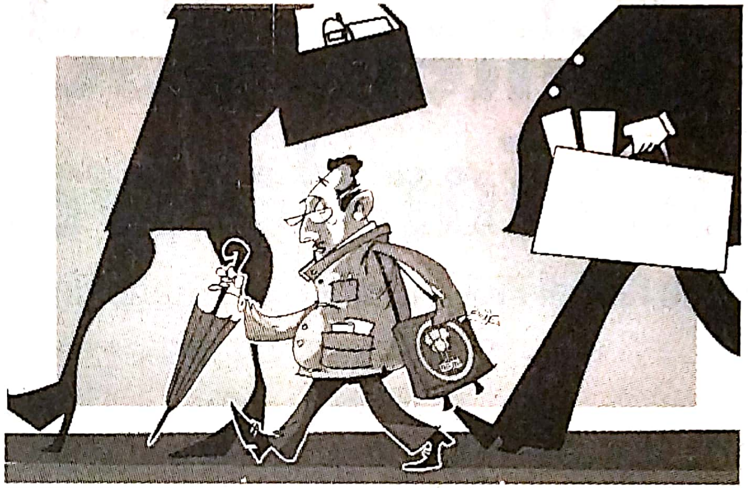
Pricing the government employees

Pay commissions must now abet price discovery through the market process. This has to be accompanied by labour market reforms, performance accountability, and so on, say **M S Sahoo** and **C K G Nair**.

THE Sixth Central Pay Commission has adopted a *dal-chawal* approach to 'pricing' the central government employees. Literally: as at the centre of its report is a table of 'essential' commodities with the quantity requirements, prices etc., used by the commission to arrive at the benchmark 'cost of living'. If governance and delivery are indeed important in the scheme of things, as being proclaimed at times, it will be an amazing miracle how the *dal-chawal* indexed *babus* will take the country forward in the 21st century and beyond! Given that over a billion people use and directly or indirectly pay for government services, the report, as expected, has evoked an intense, passionate debate.

While the macro outlook of the commission is benchmarked to the 'just-above-poverty line', the micro concerns of redistributing this 'poverty' in an unequal manner among the various classes and sub-classes of employees make interesting reading. Public reactions to the report have generally used the argument of equity in assigning a fair price for the *babus*. Some of them have demanded parity in prices for different classes of employees within the government and also parity in comparison to prices such *babus* can command elsewhere: from domestic corporate — public and private — sector to global markets. Some others have demanded parity with the output they deliver; to the price the society is capable of paying and to the general standard of living in the country. While the media is awash with these equity concerns, we look at the issue of 'fair price' from the perspective of the 21st century when technology and markets have made the world almost flat.

Government is a standard input-output conversion system. It hires funds, labour, etc., for a price, converts these into services, and provides these services for a price. It is, however, different from similar other systems in the sense that it is generally a not-for-profit, monopoly supplier of public goods. Though there may not be a *quid pro quo* between the payments made and services used by an individual, there cannot be a better *quid pro quo* relation from the perspective of the society as a whole. The society pays for the government services in a variety of forms and thereby indirectly pays for all inputs, including labour; government hires to produce these services.



ZAHID ALI

India embraced economic liberalisation in a meaningful sense from early 1990s. It essentially meant transition to a market-based delivery system. Market delivers best if the price is right. The outcome is sub-optimal if the price is wrong. One of the key requirements of discovering right price is that every participant in the market is a price taker.

Take the example of financial market which discovers the price of funds. Government raises funds at a price discovered by the market. The price discovered for funds raised by central government is generally the lowest reflecting better comfort for the supplier of funds. This forms the benchmark for the funds raised by state governments and different grades of corporates. Instead of taking the price discovered by market, if government wishes to set the price, it will be priced out of the market. This happens because our financial market is reasonably efficient and transparent.

The labour market, however, is not as efficient today as the financial market is. Labour, as a factor of production, is not homogenous. The supply of labour, in the aggregate sense, exceeds demand though there are skill-specific shortages. Given these characteristics, price of labour is not fully market-determined. This enables government to be a price maker. It is able to get reasonable supply of some variety of labour even if it offers a price substantially lower than market price. Labour being rational, higher quality labour is hired by others at market price leaving the average quality for government.

GOVERNMENT is a pass through entity. The society hires labour, capital etc., through the government and uses their services. It gets the labour commensurate with the price it pays for; which in turn decides the output. The society, therefore, has the option to pay much less for the labour and suffer the deficient service (or disservice) or go for better quality people by paying more and get more output and superior services. It is like an individual opting to pay a higher fee to a skilled doctor and save the life or vice versa. The differential outcome of the two options widens if we factor in the quality and skill set factors. Like in the present times where availability of skilled labour has become a critical factor in India; too much difference in remuneration means low quality stuff being available to the lowest payer. Peanut-monkey syndrome in full flow!

The price of labour is a signalling device: to get the right quality people as well as in solving the agency problem. Otherwise, with low wages and below-par quality, the cost of providing services would be actually more with all the inefficiencies plaguing the system. Moreover, given the monopoly nature of many of the government services, unfulfilled expectations (the other side is greener dreams) would accentuate the rent-seeking behaviour (read corruption) of the employees, adding yet another layer of cost to the society. It is, therefore, necessary to work out the total cost of labour to the society instead of being carried away by the explicit payment made to government employees. The cost to the society will be equal to the explicit price plus the inefficiency cost plus the rent. This would be substantially higher than the cost of a decent explicit wage to the employees.

This is not to argue that the market discovered price is the panacea for delivery of government services. This has to be accompanied by reforms in labour market, performance accountability for government servants, etc. Inability to get best from labour does not justify lower price of government employees.

The decennial approach to an award for the employees of one the largest employers in the world should not be just a dal-chawal issue. It is about a contracting issue that would avoid adverse selection, provide the right signals and minimise the agency problem haunting such huge input output systems. Given the pace and dynamics of a globalised society these challenges are ever more daunting now, a fact that must be explicitly factored in the entire exercise. Preserving the legacy constraints to subserve the narrow interests of the feudal past is a great disservice to the nation that is trying to unshackle itself and to hold its head high amongst the comity of nations in the 21st century.

(The authors are civil servants. Views are personal.)