

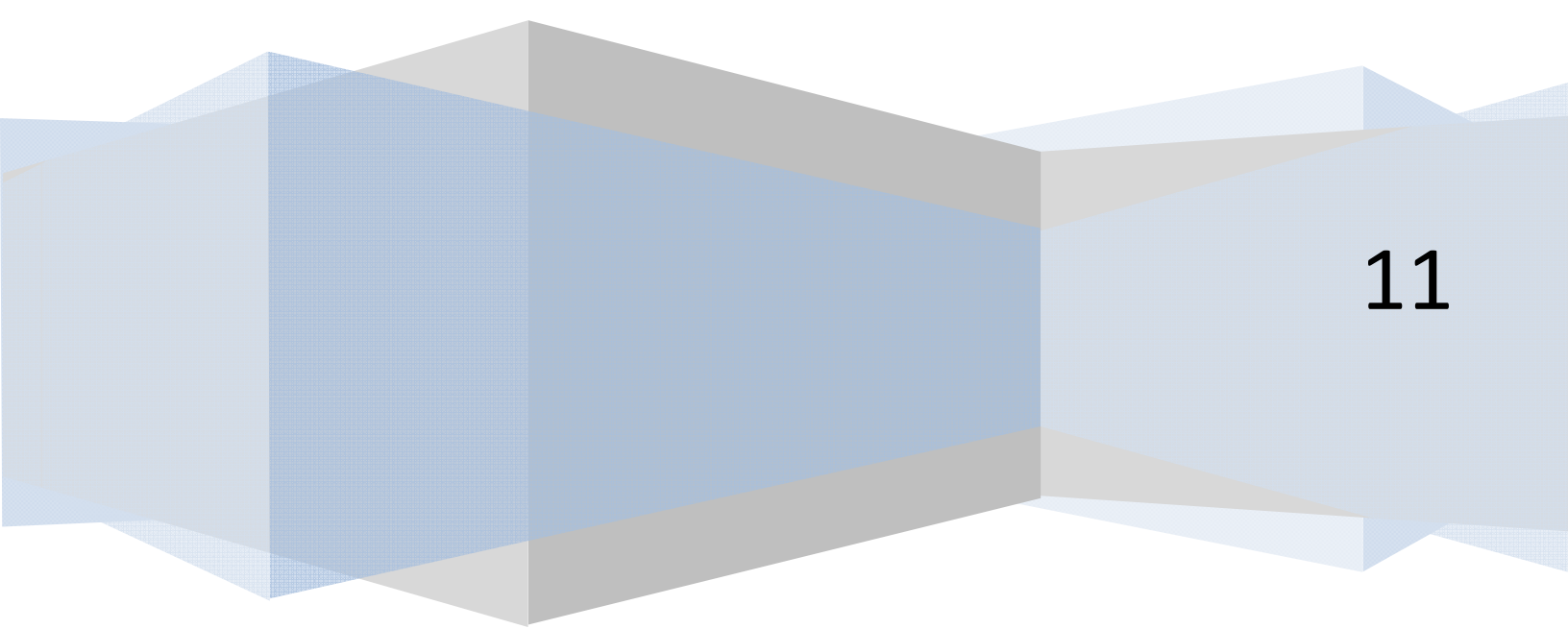
Indian Railways Technical Supervisors Association

History of Dearness Allowance

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Dearness Allowance is compensatory part of wages. In India, DA is being paid since the Second World War. During the War, DA became payable at various rates. It became payable as a result of different costs of living in different cities not known to each other.

Originally, it was the textile industry in Bombay which introduced DA scheme firstly under the bipartite settlement and subsequently they took the shape of arbitration, adjudication and finally, after knocking at the doors of industrial courts, got into awards, which is how in India DA scheme started.

In other parts of the world too DA was paid depending upon the rise in the cost of consumer goods prices. Within 5-10 years, the system of DA became a common system throughout the world but the basic principles remained the same.

In most parts of the world, though not everywhere, common platform DA became payable though not on the same rates.

Ultimately, the question of DA became a subject-matter of the Supreme Court. The court initially laid down general principles for fixation of DA grant and the link with cost of living index.

Slowly and gradually, Supreme Court gave effect to DA in terms of rise in the cost of living, higher prices and higher cost of living. This gave rise in the whole country for Consumer Price Index which is linked with rise in index in different cities in the country.

Bombay was found to be the most expensive city in the country and sometimes even in the world. It moves from time to time and so the atmosphere with it. At different times, each sphere had different price level which is recorded regularly on price index. Each price index is differently numbered and differently marked in each state.

In our country, this price index as Bombay Price Index, Delhi Price Index, Kolkata Price Index, Ahmedabad Price Index etc., and prices of each number in each city are differently made and known. This is preliminary of DA.

The issue of DA has gone much ahead and now it is paid according to the standard of each city in the country. With passing of time and cost of living going up, working class life became more and more miserable as a result of which every wage fixing authority had to view its point to the phenomenon and fortunately in our country the Government which is the biggest and model employer had to take cognizance of this fact and went on appointing pay commissions one after another after a lapse of five to 7 years and each pay commission gave thorough consideration to the problem of Dearness Allowance.

Each pay commission not only increased dearness allowance of the Central Government employees and gave higher and higher benefits under the improved schemes. On the chapter on Dearness Allowance (DA), the fourth pay commission for the Central Government employees said that the “Dearness allowance which is being paid at present is in the nature of a compensatory payment to employees for erosion in the real value of their salaries resulting from price rise.

The allowance has been in existence for about four decades and now covers almost all employees in the organised sector. Accordingly, it has emerged as an important area of pay administration having financial, economic and administrative implications.

Over the years, there have been many changes in the policy for payment of dearness allowance, particularly with regard to coverage of employees, percentage of neutralisation for different categories, periodicity of payment, etc.

The rates of dearness allowance provided a neutralisation of about 95 per cent on the lowest pay and the neutralisation percentage went on declining for higher pay levels so that in respect of the employees drawing pay between Rs.1600/- and 2250/- per month it worked out to about 30 per cent or less.

The Commission also recommended that on the price level rising above the 12-monthly average of 272 (1960=100), government should review the position and decide whether the dearness allowance scheme should be extended further or the pay scales should be revised.

Government decided on three occasions to treat part of dearness allowance as dearness pay for certain purposes more particularly to provide relief in the matter of death-cum-retirement benefits to retiring employees.

The state governments also compensate their employees for price rise in the form of dearness allowance, which is granted by them more or less on the same pattern as followed by the central government, since the pay scales of state government employees are linked to different index levels, the actual rates of dearness allowance paid by them are different from those payable to central government employees.

“We are also of the view that the compensation should provide full neutralisation of price rise to employees drawing basic pay upto Rs.3500/-, 75 per cent to those getting basic pay between Rs.3501/- and 6000/- and 65 per cent to those getting basic pay above Rs.6000/-subject to marginal adjustments. This compensation may continue to be shown as a distinct element of remuneration.

“We have recommended that compensation for price rise should be sanctioned twice a year. This would ensure that there would be no uncertainty in the minds of government employees in regard to the periodicity of grant of compensation. We realise that there may be situations when government may not find it possible to sanction the compensation for price rise according to the scheme recommended by us. We are of the view that in such situations, the restraint, if any, should apply to the entire organised sector including central government employees.”

Fifth Pay Commission also said Dearness Allowance (DA) is a compensatory payment to the employees for the erosion in the real value of their salaries, resulting from price increase. While the First and Second CPC's suggested payment of DA at flat rates for employees in different pay scales for different levels of Consumer Price Index (CPI): the 3rd and 4th CPC's while linking DA to both the CPI and pay-scales, recommended DA as a percentage of the basic pay. While DA was made payable automatically by the first CPC once a specific level of Consumer Price Index was attained, the 2nd CPC did not favour automatic sliding scale adjustments and recommended that the Government should review the position and consider the case for an increase in DA, each time the index increased by 10 points.

This they felt was necessary as allowing an automatic increase, each time prices rise, without going into the reasons for price rise, would tend to fuel inflation because of a wage-price spiral. Price increase, fuelled by a fall in production levels or due to hike in indirect taxes should not merit compensation.

The absence of a precise scheme of DA revision, however, resulted in a situation where two high-powered bodies had to be appointed in the intervening period between the 2nd and the 3rd CPC for the payment of DA because of the continuing upward trend of prices.

As a result, the 3rd CPC partially reversed the recommendations of the 2nd CPC by making DA payment automatic each time the CPI rose by 8 points over the index of 200, up to the level of 272. DA until the 2nd CPC had been imagined to be a temporary expedient and was intended to deal with the phenomenon of a temporary rise in prices. It was precisely for these reasons that the pay structure then had to have three separate components: basic pay, dearness pay and dearness allowance. While basic and dearness pay represented the irreversible components, DA represented the component which could be reversed in the case of a price fall.

"We have received several demands on Dearness Allowance. These range from uniform neutralization at all levels, to an alternative Consumer Price Index and the use of a monthly, 3-monthly or 6-monthly average instead of a 12-monthly average of CPI.

The merger of DA with basic pay when it comes to be 25% of the basic, pay and the exemption of DA from tax are some other demands.

"It has been strongly urged that a uniform neutralisation of DA at 100% should be given to employees at all levels. We see merit in this demand.

The erosion in the real value of salary at the highest level, has been the most severe, beginning from 1949 followed by other Group A officers down the line. In contrast, a comparison of the index of real earnings for the peon between 1949 and 1996 shows that the peon was more than fully neutralized for inflation and was in real terms paid 53% more than his salary in 1949. The Secretary on the other hand was not even paid full neutralization for inflation and consequently his real salary has eroded to the extent of 72% as compared to the position in 1949.

"Accordingly we, recommend that inflation neutralization be made uniform @ 100% at all levels."

So far as the newspaper industry is concerned, it normally followed the patterns of Central Pay commissions from time to time. Scheme of DA in the newspaper industry is as per recommendations of the wage boards. During the last four wage boards, dearness allowance in newspaper industry was paid as follows.

Dearness allowance through successive Central Pay Commissions

The Sixth Central Pay Commission (CPC) has devoted fourth chapter of the report to the subject of Dearness Allowance (DA) payable to government servants. The sanction of Dearness Allowance is at present based on calculated six monthly increase in the All India Consumer Price Index (Industrial Workers) (AICPI-IW) with base year 1982=100.

At the time when the scales granted by Fifth CPC came into existence (1st Jan.1996) this index stood at 306.03. Fifth CPC started with calculation of DA @ 0%, from 1st Jan.1996 .

In the month of April 2004 the rate at which DA was admissible had crossed the figure of 50% and therefore based on recommendations of the Fifth CPC 50% DA was merged in the basic pay .

This addition to basic pay was known as Dearness Pay.

Thereafter every increase in DA was calculated on (Basic Pay + Dearness Pay). It has been observed that since after the merger of dearness pay with basic pay the base for calculation of increase in AICPI was not changed the neutralization in cost of living was presently being done at a rate higher than 100%.

The Pay Commission has pointed out that the present method of calculation for increase in cost of living takes into account the price rise in a group of identified commodities. It has compared the relative merits of “chain based” and “fixed base” methods of calculation of estimated growth in cost of living.

The AICPI as stated above is based on the increase in cost of a basket of identified commodities. In the fixed base method the calculations are based on the assumption that consumer would adjust his consumption needs in relation to increase or decrease in prices of the constituent commodities.

The chain based method takes into account the possibilities of change in consumption pattern due to availability of wider range of consumption goods and the improvement in the quality thereof due to economic growth. The latter methodology has been considered to be more relevant in today’s economic scenario. However the basic data for the pattern of consumption in respect of several essential commodities would have to be compiled through a detailed all India survey if this methodology is to be adopted .

The previous Pay Commissions had different views on this matter. The Fourth CPC favoured evolution of a separate index for calculation of cost of living for the government servants. The Fifth CPC however felt that such index would also suffer from imbalances since consumption patterns of various categories of employees would be different.

The Sixth CPC has suggested a sample survey through National Statistical Commission for evolving an index based on consumption pattern of government employees.

Till this exercise is completed the present methodology of calculating the increase in cost of living and calculation of DA would continue.

Views of earlier Pay Commissions

Successive Pay Commissions have made changes to the DA formula, suggesting their own methodology for determining the quantum and frequency.

Fifth CPC recommendations

The Fifth Central Pay Commission recommended uniform neutralization of DA at 100% to employees at all levels; conversion of DA into Dearness Pay each time the CPI increases by 50% over the base index with Dearness Pay counting for all purposes including retirement benefits; and Dearness Allowance including Dearness Pay being paid net of tax. The Commission did not favour the option of employing separate indices for each category of employee because of the sheer impracticality of the task and, therefore, recommended using the 12 monthly average of All India CPI (IW) with base 1982 for calculating DA.

The Government of India presently calculates the level of inflation for purposes of grant of dearness allowance to Central Government Employees on the basis of the All India Consumer Price Index Number for Industrial Workers (1982=100) (AICPI). The twelve monthly average of the AICPI (1982 base) as on 1st January and 1st July of each year is used for calculating the Dearness Allowance (DA). Increase in DA is calculated with reference to the AICPI (IW) average (base 1982=100), as on 1st January 1996 of 306.33. The compensation for price rise is admissible twice a year i.e. on 1st January and 1st July of each year. Only the whole number component of the percentage increase in prices is adopted for estimation of DA. The Government merged 50% of the DA with basic pay w.e.f. 1.4.04 and the dearness allowance continued to be calculated with reference to the AICPI (IW) average as on 1st January 1996 of 306.33 without changing the base consequent to the merger.

Accordingly, DA at following rates was sanctioned by the Government from 1.7.04 till 1.7.07:-

As a consequence, salaries of Government employees are being neutralized more than hundred per cent. Demands made in the demands made before the Commission, it has been suggested that the existing DA formula continue with the following modifications:-

- Instead of revising the DA once in six months, it should be revised once in three months.
- The principle laid down by the 5th CPC for merger of 50% of DA with the Pay as DP should be modified to 25% to remove distortions in the pay structures.
- DA should be paid net of taxes on the same line as recommended by the 5th CPC to make the concept of 100% neutralization somewhat meaningful.

Determining the level of inflation methodology While considering the issue of the quantum of DA admissible, the Commission considered at length the procedure for estimation of inflation. Presently, inflation as determined by the AICPI (IW), is estimated using the Laspeyere's Fixed base methodology. The inflation index using this methodology captures the cost of buying a basket of goods (fixed in the base year) at current prices relative to the cost of buying the same basket of goods at base year prices. Economic theory postulates that, generally, if the price of a commodity rises vis-à-vis other goods, the consumer adjusts his consumption basket to buy less of the goods the prices of which have increased relatively and more of those goods the prices of which have fallen relatively. This envisaged shift in consumption pattern should be considered for calculating inflation. A 'chainbase index' captures the inflation taking into account the changes in quantities purchased consequent upon changes in the relative prices. Moreover, it also considers new products in the consumers' basket as well as quality of the existing products improving every year. Therefore, inflation captured using 'Chain-base' technique would generally tend to be lower than the 'Laspeyre's price index'. [Under certain circumstances, however, the chain-base index could be higher than the Laspeyre's index, i.e. if there is an increase in the price of basic items, which are necessities, having low substitutability and which form a sizeable chunk of the consumption basket. The increase in prices of such goods would result in less than proportionate reduction in quantity, thereby translating into higher expenditure in value terms. Therefore, the weightage (calculated in terms of percentage value of total consumption expenditure) attributed to these items in the construction of the composite price index would increase. This would result in the chain base price index being higher than the price index estimated using the fixed base technique.

Analysis India is on the growth path. Growth leads to wider choice with enlarged availability of substitutes. Such availability of substitutes would impact the price-demand relationship. Given this backdrop, the feasibility of developing chain base index was explored by the Commission. It was observed from the Reports of the National Sample Survey Organization on Consumer Expenditure Survey, that while expenditure data in value terms was generated through the survey, its breakup in terms of quantity and price was available only for a few items under food, clothing, bedding, etc. Data on durables consumed poses a problem as consumption of individual items is very infrequent and reporting irregular. This issue gets compounded when aggregation is attempted at the All India level.

Recommendation on chain base index

The feasibility of developing a Chain based index is dependent on the availability of time series data on both prices and the corresponding quantities demanded of each item. While there is merit in developing a chain based index for capturing inflation, this would be feasible only if the Consumer Expenditure Survey generates time series data, on both quantity consumed as well as value of expenditure for fairly large list of items in the consumption basket providing the possibility of substitution over short time span.

The Government may explore this possibility. In the meantime, the Government should keep revising the base year in the existing fixed base index method as frequently as feasible.

Use of AICPI (IW) for estimation of DA

Presently, the estimation of DA for Central Government Employees is based on the movements in the AICPI (IW) (1982=100). The Fourth Central Pay Commission, while considering the issue of suitability of the AICPI, opined that the Government should examine whether a more suitable index could be prepared for Government employees taking into account their consumption pattern and other relevant factors. This recommendation was based on the view that the AICPI does not truly represent the consumption pattern of all central Government employees. On the other hand, the Fifth Central Pay Commission took the view that consumption patterns of Group A,B,C,D employees within Government are bound to be different due to different income levels and hence a suitable index based on consumption pattern for Government employees as recommended by the Fourth Central Pay Commission is likely to suffer from the same set of problems which the AICPI(IW) suffers.

The Fifth Central Pay Commission opined that even though the option of employing separate indices for each category of employees did exist, it was devoid of merit because of the sheer impracticality of the task as well as needless suspicion such an arrangement was likely to arouse between various groups. Therefore, they recommended that the AICPI (IW) should continue to be the index used for calculating DA for Government employees.

The Fifth Central Pay Commission, observed that for the purpose of estimation of AICPI (IW) by Labour Bureau, the coverage of 'Industrial Workers' extended to 70 selected centres in seven sectors namely Factories, Mines, Plantations, Railways, Public Motor Transport Undertakings, Electricity Generation and Distribution Establishments, and Ports and Docks.

A Working Class family was defined as one where one of the members worked as a manual worker in any of the seven sectors and which derived one half or more of its income through manual work defined on the basis of classification of occupations and jobs involving sufficient physical labour but at the same time not requiring much of educational background in the field of general, scientific, technical and other areas.

The Fifth Central Pay Commission also observed that in the Family Living Survey, which is the basis for estimation of the AICPI (IW), the design of the monthly family income classes is open ended, ranging from 'less than Rs.750' to 'Rs.5000 and above'. The Working Class family Income and Expenditure Survey (1999-2000) for Delhi points to the fact that 53% of the families fall in the income class 'less than Rs.5000 per month', which is less than the minimum earning of a Government employee in Delhi. This implies that a composite price index generated from this survey may not adequately represent the price index for Government employees. This is because consumption pattern of the Government employees vis-à-vis the 'Working Class Family' sample selected in the Family Living Survey would be considerably different. Recommendation The Government of India has set up the National Statistical Commission to serve as a nodal and empowered body for all statistical activities of the country; to evolve, monitor and enforce statistical priorities and standards and to ensure statistical coordination among different agencies involved. The Commission is mandated to evolve standard statistical concepts, definitions, classification and methodologies in different areas of statistics and lay down national quality standards

on those statistics. The Commission is of the view that the National Statistical Commission may be asked to explore the possibility of a specific survey covering Government employees exclusively, so as to construct a consumption basket representative of Government employees and formulate a separate index. Meanwhile, the Government may continue to use the AICPI (IW) for estimating the DA, subject to the modifications proposed in the subsequent paras.

Revision of Base of AICPI (IW) for calculation of DA

The Fifth CPC had adopted the AICPI (IW) using the 1982 series for estimation of DA. The Government has developed a new series with base 2001, with effect from January 2006. It is possible to generate the back data series with base 2001, with the help of the stipulated linking factor of 4.63. The 2001 series has an extended coverage of 78 centers compared to the 70 centers in the 1982 series. The weightage emerging from the series with 2001 base, being recent, is more representative of the current consumption basket. The Commission, therefore, recommends that the AICPI (IW) with base 2001 may, henceforth, be used for the purpose of calculating DA till it gets revised. As mentioned earlier, the base year should be revised as frequently as feasible. The Commission also looked into the weightages assigned to various components of consumption and the manner in which the Labour Bureau conducts the survey. The examination has revealed a direct correlation in the movement of the price index for housing and the movement of the HRA rates of Government employees. If a representative sample is used for construction of the price index for housing, there should not be such a direct correlation keeping in view the fact that for industrial workers, the escalation in rental should not be so steep for various obvious reasons. Since housing has a large weightage in AICPI (IW), there is a possibility of substantial distortion in DA calculations.

The Commission recommends that the Government take expeditious steps to rectify these noticed distortions in the construction of the current AICPI (IW) series. The National Statistical Commission may also take these factors into consideration while evolving a separate index for Government employees.

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