

Creating 'Good Jobs'

Assessing the Labour Market Regulation Debate

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The current regime seeks to reform labour laws with the understanding that these reforms will improve industrial growth and expand the possibilities of enterprise. However, there is already ample evidence from within India that this obsession with reforming labour law, particularly in the way the government has done it till now, will not take us any closer in creating more jobs or a healthy industrial sector. These reforms will not help firms adapt to ever-changing market conditions, nor will they ensure greater security of employment.

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The debate on India's labour market reforms has acquired a new vigour and significance with the Union Cabinet and the Rajasthan government approving amendments to key labour laws over the past few months. The Union Cabinet cleared amendments to the Factories Act, 1948, which includes increasing the limit of overtime for workers from 50 hours per quarter to 100 hours per quarter, lifting restrictions on night shifts by women in factories and reducing the eligibility for entitlements such as annual leave with wages to 90 days from 240 days. It has also made amendments to the Apprenticeship Act (1961), dropping the provision that called for the arrest and imprisonment of employers who did not implement this Act and to the Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by Certain Establishments) Act, which seeks to allow firms employing up to 40 workers to file a combined compliance report for 16 labour laws, up from nine.

Further, the Rajasthan assembly has also passed changes which reduce the applicability of the Factories Act to units with more than 20 workers with power and 40 without power (up from the norm of 10 and 20 workers, respectively); of the Contract Labour Act (CLA) to companies with more than 50 workers (from 20); and of the Industrial Disputes Acts

(IDA) to factories employing 300 workers (up from 100). It has been often argued that it is India's inflexible and rigid labour market regime that has hurt the growth of manufacturing and therefore it is widely believed that such changes will put India's manufacturing sector on a high growth trajectory and accelerate productive employment creation (Basu 2005; Ahmed and Devarajan 2007).

The Debate

There exists vast empirical literature on the impact of labour market regulations on the growth of employment in the manufacturing sector. Much of this literature focuses on Chapter v-B of the IDA (1947), which makes it necessary for firms employing more than 100 workers to obtain the permission of state governments in order to retrench or lay off workers. One of the most influential studies in this area is by Besley and Burgess (2004), which constructs an index summarising state-level amendments to the IDA between 1949 and 1992 and finds a negative impact of pro-worker regulation on output, investment, employment and labour productivity among registered manufacturing firms.

Despite the extensive use of this index in the literature, it has been heavily criticised. Bhattacharjya (2006, 2009) argues that the Besley-Burgess scoring system can erroneously classify a state as pro-employer or pro-worker with just one or two amendments to the IDA in the 50 years covered by the index. Nagaraj (2004) points out that this index focuses only on IDA, abstracting from several other laws which are responsible for inflexibilities in the labour market. In an attempt to create a more comprehensive measure of labour market regulations, the

Organisation for Economic Co-operation and Development (OECD 2007) constructed a new measure which includes information not just on IDA but seven additional areas: Factories Act, State Shops and Commercial Establishments Acts, CLA, role of inspectors, maintenance of registers, filing of returns, and union representation.

Controlling for state-level infrastructure and product-market regulations, Dougherty, Robles and Krishna (2011) use this revised measure and find that firms in labour-intensive industries and in states with flexible labour markets have total factor productivity residuals 14% higher than those registered for their counterparts in states with more stringent labour laws. Gupta et al (2009) create a composite measure of labour market regulations across states by combining information from three key studies (Besley and Burgess 2004; Bhattacharjea 2009; OECD 2007) and categorise states as having flexible, inflexible and neutral labour regulations. They also find that states with relatively inflexible labour regulations have experienced slower growth of labour-intensive industries and overall slower employment growth.

Other studies also point out that since labour is in the concurrent list, there are far too many labour laws. Some estimates list 47 central laws and 200 state laws (Anant et al 2006). Moreover, many of these laws overlap and there is a multiplicity of them covering the same subject. Not only does this make compliance difficult, but also has the scope for exclusion of workers. Also, many laws are far too detailed and antiquated, making them difficult to implement. For instance, the Factories Act prescribes the use of earthen pots filled with water (water coolers are not sufficient) and the use of red painted buckets with sand (instead of fire extinguishers). Such details provide scope to the unscrupulous inspecting officials for harassment and extracting bribes (Debroy 2005).

In fact, the report of the Second National Commission on Labour, submitted in 2001, proposed the unification and harmonisation of labour laws under five heads of industrial relations, wages, social security, safety and welfare and working conditions. There is no disputing

the fact that the unification, harmonisation and rationalisation of India's labour laws are long overdue. But before reforming the regulatory framework, some ground realities need to be clearly understood.

Neglecting the Unorganised Sector

India's manufacturing sector is characterised by dualism, i.e., the prevalence of a formal/organised¹ sector which coexists with a large "unorganised sector". This dualistic structure has persisted for the past two decades and is unlikely to change drastically over the next decade. The unorganised sector, in particular the household sector, accounts for a disproportionately large share of employment (90%), but a very small share of value added in manufacturing. The dominance of this sector is a major factor in the low productivity of manufacturing, as a whole. Estimates suggest that over four-fifths of new jobs created in manufacturing over the next decade are expected to be in the unorganised sector (Goldar 2013). However, most of India's labour regulations cover only the organised sector, which accounts for a little over 10% of the total employment in the manufacturing sector.²

In fact, there are no regulations for decent conditions of work and no provision for social security of any kind for workers in the unorganised sector. Significantly, even in the organised sector, most laws do not apply to establishments employing less than 10 workers, which account for an overwhelmingly large share (97%) of total firms in the manufacturing sector. The proportion of workers covered by the Factories Act and Chapter V-B of IDA is as low as 2.45% and 1.8% of the workforce respectively.³ If labour laws are covering such a small proportion of the total workforce in India, what inflexibilities in legislation are we talking about? The whole edifice of the argument that it is the inflexibility of labour laws which is harming industrial growth needs closer scrutiny. The high degree of protection given to very few workers has created a false image of excessive rigidity in the labour market, thus concealing the fact that over 90% of the workforce escapes this perceived

rigidity and is left unprotected against any contingencies and arbitrary actions of employers.

The labour market debate also needs to be viewed in the backdrop of the fact that firms have worked out ways to get around the inflexibilities or rigidities in the labour market in innovative ways, which have allowed for greater flexibility in the use of labour. These include the greater substitution of contract, temporary and casual labour for permanent workers; firms moving to states where labour is less unionised; the expansion of leasing-in capacity of small firms and subcontracting; and the adoption of capital-intensive techniques of production (Papola and Pais 2007).

Contract Workers

Of these, the increasing contractualisation of the workforce is a cause for serious concern, as it reflects the deterioration in the quality of employment generated. Contractual employment has been on the rise through the decade, with the share of contract workers in total organised employment in the manufacturing sector increasing from 15.59% in 2000-01 to 26.57% in 2010-11, while that of directly employed persons declining from 61.26% to 51.73%. Estimates from Annual Survey of Industries (ASI) data indicate that contractual workers grew at 10.05% for India over the last decade while directly employed persons grew at 2.8%.

The use of contract workers provides a means of getting around stringent labour regulations, particularly the IDA, as contract workers do not come under the purview of labour laws that are applicable to directly employed workers in labour markets. Wages paid to contractual workers are relatively low as compared to regular workers and they also do not enjoy social security cover under different legislative provisions such as Employees' Provident Fund and Miscellaneous Provisions Act 1952, the Employees' State Insurance Act 1948, the Workmen's Compensation Act 1923 and the Maternity Benefit Act 1961. Given the deplorable conditions under which they work, a rapid increase of such jobs will certainly not meet India's challenge of productive employment creation.

Importantly, if we classify states as having flexible, inflexible and neutral labour market regulations (on the basis of Gupta, Hasan and Kumar 2009); we find that the growth of contract workers has exceeded the growth of directly employed workers in both flexible and inflexible states. In fact, the growth of contractual workers in the two types of states is not significantly different. Lower wages of informal workers and the savings made on the expenditure of worker benefits help in reducing costs and improving competitiveness.

Firms are thus incentivised in both flexible and inflexible states to substitute directly employed persons with contractual workers in “core” activities, in spite of the CLA prohibiting the use of contract labour in “core” and “perennial” activities. This raises concerns about whether making labour regulations more flexible will actually arrest the trend of increasing contractualisation. In fact, if labour regulations were actually as rigid as they are made out to be, how were firms able to expand their contractual workforce so rapidly, especially in the so-called inflexible states?

A Possible Agenda

There is an urgent need to expand the focus of the debate and reduce “dualism in the regulatory regime” (Papola and Pais 2007) by bringing in the largely excluded segments of the unorganised sector into a regulatory framework. If labour market reforms are to make a real difference and create more productive jobs and pathways out of poverty, it is necessary to take this debate beyond the narrow agenda of “flexibility” to macro-economic issues like “a minimum set of conditions of work to all workers, a minimum level of social security, better and efficient labour administration machinery and a simple and fast-responsive grievance redressal machinery” (NCEUS 2009: 185).⁴ The key is to maintain a fine balance between the need for firms to adapt to ever-changing market conditions on the one hand, and workers’ employment security on the other.

While there is a need for flexibility in adjustment of workforce in the organised sector, as regulations such as Chapter v-b

of IDA have neither served the interests of industries nor of labour, there is also an urgent need to ensure job security, health and social protection to all workers irrespective of the size and sector of their employment. Dilution of labour laws by raising the limit of firms to which Chapter v-b of the IDA or the Factories Act is applicable is unlikely to be of much help as these thresholds simply provide disincentives for enterprises to expand beyond a certain size and adversely affect their growth and efficiency. Also, it needs to be asked whether such measures will simply free more employers from the obligations they currently hold for ensuring job security, health, and social protection of their workers, and further increase informal employment in the formal sector, instead of encouraging the growth of formal employment.

Given the increasing substitution of directly employed workers with contract workers and the change in the nature of “core” and “perennial” activities such that even in its “core” activity an enterprise does not have the same amount of work throughout the year, there is an urgent need to review the CLA. While the need for flexibility in the use of contract labour for activities that are not of a regular nature and vary from time to time is understandable, the provision of decent conditions of work and social security for these workers must be strictly adhered to. There is also ample justification for reviewing the Apprenticeship Act and making it more effective and inclusive to meet the challenge of skilling India’s rapidly rising workforce. On-the-job training represents the easiest, most viable means to build and enhance human capital.

Finally, it is incorrect to put the entire burden of the disappointing performance of the manufacturing sector on labour market regulations. The growth of employment and the employment intensity of industrial output are not just a function of how rigid or flexible labour laws are. Instead, there are larger issues concerning the size of market, capital formation, credit availability, infrastructure, and government policies, which determine the pace and composition of

industrial growth as well as the extent of employment generation associated with it. The role of labour market regulations, therefore, in meeting India’s challenge of creating “good jobs” for its rapidly rising population maybe more modest than the intensity of the debate suggests.

NOTES

- 1 The formal sector is statistically defined by the Factories Act which covers all factories employing 10 or more workers using power, or 20 or more workers without using power.
- 2 This is based on calculations from unit level NSS (2010-11) and ASI (2010-11) data.
- 3 Estimates are from ASI (2010-11) unit level data.
- 4 National Committee for Enterprises in the Unorganised Sector, 2009.

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