8th Pay Commission Needs Better Inflation Measurement for Realistic Pay Revision

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8th Pay Commission Latest News

- At first glance, the 8th Central Pay Commission (CPC)—whose terms of reference were approved on October 28—and the Statistics Ministry's proposal to revise housing inflation in the Consumer Price Index (CPI) may appear unrelated.
- However, the two are closely linked. The CPC's recommendations on pay and pensions significantly influence government expenditure and consumer demand, while CPI inflation determines the dearness allowance (DA) component of government salaries and pensions.
- If housing inflation continues to be measured under outdated parameters, it could misrepresent actual inflation trends, leading to distorted pay adjustments.
- The MoSPI's proposed changes aim to update the inflation calculation method, preventing potential over- or under-estimation of inflation once the 8th CPC's recommendations take effect.

Flaws in Measuring Housing Inflation in India

- Housing carries a 10.07% weight in India’s Consumer Price Index (CPI).
- To compute this, the Statistics Ministry (MoSPI) surveys 13,000+ houses across 300 towns, including a significant share of government and PSU accommodation.

The Core Problem: Use of HRA as a Proxy for Rent

- For government-provided homes, MoSPI uses the House Rent Allowance (HRA) foregone—along with a small licence fee—as a substitute for rent to measure housing inflation.
- However, HRA doesn’t reflect market rent; it depends on the occupant’s position and pay grade, not on demand-supply dynamics.
- If a senior employee vacates a surveyed house and a junior employee replaces them, the HRA component falls, showing an artificial dip in inflation, even though actual housing conditions remain unchanged.

Pay Revisions Distort the Inflation Trend

- Whenever government salaries are revised, such as under the upcoming 8th Central Pay Commission (CPC), **HRA values rise automatically**, inflating the housing component of CPI — irrespective of real market trends.
- A similar distortion occurred eight years ago after a previous Pay Commission revision, confusing both investors and policymakers about the true inflation trajectory.

Why Reform Is Needed

- This outdated method causes artificial spikes or drops in housing inflation, undermining the accuracy of CPI and complicating monetary policy decisions.
- Revising the approach to reflect real rental values is crucial to ensure credible inflation measurement before the 8th CPC recommendations take effect.

How the 7th Pay Commission Distorted India’s Inflation Data

- When the 7th Central Pay Commission (CPC) recommendations took effect in July 2017, they included a 105.6% hike in House Rent Allowance (HRA) for Central government employees.
- This administrative change triggered **a sharp, artificial surge in housing inflation** — from 4.7% in June 2017 to 8.45% in June 2018 — pushing headline CPI inflation up to 4.92%, despite no real increase in housing costs.
    - Recognising the distortion, **RBI policymakers chose to disregard the inflated data**.
    - Housing inflation only stabilised by mid-2019, dropping below 5% and later staying around 3–4%, though this understated reality.
- In contrast, RBI’s House Price Index showed 6% growth, and MagicBricks’ Rental Index reported 20% quarterly rent increases.
- This revealed a growing gap between official data and real market trends — a key reason the 8th CPC now needs a more accurate inflation measure.

MoSPI Proposes Overhaul of Housing Inflation Measurement

- To address distortions in housing inflation, the Ministry of Statistics and Programme Implementation (MoSPI) has proposed major revisions to the Consumer Price Index (CPI) methodology, effective February next year.
- Key changes include:
  - **Excluding government and employer-provided housing** from the CPI sample to remove HRA-linked distortions.
  - **Collecting rent data monthly** instead of once every six months for more real-time accuracy.
  - **Including rural housing inflation** in the CPI for the first time.
- Economists note that with the **8th CPC** due to submit its report in the next 18 months, these updates are timely and crucial.
- While housing inflation may appear higher initially, the new approach will make it more representative of actual rental trends and improve the credibility of inflation data.

Source: IE | IT
