by an amount equivalent to 0.3 percent or more of the estimated GDP at the end of each financial year and reduced to no more than three percent of the estimated GDP by the financial year ending on 31st March 2009.

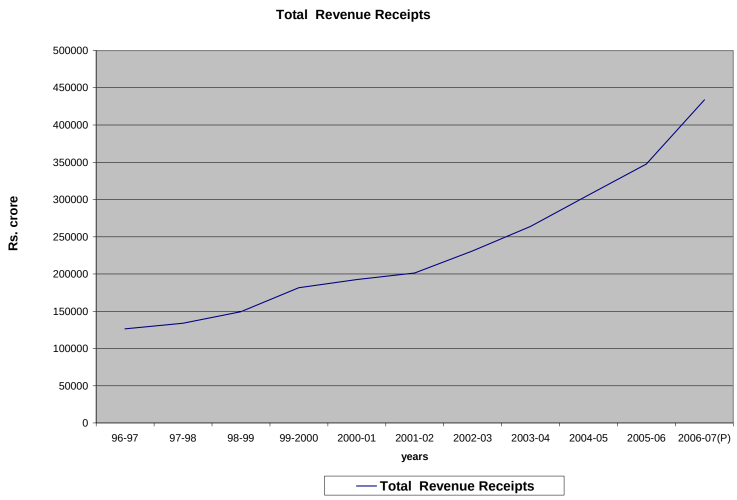
1.3.13 The continuous and essentially incremental process of fiscal consolidation under FRBMA has been satisfactory. Post FRBMA, revenue deficit as percent of GDP has declined from 3.6 percent in 2003-04 to 1.9 percent in 2006-07(P). Fiscal deficit as a percent of GDP declined from 4.5 percent in 2003-04 to approximately 3.4 percent in 2006-07(P). Revenue deficit as percent of fiscal deficit declined from 80 percent in 2003-04 to 56 percent in 2006-07(P).

1.3.14 The FRBMA stipulates that public expenditure be reoriented for the creation of productive assets. It highlights the significance of keeping the revenue expenditure under control so as to eliminate revenue deficit by 2008-09. This essentially would necessitate that revenue expenditures are kept within the contours of revenue receipts. As revenue expenditure is composed of pay and allowances, interest payments, grants to States and Union Territories, subsidies, etc., expenditures thereon would need to be synchronized with revenue generation.

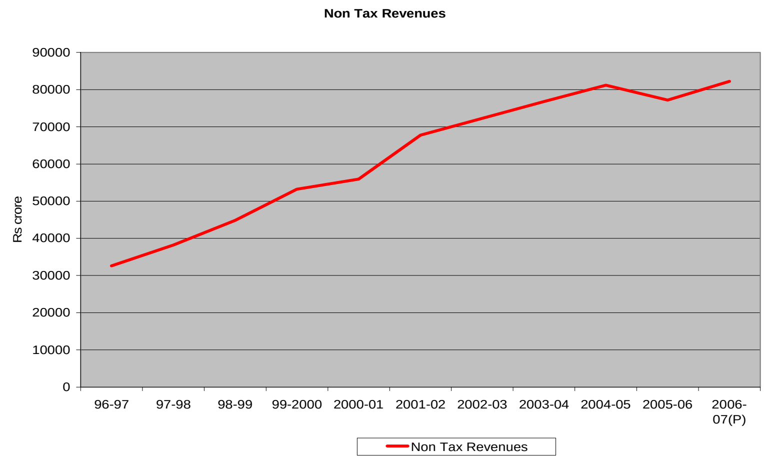
1.3.15 The non-debt receipts of the Central Government comprise tax revenue receipts, non-tax revenue receipts and non -debt creating capital receipts. The share of tax revenues in the total revenue receipt has been predominant.



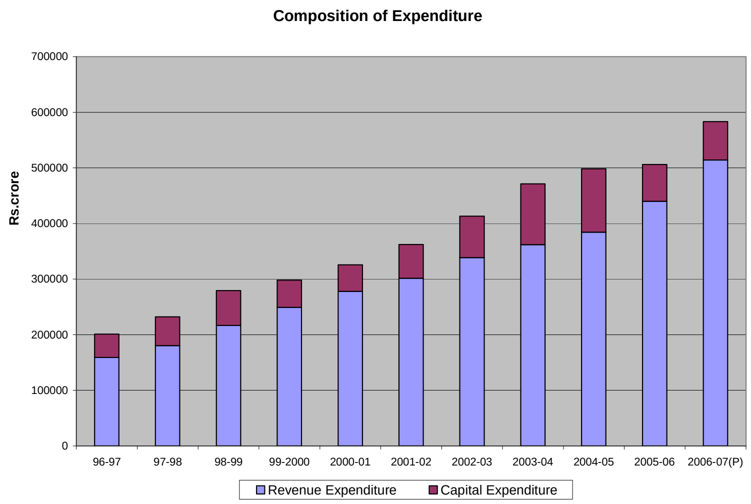
1.3.16 The tax revenue receipts of the Central Government net of share of States stood at Rs.95,672 crore in 1996-97. This increased to Rs.3,51,494 crore in 2006-07.



1.3.17 Non-tax revenue receipts mainly comprising interest receipts, dividends and profits, receipts from economic, social and fiscal services increased by 152 percent between 1996-97 and 2006-07.

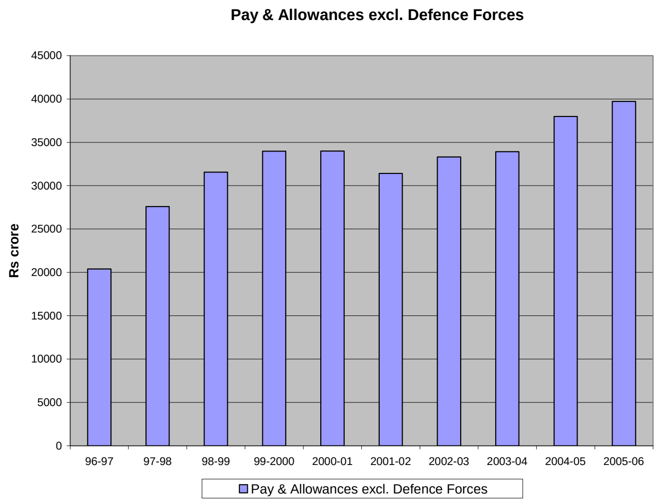


1.3.18 The expenditure of the Central Government has increased by 190 percent from 1996-97 to 2006-07. Not only has the total expenditure increased, the predominance of revenue expenditure has also increased implying that expenditure on capital formation is low and declining. The following table depicts the composition of expenditure of Central Government since 1996-97 :-



Trends in Pay and Allowances

1.3.19 The expenditure of the Central Government (excluding the Defence Forces), on pay and allowances, stood at Rs.20,396 crore in 1996-97 on the Fourth CPC scales. The Fifth CPC pay scales were implemented in September 1997, albeit retrospectively, from 1/1/1996. The impact of revision of the pay scales and allowances by Fifth CPC resulted in the expenditure on this account increasing by 67% between 1996-97 and 1999-2000. The expenditure on pay & allowances in 2005-06 is estimated to be Rs.39,811 crore resulting in an increase of 17 percent over 1999-2000. The trend in this expenditure on pay and allowances is as seen in the following chart:-



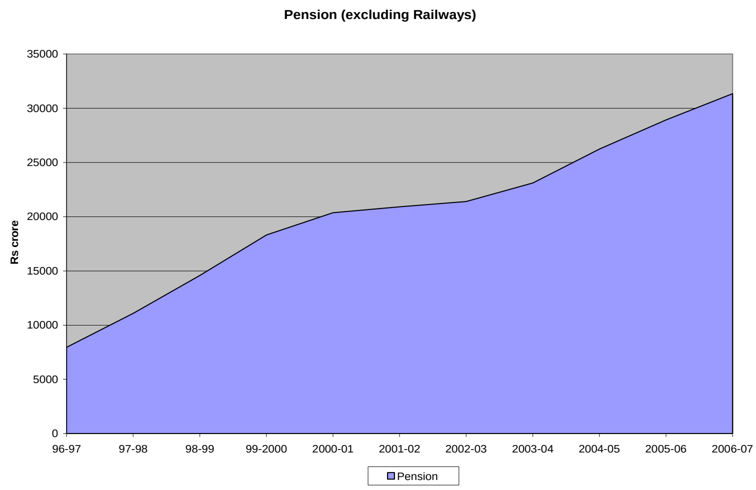
1.3.20 The major jump noticeable in the two years following 1996-97 is attributed to payment of arrears consequent upon recommendations of Fifth Central Pay Commission.

1.3.21 The dip in pay and allowances in 2001-02 is attributable to the exclusion of the employees of Telecommunications. Increase in 2004-05 over 2003-04 is attributable to the impact of merger of dearness allowance.

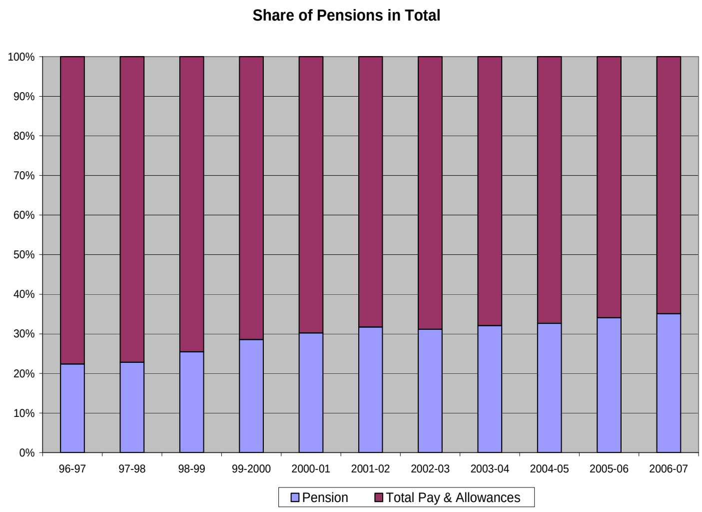
1.3.22 Expenditure on pay and allowances and pensions impact the revenue expenditure of the Government. It constituted 22 percent of the revenue expenditure in 1996-97. It rose to 27 percent as a result, *inter alia*, of the impact of the Fifth Central Pay Commission. It has thereafter been hovering around 21 percent. Average for the years 2004-05 to 2006-07 shows that pay, allowances and pensions including those for Railways comprise 24 percent of revenue receipts. Impact of the recommendations of the Fifth Pay Commission resulted in the share of pay, allowances and pensions in revenue receipts increasing from 28 percent in 1996-97 to 38 percent in 1998-99.

Pensions

1.3.23 The expenditure on pensions was Rs.7,956 crore in 1996-97 before implementation of the recommendations of the Fifth CPC. It increased to Rs.28,928 crore in 2005-06 and is placed at Rs. 31,350 crore in 2006-07 resulting in an increase of 294 percent within a span of ten years from 1996-97 to 2006-07. The impact of the Fifth Central Pay Commission resulted in an increased outflow of 39 percent in 1997-98 over the previous year which was compounded by a further increase of 32 percent in 1998-99. Thereafter, the growth tapered off. However, in 2003-04 the pension outflow saw renewed growth consequent upon merger of Dearness Allowance as evidenced from the following chart:-



1.3.24 Pension outflow constitutes 35% of the total expenditure on account of salaries, allowances and pension as evident in the chart below:-



Resources of the Centre

1.3.25 As per its Terms of Reference, the Commission, while making its recommendations, is required to assess the resources of the Centre bearing in mind the demands on its resources for the development of the economy, defence and national security. Projections made by the Ministry of Finance for the Eleventh Plan period and the assessment of the Working Group on Centre's Resources for the Eleventh Five Year Plan in regard to various items of receipts and expenditures, except expenditure on pay and allowances and pensions, forecast the following:-

i) GDP growth at current prices of 13 percent from 2007-08 to 2010-11 and 13.5 percent in 2011-12.

ii) Decline in WPI inflation from 5 percent in 2007-08 to 4 percent in 2011-12.

iii) Doubling of tax revenues from Rs. 4,66,507 crore (with Direct tax revenues constituting Rs. 2,29,272 crore and Indirect taxes constituting Rs. 2,37,235 crore) in 2006-07 to Rs.10,56,149 crore in 2011-2012 comprising Rs.6,35,053 crore as direct taxes and Rs. 4,21,096 crore as indirect taxes. As a proportion of GDP, the increase in total tax revenues is from 11.4 percent in 2006-07 to 13.9 percent in 2011-12, an increase of 2.5 percentage points.

iv) Increase in non -tax revenues from Rs.77,360 crore in 2006-07 to Rs.103,276 crore in 2011-12

Projections on expenditure, pay, allowances and pensions

1.3.26 The Commission is of the view that while recommending revision in pay and allowances, the question of adequacy of remuneration needs to be considered along with availability of fiscal space. The annual gross impact of the recommendations of this Commission is estimated at Rs.12,561 crore, including Rs.3,319 crore on account of Railways. This does not take into account the projected savings. Since the recommendations relating to pay structure i.e. pay bands as well as pensions are proposed to be implemented retrospectively from 1.1.2006, payment of arrears will be an additional one time expenditure of Rs.18,060 crore, including Rs.5,416 crore on account of Railways. This additional expenditure can be spread over two financial years in case the Government decides to split the arrears in two financial years.

Impact on Central Government's budget

1.3.27 The Commission has analyzed the impact of its recommendations on the Central Government's budget in the backdrop of the future profile projected by the Central Government on revenue receipts during the Eleventh Plan period. For assessing the Government's capacity to pay, the average ratio of expenditure on pay and allowance and pensions of civilian employees (excluding Railways) and Defence Forces personnel, to revenue receipts for the years 2005-06 and 2006-07 has been calculated and this ratio applied to the future years for determining notionally the manner in which pay and allowances and pensions are likely to grow if this ratio is maintained. These results have been compared with the projections based on the Commission's recommendations on pay and allowances and pensions without taking into account the savings. The comparison shows that after taking into account the additional annual financial implications, the ratio during the Eleventh Five Year Plan period is well below the average ratio for 2005-06 and 2006-07. Even after including the payment of arrears in the years 2008-09 and 2009-10, this position does not change. **As such, in view of the revenue receipts expected in the future, the Central Government should be in a position to meet the additional expenditure consequent to the Commission's recommendations.** The future projections also need to be viewed in the light of the projected savings expected to be generated by various recommendations like lateral shift of Defence Forces personnel to Central Police Organisations etc.; changes in mode of payment of commutation along with a revised commutation table; limiting the role of Government on various loans to Government employees to granting interest subsidy, etc. The savings on this account will, over the next decade, substantially off-set the additional expenditure to be incurred at the time of implementation of the Report.

Fiscal position of State Governments

1.3.28 The Commission has been informed by the Central Government that the Fiscal deficit of all the States in the aggregate declined from 4.09 percent of GDP in FY 2002 to 2.95 percent in FY 2006. The performance, in aggregate, of States has been quite spectacular, to the extent that many states have already achieved the fiscal correction path suggested by the Twelfth Finance Commission for the five year period. Twenty six out of the twenty eight States have enacted the FRBM Act (Fiscal Reform and Budget Management Act) as on July 2007, and have earned the debt waiver for having remained on the fiscal correction path. By 2008-09, the revenue deficit is targeted to be reduced to zero for availing the debt waiver benefits. The fiscal correction has been aided by enhanced tax revenues consequent upon introduction of VAT (Value Added Tax) which has led to reduction in structural deficit without compression of expenditures. However, Bihar and West Bengal have reduced deficits through forced expenditure cuts.

Projections by the Working group on States Resources for the Eleventh Five Year Plan

1.3.29 The Working Group on States' Resources for Eleventh Five Year Plan has also observed that there has been an overall improvement in State finances since 2002-03. Factors which have contributed to such a turn around are, *inter-alia*, overall improvement in the rate of growth of the economy leading to buoyancy in the tax revenues of the Centre and States, introduction of VAT and restructuring of the State taxes in many States. The fall in the interest rates of States' borrowings, the debt swap scheme and the consolidation and restructuring of States' debts have reinforced the States' efforts in mobilizing resources. In terms of the Working Group's estimates, the aggregate resources for 28 States is estimated to increase from Rs.1,99,384 crore in 2007-08 to Rs.3,65,922 crore in 2011-12, at current prices.

Impact on State finances

1.3.30 Many States have achieved the FRBMA mandated target of eliminating revenue deficit ahead of the scheduled 2008-09. According to the Reserve Bank of India's latest Report on State Finances, nineteen out of twenty eight states are estimated to be revenue surplus in 2007-08.The successful introduction of VAT has contributed to increase in tax receipts of States. The States'revenues in the coming years are likely to be buoyant especially in the backdrop of uptrend in the tax revenues of the Centre and consequent devolution to States. The award of the Thirteenth Finance Commission is expected for the period from 2010 – 2015. These factors would be relevant for the purpose of considering the capacity of the States to absorb the increase in expenditure if they were to adopt the recommendations of this Commission.

Analysis of the likely impact on States

1.3.31 In estimating the impact on State finances, the Commission has used a methodology similar to that followed for the Centre. As per information collected by the Commission, out of 28 States, 20 States had adopted the recommendations of the Fifth Central Pay Commission. It can, therefore, logically be assumed, that these 20 States will adopt the Sixth Central Pay Commission's recommendations as well. The States which did not adopt the Fifth CPC recommendations are Andhra Pradesh, Himachal Pradesh, Assam, Punjab, Kerala, Karnataka, Meghalaya and West Bengal. Some States adopted the Fifth CPC's recommendations with modifications. Out of the States expected to follow the Sixth Central Pay Commission's recommendations, only Goa and Tamil Nadu are estimated to be in a marginally revenue deficit situation in 2007-08, as per the RBI Report.

1.3.32 Assessment of the impact on State finances has been done on a like-to-like basis as for the Centre. Accordingly, the assumptions made for the purpose of this exercise are: implementation in 2008-09, a percentage increase in pay and allowances and pensions similar to that at the Centre and distribution of arrears in the same manner as at the Centre. **The actual situation, however, in each State may vary depending upon when the recommendations of the Fifth Central Pay Commission were implemented and the extent to which they were implemented**. The revenue receipts have been projected maintaining the ratio of State's Own Revenues to Gross State Domestic Product as in the past. The tax devolution from the Centre is projected to increase in the same manner as the Centre's tax revenues. The ratio of expenditure on pay and allowances and pensions to the projected revenue receipts has been worked out as for the Centre and a similar comparison made to estimate whether the expenditure consequent upon the Sixth CPC's recommendations is within this ratio. **It is observed that most of the States would be in a position to meet the additional expenditure.** States which do not reflect a comfortable position as far as the increased expenditure is concerned, can consider the options of :

- deciding on a date of implementation different from that of the Centre,
- staggering the payment of arrears suitably,
- generating additional tax and non-tax revenues,
- compressing expenditures.