

# Flexibility, Employment and Labour Market Reforms in India

*There is intense debate on labour market reforms in India today. It is argued that but for restrictive labour laws that create inflexibility in the labour market, the Indian economy would have experienced a higher growth of employment. On the other hand, this view is vehemently contested by trade unions and many other economists. This paper shows that the Indian labour market is quite flexible despite so-called restrictive labour laws. However, at the same time, Indian labour laws are so numerous, complex and even ambiguous that they promote litigation rather than the resolution of problems related to industrial relations. A comprehensive view on labour market reforms is required, one that addresses the needs of both employers and workers. The author recommends simplifying and rationalising the complex and ambiguous extant pieces of labour legislation into a simple code that allows for labour adjustment with adequate social and income security for the workers.*

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## I Labour Flexibility Debate

The term “labour market flexibility” comes only next to “globalisation” in frequent occurrence in the discourse on economic growth nowadays. This is natural because labour flexibility formed part of the package called the Washington consensus. The framework for producing labour market flexibility was designed to deregulate the labour market and remove or cut protective regulations [Standing 2002]. The Washington consensus was based on what Stiglitz (2002) called market fundamentalism. The basic idea behind this thesis was that free market outcomes are efficient and Pareto optimal. The free play of market forces results in employment of resources at the market-clearing prices; this leads to both efficiency (as almost all resources are employed) and equity (all are rewarded according to their marginal contribution). Regulation of the market by the state leads to deviations from full employment of all resources. Hence, attempts should be made to remove as many of these imperfections in the market as possible so as to achieve full employment of all resources and optimal social welfare. In the case of labour market, trade unions and protective labour legislations are said to be market-distorting agents, which curtail the free operation of market forces to ensure full employment of labour. Interference by collective institutions (law and trade unions) in the market process increase transaction costs, which mar investment, thereby resulting in unemployment and welfare loss. These institutional interventions in the name of equity and social justice superimpose terms set above the market-clearing prices. As a result, markets do not clear, wages become “sticky” and the cost calculations of firms go haywire. These institutions not only tamper with the “price” and the essential market signals that enable efficient functioning of the market, but also affect the freedom of employers to adjust the “quantities” of resources, which, in turn, leads to unemployment. They also result in “inequity” because by protecting the interests of “insiders”, they hurt the chances of “outsiders” entering the labour market, who thus remain unemployed. A social divide is created, which

perpetuates, inequality. While the “outsiders” remain scattered and their political power becomes diffused, the “insiders”, on the other hand, are well-organised and vocal, and influence policy decisions more than their unfortunate counterparts. Hence, it is strongly argued that the labour market should be deregulated for stimulating investment and employment, as well as equality in order to provide flexibility in entry and exit.

Several other economists [e.g., Wilkinson 1992; Sengenberger and Campbell 1994], however, contest this view with their microeconomic and macroeconomic logic. Their argument runs as follows. Competing firms may compete either on the basis of reducing their unit costs by lowering wages and labour standards (“low road to growth”) or by pushing up productivity with innovation in technology, product design, and organisation (“high road to growth”). As long as a firm can continue competing on the basis of low wages and bad working conditions, there is no motivation to innovate for improving productivity. Only when the path to competition on the basis of low wages and bad working conditions is barred by providing a floor of labour standards, the firms can become enterprising and invest in technological and organisational innovation, which, in turn, leads to better wages and working conditions. In fact, the absence of a minimum floor of labour standards would inevitably ensnare the industrial economy in the syndrome of low wage and low productivity. This is what leads to the “race to the bottom”, which is most authoritatively brought out in the study by Blanchflower and Oswald (1994). The study showed that almost all over the world, higher wages are associated with higher employment, implying that unemployment could be the result of many factors except high wages. A recent ILO study, based on data collected from 162 countries, concludes that stronger trade union rights do not generally hinder trade competitiveness, including trade of labour-intensive goods, and indeed countries with stronger trade union rights tend to do comparatively well [Kucera and Sarna 2004]. The fact that deregulation of the labour market, even in most of the advanced capitalist countries, has not been able to contain high unemployment even after decades of implementation, increases scepticism about deregulation and its supposed benefits.

Anyway, the rising tide of militant opposition to labour market deregulation (France is the most recent case) and reduction of labour standards in several parts of even the developed world puts a question mark on the rampant deregulation of the labour market.

### **Employment Growth and Labour Flexibility in India**

After liberalisation, the rate of growth of the gross domestic product (GDP) of India has increased significantly (it was estimated to be around 8 per cent during 2005-06), presently making the country one of the fastest growing economies of the world. Although this growth has been led by services, there has been considerable improvement in industrial activity and international competitiveness is seen in some Indian industries (e.g., automobiles and pharmaceuticals), in terms of both cost and quality. However, notwithstanding the high growth rate of GDP, there has been a steady slowdown in the growth of employment in recent years. Employment, as a whole, which had experienced a steady growth of around 2 per cent from 1961 to 1990 (when the growth of GDP was only around 3.5 per cent), declined sharply to 1.5 per cent during 1990-92 and further to around 1 per cent during 1993-2000. The deceleration in employment growth during the 1990s took place along with acceleration in the GDP growth rate. Thus, the employment content of growth deteriorated, as reflected in the substantial decline in employment elasticity from 0.41 during 1983-94 to 0.15 during 1999-2000. The reasons for deceleration in employment include both policy level and technological changes in the production process over the last several years. Consequently, a significant component of GDP growth came from productivity growth and increasing capital-intensity of the economy. The deceleration in employment growth has been accompanied by increasing informalisation of the workforce. Over the years, organised sector employment has grown more slowly than total employment. Organised sector employment grew at 1.20 per cent per annum during 1983-94 but this rate fell to 0.53 per cent between 1994 and 2000. Consequently, the proportion of unorganised sector employment has considerably increased in construction, transport, storage and communications, and financial services. Apart from new jobs largely being created in the unorganised sector, a large number of retrenched workers have found refuge in the unorganised sector.

Several economists, industry associations and mainstream media have attributed the deceleration in employment growth in India, particularly in the organised industrial sector, to inflexibility in the labour market, which is believed to have increased the labour costs for enterprises, thereby hindering investment (including foreign investment) and growth. Employment protection laws are also believed to be inefficient and inequitable, leading to slowdown in growth, and dividing workers into protected and unprotected categories. Social security, of a limited kind, is enjoyed by only 8 to 9 per cent of the workforce. Over-protection of a small section of workers is not only ostensibly inimical to the growth of employment, but also goes against social justice as more and more workers are faced with deplorable working conditions. A recent study on the pattern of manufacturing growth during 1958-1992 concludes thus: "...States which amended the Industrial Disputes Act in a pro-worker direction experienced lowered output, employment and investment in registered formal manufacturing. In contrast, output in unregistered or informal manufacturing increased. Legislating in a pro-worker direction

was also associated with increase in urban poverty. This suggests that attempts to redress the balance of power between capital and labour can end up hurting the poor" [Besley and Burgess 2004]. On the other hand, trade unions and certain economists claim that labour cannot be treated like any other commodity, and measures like minimum wages, job security, separation benefits, social security, trade union rights, etc. are socially and politically necessary even for sustaining the process of globalisation, as they increase labour productivity. The government is facing an acute dilemma over this issue and labour and managements are at loggerheads with each other, forcing the government to be circumspect in reforming the labour market. This dilemma is rooted in the philosophy of social and labour policy in the country. The essential ingredient of social policy concerning labour and employment in the country, particularly during the first three decades of planning, has been to treat labour not as a mere resource for development, but as a partner in and beneficiary of social and economic development. This philosophy of labour had its roots in the national movement and many legislative provisions for protecting labour were enacted before independence, which were strengthened later. Accordingly, provisions of social security were made more comprehensive and expanded to include various kinds of risks. Further, detailed laws governing industrial relations were enacted, and a mechanism for fixing and implementing minimum wages was developed. The basic idea behind all these protective measures adopted for labour was that the workforce was a relatively weaker partner vis-à-vis capital in the production process and that in a poor country like India, it was desirable to safeguard workers to promote both social justice and an appropriate industrial and productive climate.

The debate has been intensifying over the years. In the earlier years of planning when the expectations of economic growth were higher and unemployment was not thought to be a serious problem, the issue did not draw much attention. However, with a significant slowdown in employment growth in the organised sector, the debate has taken centre stage in recent years. Faced with fierce resistance from trade unions, the government is hesitant to introduce drastic labour reforms, especially that of providing employers the flexibility to hire and fire workers, but there is certainly serious thinking on labour reforms. The *Economic Survey 2005-06* says: "...Indian Labour Laws are highly protective of labour, and labour markets are relatively inflexible. These laws apply only to the organised sector. Consequently, these laws have restricted labour mobility, have led to capital-intensive methods in the organised sector and adversely affected the sector's long-run demand for labour" (p 209). In this context, very often the example of China is given, which has drastically changed its system of labour market from a rigid security of employment to one in which labour is extremely mobile. It is said that it has greatly helped China in generating employment as well as successfully redeploying workers who were laid off in the process of restructuring of enterprises. It is argued that more than 100 developing countries have reformed their labour laws in response to competitiveness in the era of globalisation, but India remains among a select few countries with a rigid system of labour protection.

While there is an element of truth in this argument, often there is lack of objectivity in the debate. Also, the ground realities prevailing in the Indian labour market in terms of insecurity, dynamics of labour processes, extent of the implementation of labour laws and regulations, etc. are generally overlooked. In

the next section of this paper, we will discuss the quantitative and qualitative aspects of changes in employment and other aspects of the labour market in the manufacturing sector in India. This is followed by empirical findings of a survey in the manufacturing sector on flexibility of the Indian labour market in the wake of globalisation. Lastly, we assess how the findings can help resolve the debate on labour reforms and point towards a possible direction of change required in the labour regulation regime.

## II Employment, Restructuring and Labour Adjustment

The issue of flexibility in the Indian labour market has been particularly debated in recent years in the context of manufacturing sector employment – comprising both the factory and the non-factory segments – particularly the former one, as this sector is supposed to have borne the brunt of the mild dose of restructuring in the 1980s and later of liberalisation of the economy, which started in the early 1990s. The sector experienced an annual average growth rate of 7 per cent per annum (in value added or output) during the decade of the 1980s, as compared to 4.3 per cent per annum (in value added or output) during the 1970s. The organised factory segment registered a higher annual average growth rate of (output) – 7.9 per cent in the 1980s as compared to 4.6 per cent during the previous decade [Sundaram and Tendulkar 2002]. However, the faster growth rate of the 1980s was associated with a virtual stagnation in factory sector employment and the decade was widely described as one of “jobless growth” in the factory-manufacturing segment [Sundaram and Tendulkar 2002; Ghose 1994]. Employment elasticity in the organised manufacturing sector has also been very low and declining rapidly. These trends, are often attributed to the rigidities in the labour market leading to high labour adjustment cost [Fallon and Lucas 1991; Ahluwalia 1992; Besley and Burgess 2004], identified in terms of job security provisions, and lack of any relation between productivity and wages. It is argued that the legal provisions of job security and institutional factors like the pressure of trade unions make adjustment of the workforce of enterprises difficult, and discourage organised sector enterprises from expanding employment. In particular, the provision in the Industrial Disputes Act relating to prior governmental permission to retrench workers or close down enterprises of a particular size is held to be the main culprit. According to Fallon and Lucas (1991), employment in organised manufacturing would have been 17.5 per cent higher in the absence of job security regulations.

A sharp increase in real wages has also been held responsible for a decline in employment in the organised manufacturing sector. The faster growth of industrial wages relative to consumer prices, abetted by job security provisions, resulted in a significant long-term reduction of employment during the period 1980-60 to 1981-82 [Fallon and Lucas 1991]. According to Ahluwalia (1992), a 34 per cent increase in the real wages of manufacturing sector workers between 1980-81 and 1985-86 significantly contributed to a decline in employment during that period. Some studies also noted that the major factor behind “jobless growth” during the 1980s was the rise in the product wage [ILO-ARTEP 1993; Sundaram and Tendulkar 2002], which was both due to inflationary consequences of macroeconomic policies and pressures in the labour market [ILO-ARTEP 1993]. This

encouraged enterprises, irrespective of their size and organisational set-up, to adopt a strategy of capital deepening [Ghose 1994]. The process involved both modernisation and pure substitution of capital for labour. Although Ghose finds rising labour cost to be an important factor behind the slowdown in employment growth, he does not find evidence that employment security regulations adversely affected employment growth. According to him, the rise in the relative price of labour was caused by both macroeconomic policies and labour market policies pursued by the government. Jose (1992), on the other hand, argues that instead of high wages causing low levels of employment during 1980s, rapid productivity growth led to improvement in real wages. He also opines that the decline or deceleration in the rates of growth of employment and the concomitant increase in worker productivity levels during the 1980s were the outcome of structural reforms and technological changes in the manufacturing industries. Some other scholars also argue that it is not the rising labour cost or real wages that caused a slowdown in employment growth. Papola (1994) found that increases in real wages were generally accompanied by a still higher increase in productivity across industry groups, resulting in lower unit cost across industry groups. Nagaraj (1993) disputes the extent of increase in real wages, as according to him, the increase in annual earnings was primarily accounted for by the increase in the number of person-days per worker during the year, and only to a small extent by the increase in earnings per day. Increase in union power to raise wages should have led to a rise in strikes. But there has been a decline in the incidence of strikes since the early 1990s and now lockouts account for a lion’s share in the total workdays lost [Datt 2003].

Wage increase does not seem to be an important factor in reducing employment in the organised manufacturing sector. This is corroborated by the fact that by and large, employer organisations and industry have not made wage increase their main target of reform in the labour market. In fact, minimum wages have generally been set lower than the market wages in industry and their rationality has not been questioned. Most of the industry organisations and some scholars argue that job security regulations, which were strengthened by changes in law during 1980s, restricted the flexibility in the labour market. Changes in the Industrial Disputes Act, 1976 made it necessary for enterprises employing 300 or more workers to seek government permission to effect lay-offs, retrenchments and closures, and later in 1982, these provisions were made applicable to establishments employing 100 or more workers. It has been argued that due to these rigid provisions, the employers were highly reluctant to increase the number of employees, because they were unable to reduce their workforce. The industries either opted for more capital-intensive technologies or contracted out increasingly larger volumes of work to smaller enterprises wherein the provision of government permission did not apply.

In spite of all the “protective” labour legislations, however, there was improvement in the growth of employment in organised manufacturing during the first half of 1990s. At the aggregate level, the growth rate of employment was 1.6 per cent per annum during the period 1972-73 to 1989-90, which increased to around 3 per cent per annum in the period 1990-91 to 1997-98. The employment elasticity also showed an increase – 0.33 in the period 1990-91 to 1997-98 as against 0.26 in the period 1972-73 to 1989-90 [Goldar 2002]. There was also acceleration in output growth, which was responsible for expansion of industrial

employment. Goldar attributes this, in large measure, to economic reforms, especially trade reforms and foreign direct investment. The picture drastically changes since the mid-1990s, when a significant reduction in employment occurred. Between 1995-96 and 2000-01, about 1.1 million workers, or 15 per cent of workers in the organised manufacturing sector across major states and industry groups, lost their jobs. Real wages practically stagnated, though emoluments of supervisors and managers rose sharply [Nagaraj 2004]. Retrenchments were initiated by the voluntary retirement scheme (VRS) of the public sector enterprises but subsequently the private sector followed suit, as enforcement of labour laws was relaxed. Until the mid-1990s, job losses did not show up in the aggregate, due to considerable job creation owing to the boom in industrial output and employment. However, with the boom ending and lay-offs continuing, there was a sharp fall in employment in the second half of 1990s. Productivity gains largely accrued to employers, as real wages were practically stagnant [Nagaraj 2004].

Along with reduction of workforce, the employers also resorted to the increasing use of contract labour. The percentage of contract workers to total workers in manufacturing as a whole increased from about 12 per cent in 1990 to about 23 per cent in 2002. In states like Andhra Pradesh, the increase was phenomenal – it rose from about 40 per cent in 1990 to about 62 per cent in 2002. In fact, contract labour has been one of the principal methods used by the employers to gain flexibility in the labour market. Thus, employers have been able to find ways to reduce the workforce even with the “restrictive” provisions in place. The decline and increase in employment seems to have taken place primarily on considerations of market and technology. As noted by Papola (1994), the decline in employment in the organised manufacturing sector during the 1980s was largely accounted for by a large reduction in employment in only two major industry groups – cotton textiles and food products, which account for one-third of the total employment in the organised sector. These two industries experienced a decline of more than 3.5 per cent per annum during 1980s, which was mainly due to the closure of a large number of mills because of sickness caused due to several factors and rationalisation to overcome obsolescence. Most other industry groups, including those with high wage levels and capital intensity, experienced growth in employment. Thus, the existence of stringent labour laws is only one among several other factors responsible for deceleration in employment growth.

### **III Findings From a Survey<sup>1</sup>**

The studies based on secondary data at the level of the industry or the economy show that net change is the result of a large number of employers’ increasing or decreasing employment by reacting not only to the changes in law or union behaviour but also to other factors. Hence, it may be appropriate to study the issue at the level of individual enterprises. Several factors affect employment, which can broadly be classified as those relating to the product market, the factor market, the nature of industry, the size of employment, the state wherein the unit is located, the presence of a trade union and the choice of technology, to mention a few. On the basis of a comprehensive survey of about 1,300 manufacturing firms across nine industry groups, Deshpande, Sharma et al (2004) have identified in their study the determinants of the levels and changes in employment between 1991 and 1998 and

the extent of labour flexibility.<sup>2</sup> The main objective of the study was to find out the extent of flexibility enjoyed by employers in adjusting employment and labour processes within an establishment to external changes. It further ascertained whether the presence of unions, collective bargaining, and laws, especially the provisions of the Industrial Disputes Act regarding retrenchment and closure, deter employment. The study also assessed if the extent of labour flexibility differed with the ideology and administrative efficiency of states. We will discuss these briefly in this section.

### **Employment Change and Wage Flexibility**

Total employment in the nine industry groups studied increased at 2.8 per cent per annum between 1991 and 1998. Non-manual and manual employment increased at the rate of 5 per cent and 2.3 per cent per annum, respectively. While 60 per cent of the employers increased their total employment, 27 per cent downsized their workforce. The expansion and contraction of manual employment were undertaken by an almost equal proportion of employers. While non-permanent employment contributed to an increase in total employment, the increase in manual employment mainly resulted from an increase in the number of women workers. While employment in textile and chemical enterprises increased, employment in the basic metals and alloys industry decreased. A higher rate of growth was observed in the case of smaller firms than bigger firms. The firms, which experienced an increase in demand and consequently increased their production were more likely to increase rather than decrease both their manual and total employment, with the latter being greater than the former. Thus, changes in business constituted a significant determinant of employment. Employers who increased the fixed capital per worker reduced manual employment but increased employment only by employing non-regular flexi workers.

Respondents were reluctant to provide information on wages and allowances. An overwhelming proportion of firms did not employ women at all and the few who did, employed them to do only unskilled work. Since many of the firms did not employ skilled and semi-skilled men, the analysis is confined to unskilled male manual workers. It is generally believed that in the formal sector, the earnings of a worker consist of a basic wage, dearness allowance (DA) and a bonus. But the study showed that more than 80 per cent of respondent firms paid a consolidated wage. The basic wage constitutes the fixed component of the total wage, while DA and bonus are the variable components. Generally, a higher share of the fixed component is accompanied by higher protection for the worker. However, this does not appear to be true of the workers in the sample firms.

In most firms, the statutory minimum wages, by and large, prevail as basic wages, and collective bargaining plays an insignificant role in determining the basic wages. This is also true, though to a much smaller extent, of the firms in the cotton textile industry, which is among the most unionised industries in India. In the case of textile products, factors such as experience, qualification, job evaluation and, to a negligible extent, adjudication determined the basic wage in a majority of the firms. A higher proportion of the larger firms reported collective bargaining as the basis of their basic wage simply because it posits the collectivity of workers usually in the form of unions that come up more easily in large firms.

Only 12 per cent of the firms reported the payment of a separate DA while 75 per cent paid consolidated wage. A little over a

third of the employers paid bonus at the minimum rate, whereas three out of every ten paid bonus at the maximum rate. Unionisation was associated with higher rates of bonus. Separate DA, other allowances and higher rates of bonus correlated positively with collective bargaining.

Firms are expected to increase employment if their unit labour costs are decreasing rather than increasing. But in the case of total or manual employment, 49 per cent of the sample firms, which reported either an increase or decrease in labour cost, increased manual employment. The share among those who increased total employment in response to an increase or decrease in the unit labour cost did not differ much.

### **Impact of Trade Unions and Collective Bargaining**

A trade union is both an economic and a political institution. Its impact is determined by several factors such as qualitative and quantitative strength, leadership, etc. This study shows that only 28 per cent of the firms had unions, and of these, 30 per cent had more than one union. Larger firms are expectedly more unionised than the smaller ones; one in every 10 of the small firms employing 10-19 workers, but nine of every 10 firms employing 1,000 or more workers, were unionised. Hence, though the number of unions may not be sufficient to influence the manufacturing sector as a whole, they still have a substantial presence in large firms.

Both unionised and non-unionised firms increased capital intensity and hence unions cannot be blamed for forcing employers to adopt capital-intensive technology. However, the absence of a union appears to be slightly more likely to facilitate a growth in employment than its presence as a larger proportion of unionised than non-unionised firms reduced their employment.

Ceteris paribus, the study showed that firms with unions paid the unskilled and skilled workers about 17 per cent more than those without unions. Older firms paid a higher wage than the newer firms. The greater the share of women in employment, lower was the wage paid both to the unskilled and skilled male worker, but the higher the share of contract labour, the higher was the wage paid to the skilled worker. Size did not affect wage significantly. Firms situated in Maharashtra paid 20 per cent higher wage to the unskilled worker while those situated in West Bengal paid 28 per cent less to the unskilled and 39 per cent less to the skilled male worker than those situated in Andhra Pradesh. Generally unions raised the wages of the unskilled more than that of the skilled workers, thereby narrowing the wage differentials based on skill. The differentials were narrower in Kerala and West Bengal, the two states traditionally dominated by left parties and also in Gujarat where the wages of the unskilled workers might have gone up due to the growing demand for labour.

### **Impact of State Regulation**

The state in India has played an active role in the regulation of employment, wages and conditions of work in the organised manufacturing sector. Nearly half the firms reported paying only the statutory minimum wage. The importance of minimum wage law (MWL) declines as the incidence of presence of a union increases with size of employment. MWL is the most important determinant of wages in some industries such as beverages and tobacco, which are least unionised. Nearly two-thirds of the firms employing less than 10 workers paid only statutory minimum

wages, while only 17 per cent of the firms employing 1,000 or more workers could do so. The fact that 17 per cent of the firms employing 1,000 and more workers could pay merely statutory minimum wages despite the so-called restrictive industrial relations laws still being on the statute book is probably also due to the recent anti-labour twist in the approach to labour rights of both the executive and judicial arms of the state. Payment of bonus is determined entirely by the Payment of Bonus Act. The study found that firms employing less than 100 workers increased their employment faster than those employing 100 workers or more. However, all other factors remaining unchanged, the advantage of small firms appeared to be marginal as far as total employment was concerned and it was almost zero in the case of manual employment. Considering that in the case of firms with more than 100 workers, all labour laws are applied, particularly the provisions relating to retrenchment and closure, the size of employment may be treated as a proxy for the role of the state. Hence, the existence of labour laws and state regulation seems to have only a marginal adverse impact on employment.

### **Employment Flexibility**

Indian labour markets have been dualistic, and the process of liberalisation and globalisation was expected to widen this dualism. In fact, it was found that dualism did accelerate during the post-liberalisation era – the share of permanent manual workers declined from about 69 per cent in 1991 to 62 per cent in 1998, increasing sharply in industries such as non-metallic minerals, beverages and tobacco. Not only did the share of non-permanent workers increase but the share of casual workers in the non-poor permanent category increased even faster. The big firms resorted to greater use of non-permanent workers. With all other factors remaining the same, firms employing 50-99 workers and those employing 500 or more workers increased their share of non-permanent workers significantly between 1991 and 1998. Casual employment did not show any relation with the size of employment. Gender-wise, women workers were mostly employed in large firms. Firms employing 1,000 workers or more accounted for more than 75 per cent of all women workers. Firms, which employed a higher share of non-permanent workers, also employed a higher share of women workers.

### **Impact of Ideology and Administrative Efficiency**

Some states experienced faster employment than others. Total employment increased much faster in Kerala than in West Bengal, changes in production workers did not show a statistically significant relationship with location. Employment was expected to grow at a slower rate in these two states, which were dominated by left parties, as the real cost of employment to the employers situated there might be higher than for those located in other states. However, the case of Kerala and, to some extent, even that of West Bengal, give the lie to this prognosis based on the static efficiency criterion.

Generally, the relationship between location and the share of non-permanent workers was not significant in the case of manual workers. It was significant in respect of the total employment in Kerala, Madhya Pradesh, Maharashtra and West Bengal. Firms located in Madhya Pradesh, Maharashtra, Tamil Nadu, Uttar Pradesh and West Bengal employed a smaller proportion of casual workers in total and manual employment. Of these states,

only West Bengal was ruled by left parties. While the states of Maharashtra and Tamil Nadu may have an efficient labour administration, it is unlikely for the labour departments in the states of Uttar Pradesh and Madhya Pradesh to be equally efficient. The share of female labour in 1998 was significantly higher only in Kerala. Even West Bengal showed a smaller share of women workers. The states of Madhya Pradesh, Maharashtra and West Bengal also reduced the share of women in manual employment significantly. Thus, the study indicates that state regulation, be it in the form of the MWL, the Bonus Act, or the employment of flexible categories such as contract labour, does not appear to have been as effectual as critics have claimed.

This survey shows that (i) employment in the factory sector of manufacturing has increased ahead of the corresponding population; (ii) the share of employers covered by the exit ban reporting a decrease in employment is not only higher than that of the employers not restrained by the 1982 Amendment but also increases with the size of the firm. In other words, a higher number of the bigger firms than smaller ones have been able to proportionately reduce employment. The fact that firms subject to the same restrictive labour law but different sizes have differential needs and capacities to downsize points to factors other than the restrictive labour law for employment reduction. The number of firms that have closed down is not known but the general impression is that it has increased. These two facts show that employers can and do increase or decrease employment though perhaps not as much as they want.

## IV Summary and Conclusions

The foregoing analysis shows that despite all the hue and cry about inflexibility in the labour market and stringent labour laws, the Indian industry has been adjusting its workforce, more so after liberalisation. This is amply evident from the cotton textile and garment sectors wherein workers were retrenched on a massive scale during the 1980s and from the loss of more than one million jobs during the latter half of 1990s in the organised manufacturing sector. Although VRS has been the main instrument to reduce workforce, large-scale closures through adopting informal routes (non-payment of electricity bills, etc) have also been used. The firms have increasingly dispensed with permanent workers in the non-core activities and have hired temporary (either regular or casual) and contractual workers, either through outsourcing to other firms or directly recruiting more and more such "flexible" workers. They have also been able to achieve flexibility with respect to wages, as evident from the fact that while real wages of workers in the latter half of 1990s stagnated, the emoluments of supervisors increased significantly. This happened along with reduction in the workforce and significant growth in output. All these took place without much resistance from trade unions. This is because of the dominant ideology of liberalisation and globalisation in which increasingly the state and its various organs, including the executive and the judiciary, have either retreated from the collective bargaining process or have taken an implicitly or explicitly anti-worker stance. Several states have relaxed the provision of enforcement of labour laws leading to flexible practices at the ground level. Some of the states have issued directives to prevent or hinder inspection of firms. For example, in Uttar Pradesh, the labour inspectors can carry out inspection only after prior consent of an officer of the rank of

labour commissioner or district magistrate. The states of Rajasthan and Andhra Pradesh have also reduced the scope of labour inspection, and have exempted several establishments from the purview of labour inspection. At the same time, flexible labour practices have adversely affected the trade unions and there has been a general decline in their strength. There has been an increase in the number of unions at the level of firms as a result of which the federated and central trade unions have experienced further erosion in their bargaining power. Trade unions have been further weakened by the ascendancy of managerial rights and new strategies like outsourcing and parallel production. Apart from an aggressive shift in employment from permanent to temporary, casual and contract employment, there has been a systematic transfer of jobs from the bargainable or unionised category to the non-bargainable or non-unionised one through the use of several tactics such as the redesignation of workers. All these developments have weakened the collective bargaining machinery and in a significant number of cases led to agreements between local and plant level unions and employers, which have, in turn, adversely affected the interests and welfare of workers. For example, the fear of losing jobs has impelled unions to accept relocation, downsizing, productivity linked wages, freezes in allowances and benefits, voluntary suspension of trade union rights for a specific period and commitment to modernisation [Sharma 2004; Papola and Sharma 2005]. The weakening of workers' bargaining capacity and rise in the militancy of employers are also manifested in the significant increase in the incidence of lockouts and a decline in the incidence of strikes [Datt 2003]. All these have enabled employers to resort to flexible practices on a wide scale, bypassing the formal rigidities of the labour market. In a significant number of cases where informal routes have been adopted (e.g. unofficial closures), the workers have suffered a lot, as they have been deprived of their dues [Roy 2003].

Thus the logic of attributing the slow growth of employment to labour market inflexibility is not correct in all cases. Labour market institutions play a minor role, if any at all, in determining investment and employment. This weakens the case for the total removal of the provisions relating to closure and retrenchment. If the exit clause were to be rolled back, the employment of non-regular categories of workers would increase considerably thereby significantly increasing the dualism in the labour market. In such a situation the labour market should tighten and employment increase fast enough to reduce unemployment. This is highly unlikely to happen in the near future in view of the pattern of growth and trend in the labour market. The insecurity of employment and income that the total deregulation and flexibility would engender would be politically unacceptable.

The policy of free hiring and firing, leading to a high labour turnover, is in nobody's interest: employers lose industrially accumulated useful skills while workers lose jobs and incomes. Yet job security is a major concern for a worker for perfectly valid reasons. There are very few "good" jobs and there is no social security in an unorganised sector job. At the same time, job security provisions, particularly those relating to the legal provision for retrenchment, have led to an accumulation of surplus labour in large enterprises. This necessitates rethinking on employment security in the context of economic reforms and globalisation. An income security system consisting of unemployment benefits for a specified period, provisions for re-training and active assistance for job search should precede the grant of reasonable and limited freedom to employers to retrench

workers with sufficient notice and adequate as well as timely compensation. While this could be a medium-term goal, in the short run, relocation and re-adjustment of workers within and among groups of enterprises should be allowed in active consultation with trade unions.

In such a milieu, the insertion of a proposal for reasonable income security of the workers instead of job security in the Industrial Disputes Act should be considered. However, this must be done with the mutual consent of workers and employers after all options have been explored. In such a scheme, while employers should promise to ensure employment and incomes, workers may agree to flexible deployment of their labour, including relocation and re-training in marketable skills as required by employers. Rationalisation of work practices in consultation with trade unions should be allowed in order to adjust to the rapid changes taking place in technology and markets [Nagaraj 2005]. However, workers and employers must differentiate between intensification of labour and labour productivity. In no case should workers be subjected to intensification of labour. Since labour productivity is a function of skill and technology, employers should agree to invest in both the development of workers' skill and upgradation of technology. An active labour market policy of skill development and re-deployment, as has been successfully implemented in the Scandinavian countries, should be pursued in which the trade unions, employers and government should closely collaborate. This measure would, in turn, create the need for adequate social security for those losing employment due to industrial restructuring and consequent obsolescence of skills.

The burgeoning employment in the informal sector, along with its low productivity, low wages, fragile employment and income insecurity, necessitates the regulation of this sector in such a way as to create organised sector-like conditions of higher productivity, better employment and wages. The prevalent abysmal conditions of employment have made the modern informal sector competitive. In the absence of unionisation of workers and the enforcement of even minimum labour standards, this sector is inevitably caught in the conundrum of low productivity and low wage equilibrium. This equilibrium needs to be disrupted by ensuring a floor of labour standards in this sector, irrespective of the size of employment of enterprises so that innovation in productivity devices is the only option left for staying competitive in the market. These enterprises may also be protected through other means such as cheap supply of raw materials and an assured market, but not at the cost of productivity and labour standards.

Thus, there is need for a cautious and balanced approach towards labour market flexibility; too much flexibility may be as bad as too much rigidity. The challenge before the Indian industrial relations system therefore is to devise a framework, which combines the efficiency of the enterprise with the interests of the workers. The problem with the entire debate on labour market reforms is that an integral view of labour market regulation is missing. Chapter VB of the Industrial Disputes Act, 1947 and Contract Labour (Regulation and Abolition) Act, 1976 appears to rivet the attention of both the employers and labour too strongly to enable them to take a holistic view of labour market regulation. It goes without saying that labour laws are too voluminous and

ambiguous to be effective from the point of view of either labour or capital. This only promotes costly litigation and corruption in the labour departments of state governments. A simple concept of wage has as many as eleven definitions in the corpus of Indian labour legislation. Each piece of labour legislation that needs to be enforced requires the maintenance of a separate register and submission of annual returns to the authority designated in the Act and its rules, which not only costs valuable time and money but also adversely affects the implementation of labour standards, besides ironically making the cost of compliance higher than the cost of violation. Accordingly, a rational businessman would prefer to violate labour laws at the lesser cost of bribing the inspector or paying the measly fine imposed by the courts. In view of the abundant flexibility of the labour market in India, as revealed by the foregoing analyses, it is alleged by many that the hue and cry about getting rid of the inspector raj and the non-existent inflexibility of the labour market is intended to get rid of both the cost of compliance and that of violation altogether.

While taking an objective and holistic view, there is an urgent need to simplify, rationalise and consolidate different labour laws into a maximum of three simple pieces of labour legislation after wide consultation among employers, trade unions and labour law experts. Any change in labour law in favour of flexibility and efficacy, however, leads to a blind alley in the absence of social security for those who lose employment because of labour flexibility. It has been suggested by many including the second national labour commission that the restriction on retrenchment of workers and closure imposed by Chapter VB may be eased with quid pro quo of higher retrenchment allowance based on the number of years of work. This may be quite reasonable quid pro quo for an employee who is retrenched after long years of work but leaves in the lurch those who are retrenched after only a few years of work, who would constitute the bulk of those retrenched on the principle of last-come-first-go for retrenchment. The recent revolt of young workers in France should alert us to the possibility of such social unrest anywhere in the name of promoting labour flexibility if “free hire and fire” sanction is given to employers. This problem can only be tackled if the state intervenes to ensure the security of income to all workers. India is among those countries that spend least on social services and social security. China, whose example is often cited in the context of labour flexibility, adopted a wide range of security of workers before introducing reforms in the labour market. At the same time the Chinese economy was able to generate much more jobs than are being generated in India. Though the Chinese workers suffered, but state actively intervened. The recently introduced national rural employment guarantee scheme in India is an important step, but a lot more needs to be done for social and economic security in the country. A country which is growing at 8 per cent cannot escape from such responsibility. Labour market flexibility can be implemented only alongside economic and social security. [EPL](#)

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## Notes

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- 1 This section is based on the main findings of a study undertaken by the Institute for Human Development (IHD), New Delhi, which was sponsored by the ministry of planning and statistics of the government of India. The author was also involved in this study. For details, see Deshpande, Sharma, Karan and Sarkar (2004).
- 2 The study, conducted by IHD during 1998-99, covered nine industries scattered in ten states. The selected industry groups were: beverages, tobacco and related products; food products; textile products; basic chemicals and chemical products; paper and paper products; machinery and equipment; basic metal and alloy industries; non-metallic mineral products; and cotton textiles. The study was based on the response of the enterprises and covered both the public and private sectors.

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