

Central Pay Commissions and Performance-related Pay

An Unfinished Reform Agenda

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India's Union government pay structure remains largely seniority-based despite repeated recommendations by successive Central Pay Commissions to link compensation with performance. This article argues that the persistent failure to implement the performance-related incentive scheme represents a major weakness of the CPC framework, allowing substantial pay increases without corresponding productivity gains. Tracing PRIS from the Fourth to the Eighth CPC, the article estimates an opportunity cost of nearly ₹2 lakh crore since 1987 and proposes reforms to institutionalise performance-based public sector compensation.

The Government of India (GoI) periodically constitutes Central Pay Commissions (CPCs) to review and recommend revisions to the pay structure, retirement benefits, and service conditions of Union government employees. Since the establishment of the First CPC in 1946, these commissions have generally been constituted at intervals of about a decade to align public sector compensation with changing economic conditions. While the early CPCs focused primarily on pay scales, cost of living adjustments, and service security, subsequent commissions increasingly recognised the need to improve bureaucratic efficiency, accountability, and the quality of public service delivery.

Fourth CPC and Performance-related Pay

The concept of explicitly linking financial rewards to performance was formally introduced by the Fourth CPC (1986). The commission observed that the prevailing compensation system did not differentiate between average and high-performing employees, thereby weakening incentives for improved performance. It argued that a purely seniority-based system was inadequate for promoting efficiency and recommended the introduction of performance-linked financial incentives as a means of rewarding merit and enhancing accountability in the public service.

The Fourth CPC also proposed the introduction of "variable increments" to reward employees demonstrating outstanding performance, thereby moving beyond uniform annual increments based solely on seniority. In addition, it reviewed the existing bonus system and argued that the "ad hoc bonus" should not

become a permanent feature of government compensation. Instead, it recommended extending the Productivity Linked Bonus (PLB), then confined largely to commercial departments, such as the railways and the department of posts, to other government departments where productivity could be objectively measured.

History of Non-implementation

Despite the progressive vision of the Fourth CPC, its principal limitation lay not in the recommendations themselves but in their implementation. Although the GoI accepted the broad framework of the Fourth CPC through a Ministry of Finance resolution issued in September 1986 (Resolution No 11(1)-E III(B)/86), it did not implement the proposed performance-linked components. The proposed system of variable increments was not adopted for general implementation. The government argued that performance appraisal across a large and diverse bureaucracy would be difficult to administer objectively and could give rise to allegations of subjectivity and favouritism. Consequently, the existing timescale system, under which annual increments are granted automatically, was retained. Likewise, the PLB remained confined to commercial departments, while employees in the central secretariat continued to receive the non-performance-based ad hoc bonus.

Evolution of PRIS: Fifth, Sixth and Seventh CPCs

Subsequent CPCs consistently reiterated the need to link compensation with performance, highlighting the persistent disconnect between remuneration and productivity in the public sector. The Fifth CPC (1997) proposed a system of performance-related increments, recommending an additional increment for employees demonstrating exceptional performance while withholding the annual increment from those whose performance was found to be consistently unsatisfactory.

The Sixth CPC (2008) presented the most comprehensive framework for linking compensation with performance by formally recommending the performance-related incentive scheme (PRIS). Unlike

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earlier proposals, PRIS envisaged a “variable pay” component that would be strictly budget-neutral, with incentives financed entirely from savings generated through improvements in departmental efficiency, rationalisation of processes, or reductions in administrative expenditure. However, the scheme was never operationalised. Acknowledging this, the Seventh CPC (2016) observed that PRIS had remained unimplemented and proposed a revised framework for “performance-related pay” (PRP) matrix. While modifying the institutional design, the commission reaffirmed the principle that a part of public sector remuneration should be linked to measurable performance outcomes.

Systemic Roadblocks to PRIS

The GoI accepted the Sixth CPC’s PRIS recommendation in principle through a Gazette Notification dated 29 August 2008 (Resolution No 1/1/2008-1C). However, the scheme was never effectively implemented across the Union government.

A major impediment was its financing mechanism. PRIS envisaged that incentives would be funded entirely from departmental savings generated through efficiency gains. In practice, however, government financial rules require unspent budgetary allocations to be surrendered to the Consolidated Fund of India, leaving departments with little scope to retain and redistribute such savings. The absence of a clear institutional framework further constrained implementation. In particular, the Department of Personnel and Training (DoPT) and the Ministry of Finance did not finalise the operational guidelines required to identify, quantify, and distribute efficiency-linked savings. Consequently, despite formal acceptance, PRIS remained unimplemented.

PRIS and the Eighth CPC

The failure to operationalise performance-linked pay has persisted into the current decade. Nevertheless, the terms of reference (ToR) of the newly constituted Eighth CPC indicate that performance-based remuneration remains an important policy priority. The ToR requires the commission to review the existing bonus

framework and recommend an appropriate incentive mechanism to reward improvements in productivity and performance. This reflects a renewed commitment to strengthening the link between compensation and performance, although its success will depend on addressing the institutional and administrative constraints that hindered the implementation of earlier proposals.

Economic Irrationality of Unlinked Wage Hikes

Universal revisions in the salaries of Union government employees, without a corresponding link to performance, weaken the incentive structure underlying public administration. Performance-linked incentives are an established feature of compensation systems in many countries and are widely regarded as a means of improving organisational efficiency and service delivery. In this context, introducing credible performance-related incentive mechanisms has become increasingly important. Salary revisions that are decoupled from measurable performance outcomes may reduce accountability and weaken incentives for higher productivity. A system that differentiates rewards on the basis of performance could strengthen motivation, improve institutional effectiveness, and enhance the quality of public service delivery.

Staggering Opportunity Cost

The fiscal implications of not implementing the Fourth CPC’s 1987 recommendations on performance-linked incentives have been substantial. Had the PRIS been operationalised, improvements in organisational efficiency could have generated significant fiscal savings. Based on empirical evidence suggesting that a performance-based incentive scheme can improve productivity and reduce relevant administrative expenditure by around 10%, the annual opportunity cost of non-implementation of PRIS is estimated at approximately ₹11,000 crore. Over a 25-year period (1987–2012), assuming an annual rate of return of 7%, cumulative opportunity cost is estimated at ₹1,87,491 crore (approximately ₹2 lakh crore). At the time, this

squandered potential equated to roughly 7.7% of India’s total internal debt. As discussed in the author’s paper, “Pay for Performance in Government: Has Its Time Finally Come?” this estimate is conservative. It excludes the broader spillover effects of improved administrative efficiency and the potential savings arising from plan revenue expenditure, suggesting that the actual opportunity cost of non-implementation may have been considerably higher.

Policy Recommendations for the Future

For the effective implementation of a performance-linked compensation system, and to address the long-standing structural limitations within the Indian bureaucracy, a set of institutional reforms—drawing on the experience of the Fourth to Seventh CPCs—is essential.

Establish objective evaluation metrics:

Funding for PRIS must be tethered to measurable targets. Departments should only qualify for financial incentives if they achieve a minimum performance score of 70% under the Results Framework Document (RFD) or an equivalent performance assessment framework.

Ensure transparency in incentive payments:

Incentive payments should be determined through a predefined and transparent formula to minimise discretion and ensure consistency. The proposed framework computes the total incentives as $0.15 \times 0.15 \times [(Composite\ Score - 70) / 30] \times (Budgeted\ Cost - Actual\ Cost)$, thereby linking rewards directly to both performance outcomes and efficiency gains.

Preconditions for eligibility:

The implementation of a performance-related incentive system should be accompanied by administrative modernisation. Departments should prepare a citizen’s charter, establish an effective public grievance redressal mechanism such as the Centralised Public Grievance Redress and Monitoring System, offered by the Department for Administrative Reforms and Public Grievances. Departments must adopt reliable biometric attendance systems to ensure accountability, punctuality,

and staff availability. Compliance with these institutional requirements should be a precondition for participation in the scheme.

Reform budgetary rules: The Ministry of Finance should revise existing expenditure rules to address the “savings trap.” Departments should be permitted to retain a specified proportion of efficiency-induced operational savings for financing performance-related incentives, rather than surrendering all unspent funds to the Consolidated Fund of India.

Adopt a phased implementation strategy: The scheme should initially be introduced on a pilot basis in a limited number of departments before wider implementation. The six departments identified in earlier proposals—Agriculture and Cooperation, School Education and Literacy, Steel, Tourism, Science and Technology, and Food and Public Distribution—would provide an appropriate testing ground for refining the design and assessing operational feasibility before scaling up the programme across the Union government.

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