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Special Issue on

Labor Law Reforms In India

Guest-Editor

Lord Meghnad Desai



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By Invitation

Transition to Labor Law Reform: State-Level Initiatives & Informal Sector Labor Relations

Hemal Shah

The 1991 economic reforms in India quadrupled growth, but kept good quality jobs stagnant. About 93 percent of the workforce is employed in the informal sector, holding back India's growth potential. If India is to realize its full growth potential, reforming the heavily regulated labor market is indispensable. However, resistance from vested interests in an inflexible market and lack of political capital in New Delhi has contributed to more than six decades of impasse. This paper accounts for interests of all stakeholders in addressing this issue. The paper identifies best practices that individual states have undertaken to simplify labor laws to ease doing business and address the lack of skilled labor. It also identifies smaller reforms to extend security coverage to informal workers.

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Restrictive, Archaic, Convoluted Labor Laws

For India to transition to a modern economy – from agriculture to industry, informal to formal sector, and shift to urbanization – she must realize her true growth potential by focusing on the creation of good quality jobs and infrastructure. One of the key enablers is the modernization of the labor market, which is regulated by extremely restrictive laws. This forces businesses to remain small, and in turn operate in the informal sector. About 450 million informal employees who make up 93 percent of the total workforce stand to benefit from reforms to labor laws and improve business productivity.

Informal or unorganized sector workers, by definition, are those employed in enterprises that use power and employ fewer than 10 people or do not use power and employ fewer than 20 people (Debroy & Bhandari, 2008). Common occupations include small farmers, fishermen, beedi packers/bonded laborers, migrant workers, contract and casual laborers (Planning Commission, 2001). Informal workers are often characterized as low-skilled,

poorly paid and seldom covered by social security provisions. This paper uses the terms 'informal' and 'unorganized' interchangeably.

Indian labor legislation is convoluted, archaic and restrictive in nature.

Indian labor legislation is convoluted, archaic, and restrictive in nature. About 50 Central laws overlap with 150 State regulations. The clauses of the Industrial Disputes Act (IDA) of 1947, one of the major regulations, were conceived under the British Raj. In 1976, the introduction of Chapter V-B to IDA decreed that firms employing 300+ people should seek government permission to effect lay-offs, retrenchments and closures. This was further restricted to firms with 100+ workers in 1982, making hiring or firing new workers extremely difficult even if they are inefficient (Sharma, 2006). The Trade Unions Act is as old as 1926 and Workmen's Compensation Act from 1923.

The 1970 Contract Labor Act allows firms to employ contract workers for tasks of permanent nature but the arbitrariness of the law allows the government to ban contract use if similar establishments use regular workers for that same task (Bhagwati & Panagariya, 2013). The 1948 Factories Act limits the maximum hours of work per week to 48, requires paid holiday for each 20 days of work, bans the employment of women for more than nine hours a day, among other things (Bhagwati & Panagariya, 2013).

Adverse Effects

Stringent labor regulations affect industrial development, thereby economic growth and jobs. Firms are disincentivized from expanding and harnessing the economies of scale and forced to remain informal. The World Bank's (2013a) World Development Report focusing on labor issues directly links larger, formal sector firms to a range of positive factors. Surveying businesses in 102 countries, the report found that larger firms (with more than 100 workers) are likely to be more productive.

For instance, value added per worker in India's informal manufacturing sector is on average about one-tenth that in the formal manufacturing sector (Sharma, 2009). The World Bank report also found that larger, formal sector firms innovate more, and compete in export markets, especially in the presence of foreign competitors. They are also likely to pay higher wages and control for worker characteristics like age or education through a wage premium. However, India misses out on capitalizing on such economies of scale. For example, about 84 percent of manufacturing firms in India are micro and small firms, employing less than 49 people. A miniscule 6 percent of ("medium size") firms employ between 50 and 199 people. Only 11 percent employ over 200 people ("large size"); in China large sized firms account for 52 percent (Hasan & Jandoc, 2012).

On the other hand, economic growth in India has not brought about sufficient jobs. For instance, overall employment,

which experienced a steady annual growth of around 2 percent from 1961-90 (when average growth was about 3.5 percent) declined sharply to 1.5 percent during 1990-91. Employment further declined to around 1 percent during 1993-00, when growth rose to an average of 6 percent (World Bank, 2013b). This situation improved in 2000-2005 when India's GDP growth rate averaged at 7 percent, and employment went up by 1.6 percent (World Bank, 2013b). But as a u-turn, in 2005-2010 when growth averaged higher at 8 percent and employment dropped by 5.4 percent (World Bank, 2013b).

Even if employment increased slowly over the years, the rate of good jobs creation was going the opposite direction. While the formal sector grew slowly at 1.2 percent annually in 1983-94, this rate fell to 0.53 percent in 1994-2000 (Sharma, 2006). Overall, employment in India increased by 92.7 million during 2000-2005 but a mere 2.2 million during 2005-2010 (Mahambare & Nadkarni, 2011). Even then, the quality of jobs added to the economy was dismal. The small increase in aggregate employment of 2.2 million during the high economic growth, but low job growth period of 2005-2010 was due to a massive increase in informal or casual jobs.

Fallon & Lucas (1991) argued that employment in formal manufacturing firms would have been 17.5 percent higher in the absence of job security regulations. But not only has the share of informal workers gone up to 93 percent today, the share of informal jobs in for-

mal sector companies is also on an upward trajectory (Papola & Sahu, 2012). In fact, India has been the main driver of increase in informal employment in all of South Asia (Iyer & Vijay, 2013). The immediate reasons for a burgeoning informal economy are increased taxes and social security contribution burdens, intensity of regulations, and low quality of public sector services (Schneider, 2002).

Urgent Need

India is amongst the most difficult places to do business.

India is amongst the most difficult places to do business. The World Bank's Doing Business index shows India falling down three places to 134th this year, the worst performing country in South Asia after Bhutan and Afghanistan. Starting a business and enforcing contracts are amongst the major problems (World Bank, 2014). The World Economic Forum's 2014 Global Competitiveness Index ranks restrictive labor regulations as among the top problems for businesses to operate in India. Addressing this could help India make the transition from a factor-driven economy to an efficiency- and innovation- driven economy (Schwab, 2013).

Growth of India's manufacturing sector record is also waning. In the 1970s, the share of manufacturing to GDP was around 12 percent. After barely rising over the years, this share fell again to 14.6 percent in 2012-2013, the lowest in 20 years. To meet the goals of the

National Manufacturing Policy (NMP) – boosting the share of manufacturing to GDP to 25 percent and adding 100 million jobs – strong labor law reforms are needed now to put India on the path to create around 110 million jobs by 2025 (Goldman Sachs, 2014). With more than 10 million Indians entering the job market annually, the stakes to reform sooner rather than later will be particularly high in the coming decade to exploit the opportunities from the demographic dividend.

Strong labor law reforms are needed now to put India on the path to create around 110 million jobs by 2025.

Current Organization of Labor Legislation

The Centre failed to make a case for flexible labor markets due to strong trade union resistance (and political party affiliations) and problems with re-drafting amendments. To curtail this, there is a tendency on the Centre's part to pass the buck on to States (Debroy, 2012). India's labor legislation is a subject in the Concurrent List, which means that both the Centre and the State could enact laws pertaining to the relevant category. There are:

- Labor laws enacted and enforced by the Central government
- Labor laws enacted by Centre but enforced by both Central and State governments

- Labor laws enacted by the Centre but enforced by the State government
- Labor laws enacted and enforced by the various State governments which apply to respective States (Ministry of Labor and Employment, 2011).

The following items related to labor appear under the Seventh Schedule (Article 246) of the Constitution, under the Concurrent List, allowing State governments to amend some Central statutes, and also add new statutes to a certain extent:

22. Trade unions; industrial and labor disputes
23. Social security and social insurance; employment and unemployment
24. Welfare of labor including conditions of work, provident funds, employers' liability, workmen's compensation, invalidity and old age pensions and maternity benefits

This paper identifies the most ideal reform scenarios in order of importance but also rates their difficulty level.

Most Difficult Scenario

While India needs a major overhaul in labor legislation, the IDA of 1947 warrants reform most urgently. Bhagwati & Panagariya (2013) highlight some of the pressing changes required that include tightening the definition of retrenchment and deferring disputes to independent authorities to deliver time-bound justice as opposed to labor courts and tribunals. Section 9A should be amended to give

the employer more flexibility to reassign workers to similar but alternative tasks at short notice should the need arise. The IDA also prohibits strikes only by public utility services without notice, but such restrictions should also be extended to other industrial establishments to discourage “wildcat strikes.” And perhaps the most crucial reform of all is to Chapter V-B that restricts laying off workers in a factory with 100 or more workers (Bhagwati & Panagariya, 2013). Besides India, Pakistan and Sri Lanka are the only countries that require approval by public administration before undertaking any dismissal (Iyer & Vijay, 2013). The Contract Labour Act and Factories Act also need to relax their caps on restrictions.

However, the Labour Ministry in New Delhi rejects any idea of reform on the pretext it would only apply to the 7 percent in the formal sector anyway. On the contrary, the discussion should be about how to bring the 93% under the system and balance flexibility and security. Furthermore, almost all major Indian political parties have a trade union wing. “This means political parties (more so in a coalition) are reluctant to legislate on labor flexibility, since this would antagonize their own trade union wings” (Debroy, 2012). For instance, in February 2012 and 2013, millions of trade union members organized a national strike (All India Bandh) to demand permanent jobs and elimination of contract labor preventing any change in status quo. However, the dismal showing of the 2014 Lok Sabha elections marked a clear defeat for the left-wing political parties – especially the bloc of commu-

nist parties whose hold was reduced to the lowest ever vote share of 4.4 percent – and a decisive victory for the centre-right Bharatiya Janata Party (BJP), making way for some reform discussion.

Moderately Difficult Scenario

India is becoming more federal in nature. The number of states has been on the rise in India: from 14 states in 1957, India federalized to 29 in 2014. This is just one of the reasons to devolve more power to India’s 29 chief ministers, rather than concentrating it in New Delhi. In addition to a majority in number, it also makes sense to move labor law items completely from the Concurrent to the State list (by amending the Seventh Schedule, Article 246, of the Constitution) for several reasons:

First, the current arrangement of shared responsibility encourages inaction, non-accountability, and free-riding. On the one hand, it keeps the Centre tight-fisted and avoid rocking the boat, and on the other hand States remain complacent, contributing to the decades-long impasse.

Second, performance-driven states are punished and complacent ones rewarded. For instance, states like Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, and Maharashtra, wish to make labor laws more flexible to allow choice and opportunities for employees. This includes flexibility in work hours, night shifts for women, or freedom to fix minimum wages. But these initiatives would require changes in legislation and have thus been shot down from the Centre (Debroy,

2011). But moving such legislation to the State list could avoid this problem.

Third, evidence suggests that States which were able to enact seemingly more “pro-worker regulations” have lost out on industrial production in general (Ministry of Finance, 2005). Study by Hasan and Jandoc (2012) shows that in labor-intensive manufacturing, states with flexible labor regulations enjoy a higher concentration of large-scale firms and smaller share of employees in small-scale firms. State-level reforms also help “to mitigate the detrimental effects that strict federal labor laws have on industrial outcomes” with regard to formal sector manufacturing units (Dougherty et al, 2013).

However, moving labor laws from Concurrent to State list will require a legislative amendment backed by the use of significant political capital. While this is difficult, it could be possible in the near future given the new Prime Minister Narendra Modi’s BJP being the first party with a majority seats since 1984 and first non-coalition since 1989. His affinity for decentralization (as former chief minister of Gujarat) increases his potential to push for decentralizing labour laws but the BJP does not yet have a majority in the Rajya Sabha. While moving these items to the State list would be best, there is no reason for states to try and reform laws that are still within their power on the Concurrent list.

Easier Scenario

Even with the reform-oriented approach of the new government and their

majority in the Lok Sabha, moving labor from Concurrent to State list is not an easy task. One way around this would be to use Parliament’s power to confer enabling power to states. In other words, the Lok Sabha could push for a politically easier reform by inserting additional wording to subjects in the Concurrent list stating two things: The particular piece of Central legislation shall apply to all states that *do not amend* that law; whereas amended legislation shall apply in states that took the initiative to amend it (Panagariya, 2014). In general, changes made by states are void if “repugnant” to existing Parliamentary legislation unless the state has the President’s consent (Bakshi, 2013).

However, considering that the new government does not yet enjoy a majority in the Rajya Sabha, Parliament’s attempt to enable State power may be difficult. In this case, another approach could be seeking Presidential assent. Panagariya (2014) suggests that the “new government could facilitate this process by adopting a policy of time-bound decisions on proposals for amendments submitted by states.” For instance, he explains that government permission needed to lay off workers under IDA 1947 is rarely granted making the law restrictive. Here, a time clause could be added wherein the government has to make a decision on the layoff application within a stipulated period of time, failing which permission would be assumed as automatically granted. This could not only make labor laws relatively more flexible but also result in efficient decision-making.

The new BJP-led government in Rajasthan has recently adopted this route. The state's Cabinet cleared amendments to three labor-related Acts and is seeking Presidential assent directly, as it may be "repugnant" to existing Parliamentary legislation. The state has proposed changes to IDA so that permission for retrenchment is only required for firms employing 300+ people, as opposed to 100+ people. The state Cabinet has also introduced a three-year time limit for raising disputes; trade unions can't be registered without 30 percent worker representation, instead of the current 15 percent. Restrictions from the Contract Labor Act will apply only to companies with more than 50 workers, as opposed to the current 20; Factories Act would be applicable only to companies with 20 workers with power and 40 without power, as opposed to 10 and 20 respectively (Iyer, 2014).

Easiest Scenario

While much hope is pinned on the new government, even the easier potential changes outlined would still take a while. In that interim, this paper attempts to identify the most common problems for business and workers and how State governments could undertake smaller reforms to achieve marginal progress to pave the way for bigger reforms in future. With six decades of deadlock on labor reforms, it is time to find a feasible approach by accounting for perceived short-term interests of those favoring the status quo and those demanding immediate reform.

The hope is that marginal progress now will ease the transition to bigger future reforms.

State Freedom & Flexibility for Employers

Difficulties in complying with restrictive labor laws and inadequate supply of skilled labor are two of the major constraints for business (CII-KPMG, 2014). Employers with more than 100 workers are covered by the IDA and cannot fire anyone without prior consultation, notification to the public administration and workers' representation, followed by approval from both before collective dismissal (Iyer & Vijay, 2013). Only India, Pakistan, and Sri Lanka have such stringent rules. In addition, TeamLease (2009) recognises how "educated unemployment and shortage of competently skilled labour co-exist." State governments can act on some of the "controllable areas" of these problems in the interim of unleashing bigger reforms (FICCI-Bain, 2012a). Best practices emerge in areas where states have a larger ability to introduce reforms. However in this case, where states have a lesser capacity to legislate, strong, piecemeal initiatives undertaken by states can also serve as useful examples for other states (FICCI-Bain, 2012a).

Educated unemployment and shortage of competently skilled labour co-exist.

There is already some evidence of State initiatives that have brought about positive results. Besley and Burgess

(2004) show that states that “amended the IDA in a pro-worker direction experienced lower output, employment, investment and productivity in formal manufacturing.” A more recent study by Hasan and Jandoc (2012) concludes that Indian states with more flexible labor regulations tend to have larger-sized firms in labor-intensive industries. Debroy (2011) also identified various States – Uttar Pradesh, Andhra Pradesh, Punjab, Gujarat, Karnataka, Orissa, and Rajasthan – that took initiatives to reduce the number of inspectors for business enterprises. Gujarat has also amended the IDA to allow retrenching workers but only at a higher compensation of 45 days’ pay.

That positive state initiatives result in labor market flexibility and productivity is clear from indices produced by organizations like TeamLease or the Cato Institute, who have undertaken studies to rank State initiatives to improve labor regulations for business. The TeamLease (2009) labor ecosystem index aggregates labor demand, supply and regulation, showing Andhra Pradesh and Karnataka beating Delhi and Gujarat for the top spots on overall labor ecosystem, but several others who are improving on other variables. Cato’s 2013 Economic Freedom of the States of India index also ranks states under the category of regulation of labor and business (Debroy et al, 2013). While Gujarat and Tamil Nadu have maintained top spots since 2005 until now, states like Karnataka, Himachal Pradesh, Uttarakhand have made tremendous progress over the years, whereas Jharkhand and Madhya Pradesh

have slipped down in the same period. While this is not a definite measure, it gives a rough blueprint to assess what went right and wrong in the respective states. But most importantly, it creates competition to drive change.

Identifying Best Practices

The Planning Commission’s state level assessment for manufacturing environment in March 2014 is a serious step in institutionalizing state initiatives in this area. It acknowledges that the first step should begin with generating awareness and motivation amongst states by comparison with other states. The next step is to highlight best practices, followed by how states can “tune up” their regulations by getting a sense of best practices in successful states (Planning Commission, 2014).

In association with Deloitte, the Planning Commission recently ranked states by the time taken and the effectiveness of the process for registration of manufacturing units under the Factories Act and other labor laws. The most popular practices that emerged were in areas like simplifying information and creating awareness, online renewals, and rationalization of inspections (Planning Commission, 2014). Mr. ArunMaira, member of the Planning Commission, argues that easing regulations for manufacturing enterprises should be in the hands of the states since almost three quarters of the regulations are state regulations (Rao, 2014). Outlined below are some examples of such state initiatives that aim

to simplify labor regulations, both to ease doing business and bolster a skilled workforce.

Labor Management System

The “Mahashramm” initiative launched in 2010 by the State government of Maharashtra is an important electronic portal that enables efficient and timely services to businesses and reduces inspections. The portal provides online registration, application for licenses, exemptions, and renewals, in addition to paying salaries by cheques. Businesses can track the status of their application putting an end to delays and corruption that may arise in such cases. Filing and reconciling returns are simplified: businesses can file the 14 mandated returns in one go through one comprehensive annual report. Monthly returns are verified against bank statements and alerts are generated for non-compliance. In this manner, days taken to apply for licenses were reduced from 10 to 0.5; license renewal from 7 to 0.5; and returns filing from 15 to 0.5 (DIPP, 2014). However, businesses have to ensure that their employees are all registered on this system and have individual bank accounts (FICCI-Bain, 2012b).

Compliance in Special Economic Zones

Special economic zones (SEZ) are designated areas to attract cutting edge infrastructure and foreign investment with the least possible regulations to boost economic activity. Gujarat has pioneered labor compliance in this area by the SEZ

Act of 2004 by making clear clauses for appointment and termination of labor for SEZ units. Flexibility in complying with IDA’s section V-A, V-B, V-C and V-D are offered (MSME, 2014). The SEZ Act has institutionalized the concept of ‘fixed term’ – different from contract workers – to satisfy work needed to be done for short periods (Debroy, 2011). This feature has brought about a major reduction in manpower days lost due to labor strikes. Gujarat, therefore, accounts for only 0.6 percent of India’s manpower days lost (CII-KPMG, 2014). In fact, recent research by Goldman Sachs (2014) argues that 40 million manufacturing jobs could be added to the economy if states made their labor laws as flexible as Gujarat. The state’s reform initiative brought a growth of 60 percent in manufacturing employment between 2000 and 2012 whereas West Bengal saw only a 22 percent increase (Goldman Sachs, 2014).

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Self-certification & Inspector Rationalization

The introduction of Single Window Act in 2002 made Andhra Pradesh the first state to introduce the concept of self-certification. This enabled firms to avoid arbitrary inspectors by submitting their muster rolls and registers along with a self-certification form showing compliance with various labor laws. However, it is the

state's thriving IT industry that goaded this practice. This is yet to be scaled up to the manufacturing sector, whereby labor laws are more in number as it falls under the jurisdiction of the Centre's Factories Act. While this initiative is laudable, improvements can be made by making inspections complaint-based or random as opposed to mandatory inspection currently. Third party agencies could also be recognized to issue compliance certificates (FICCI-Bain, 2012c).

Third party agencies could also be recognized to issue compliance certificates.

Industry -University MoUs

Gujarat, like a few other states, has been steering the setup of industrial training institutes (ITIs) to implement vocational training courses. But the state's government differentiates itself from ITI initiatives by other states with its campaigns to increase the participation of industry to strike a match between skills training and academia. As noted by FICCI, industrial organizations like Tata, LG, Eicher have signed MoUs with the state government's employment and training department specifying skills they require and in exchange offering placements to successful students. This has led to university-business integration. For example, Saurashtra University and Essar Group work together in designing course curriculum relevant to industry; ITI Kuberanagar works with Toyota and Eicher to make skills relevant to their business (FICCI-Bain, 2012d).

State Freedom to Redesign NREGA

Though well-intentioned, the former government's National Rural Employment Guarantee Act (NREGA) that guarantees 100 days of work to the rural poor, has unintended consequences. For India to boost growth, jobs, and productivity, it has to make a rapid transition from agriculture to manufacturing coupled with skilling programs, and thereby urbanization. Labor is four times more productive in industry and six times more in services compared to agriculture (Goldman Sachs, 2014). Government policies should incentivise this transition, but NREGA does the opposite. While rural wages are going up, slowing urbanization and productivity are together stoking inflation in India (Goldman Sachs, 2014).

NREGA could be reformed to limit the number of rural jobs to those who strongly prefer to remain close to their households (for example, women).

NREGA could be reformed to limit the number of rural jobs to those who strongly prefer to remain close to their households (for example, women). The government could instead channel the remaining funds to sponsor or subsidize these workers for 100 days in private sector labour-intensive industries. This would also incentivize employers to invest in their skills in that subsidized time and hire them full-time by paying wages for the rest of the 265 days or more (Kumar & Busvine, 2014). However,

NREGA is a one-size-fits-all Centrally Sponsored Scheme (CSS), where state governments contribute a share of the finances and responsible for implementation but have no say in design (Raghunandan & Aiyar, 2013). With the current government poised in favor of decentralized decision-making over CSS, the Planning Commission, with Prime Minister Modi at the helm, could extend more freedom to state governments to redesign their NREGA schemes to align more with productive jobs and urbanization.

Social Security Reform

In the first quarter of 2014, 3,057,472 man-days were lost due to strikes and lockouts (Labor Bureau, 2014). While the formal sector is characterized by a rigid labor market, the 93% of the Indian workforce in the informal sector work under extremely flexible conditions. However, social security coverage is miniscule or non-existent. Evidence from the most unionized state of India, West Bengal, suggests that three of their largest trade unions (CITU, INTUC, AITUC) focus their work around security for workers in the informal economy (Sen, 2009). Scaling up security for informal sector workers could therefore be one of the most crucial factors in reducing the fierce resistance from trade unions. Trade unions worry about any discourse of reform equating it with dilution of their rights. This section argues for a two-pronged approach: identify and address trade union problems to the extent that it makes bargaining unnecessary and unattractive.

The EPFO is 10-20 times more expensive than any other public or private government securities mutual fund in the world.

Social Security Cost-Value Mismatch

The cost and administrative burdens of India's social security schemes disincentivize employers from administering them. At the same time, employees find it unattractive to contribute to them. Benefits and contributions leave low-wage employees with only 50% of their monthly salary (Sabharwal, 2012). The EPFO is 10-20 times more expensive than any other public or private government securities mutual fund in the world (Sabharwal, 2012). In addition, its pension scheme has an unfunded hole of rupees 50,000 crore (Sabharwal, 2014). Moreover, the perceived value for money is fairly less for low-wage workers — the EPF has often been criticized for poor customer service. The ESI, on the other hand, is also blighted with poor hospital facilities and lack of staff (Sabharwal, 2012). It is also the world's only health insurance plan with a claim ratio of less than 50 percent (Sabharwal, 2014). Thus, businesses are increasingly moving to the cost-to-company approach of monetizing all benefits to include in salaries, as opposed to providing benefits over and above the gross salary.

Cost-cutting also leads to collusion between businesses and labor inspectors; unregistered firms often don't return their ex-employees contributions (Rajeev,

2009). Maharashtra's "Mahashramm" initiative mandates all businesses – in formal and informal sectors – to pay all salaries/wages by cheque. Businesses, banks, labor and network correspondents have to be all linked and financial institutions are expected to provide the linkage by extending the option of "no frills" bank accounts. This also ensures the payment of EPF to workers (FICCI-Bain, 2012b).

Competition to Reform

Competition is yet another way to reform social security and improve value for money. With the extension of the National Pension System (NPS) to all Indian citizens, including from the informal sector – and the Pension Fund Regulatory and Development Authority (PFRDA) as regulator of the pension sector – employers should allow and encourage employees to opt into the scheme of their choice. The NPS, unlike the EPF, runs on a defined contribution mechanism whereby a pensioner gets back the amount proportional to his contribution, rather than a fixed return. The NPS also enjoys a higher rate of return than the 8.25% under EPF. The NPS scheme is web-enabled and removes the human interface that could invite rent-seeking, thereby inviting choice and contestability, and incentivizing EPFO to reform alongside (Asher, 2011).

Setting up Organizations

State governments should look into investing and encouraging formal sector organizations modeled after private companies, like TeamLease Services, Ma

Foi, Randstad, and Manpower, in the informal sector. Besides offering human resource services, such organizations dedicate their operations towards improving their people supply chain by identifying and matching contract laborers, or temporary staff, a sensitive subject amongst the trade unions. Contract labor is often exploited in India's formal sector as short-term "informal" laborers absent social security provisions. The presence of such organizations would ensure that contract laborers get a fair wage for their services in addition to social security, on the assumption that temporary jobs are still better than no jobs.

Developing the Informal Sector

Though ideal, formalization is impractical until informal workers are equipped with required skills and training to enable employers to invest in them and administer expensive social security options. Needless to mention, compliance with restrictive labor laws and poor infrastructure add to the problem. Policymakers need to think of ways to reduce the formality-informality trade off.

Costs of formalization include entry costs and operating costs (Loayza, 1997). Entry costs of doing business in India involve 12 procedures that take 27 days, costing 47 percent of income per capita with paid-in minimum capital of 125 percent - as opposed to 5 procedures in 11 days, costing 3.6 percent of income per capita, with just 10% paid-in minimum capital in the OECD (World Bank, 2014). Operating costs – complex taxes, labor regulations, property rights, contract en-

forcement, access to infrastructure – are already high. Ranking 134th out of 189 countries on the World Bank’s Doing Business index, India falls behind even her BRICS counterparts.

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Costs of remaining informal include penalties and corruption, limited access to public services, missed opportunities on expansion, limited access to finance and cooperation with formal enterprises (Ishengoma & Kappel, 2006). However, the situation in India can be summed up as follows: “the opportunity costs of informality seem to be much lower than the cost of operating formally...total formality may mean closing up the business unless the business environment within which firms operate is improved” (Ishengoma & Kappel, 2006).

Instead, until costs decline, attempts should be directed at creating an assurance of sustainable livelihoods in the informal sector. For instance, states like Gujarat have been proactive in creating more choice and opportunities for farmers by amending restrictions on the Agricultural Produce Marketing Committee Act to allow them to sell their produce to wholesalers, exporters, industries and large trading companies (Shah, 2013). This would ensure a smooth transition for informal sector workers when the time is right to formalize.

Flexibility & Security – “Flexi-curity”

Any use of the term flexibility or reform agitates trade unions.

Any use of the term flexibility or reform agitates trade unions. India’s formal sector offers no flexibility to firms, but as a contrast, workers enjoy good security coverage. So currently India has an absolute welfarist model – something that a low middle income country cannot afford. Instead, a good formula to emulate is Denmark’s flexi-curity model: a tripartite model that combines flexibility for employers, security for workers, and an active labor market policy to encourage skilling programs and matching the unemployed.

In addition to the reforms highlighted above, flexi-curity could be kickstarted by segregating IDA’s meanings of lay-off, retrenchment and closure provisions. The three concepts reflect increasing degrees of severity, and unbundling them could make them more palatable to trade unions, making it easier to sell reforms (Debroy, 2012). It is speculated that if compensation for layoffs and retrenchment were increased from 30 days’ pay per year worked to 45 days, political resistance may diminish. In West Bengal, this compensation is higher for layoffs – 50% of basic wages plus other benefits for the first 90 days and 75% thereafter until disposal (Sen, 2009).

Severance pay policies in India are already “modest” by international com-

parisons (Asher & Mukhopadhyaya, 2005). That brings forth the scope to trade off higher severance pay for three important opportunities – greater operational flexibility for businesses, greater professionalism in policy design and implementation by labor ministries, and lower transaction costs for new companies (Asher & Mukhopadhyaya, 2005).

Like-minded Unionism

Trade unions comprising similar industry units are more credible and easier to engage with. On the other hand, unions with members from mutually exclusive industries and varied interests lead to unchecked multiplicity whereby member demands arise out of herd mentality, and lack credibility. The Amendment Act 2001 to Trade Unions Act 1926 was channeled towards addressing superfluous multiplicity. As a result, 10,274 registrations were cancelled in 2001 in West Bengal, they probably did not meet the criteria of the Amendment in terms of industrial homogeneity (Sen, 2009). While there has not been much research on the direct implications of such outcomes, the main aim of such reforms is to ensure “orderly growth, reduce multiplicity and promote internal democracy in the industrial organization and the economy” (Business Portal of India, 2013). With state unions comprising 89 percent of the total pie and informal unions on the rise, there is more reason to make this item part of the State list.

Improving Work Conditions

In addition to scaling up security in the informal sector, creating better work

conditions could also make bargaining through unions unnecessary making labor relations more efficient. Examples from successful approaches used by companies show minimized backlash from unions. This includes community development, work benefits, and timely breaks.

Community development measures include renovating railway stations, bathing ghats, or social welfare activities like eye test camps – sometimes in partnership with local bodies like the panchayats (Sen, 2009). Benefits that go over and above the pay package, like free transport, dining halls, or extra cash for buying household items have also worked in the past. The kind of composition of work times, breaks, and benefits could also incentivize amicability.

In this manner, unions in large firms with increased benefits are seeing a decline especially in the case of young and white-collar employees, who do not indicate a strong urge to unionize. Moreover, state unions comprise nearly 90 percent of the total pie and informal unions are growing. Such patterns summon the increasing need to shift reform narrative to the states and the informal sector (Sen, 2009).

Concluding Remarks

Labor market reform is one of the most politically difficult tasks in a large democracy like India. India’s labor legislation is archaic, restrictive, and convoluted, thereby discouraging businesses to expand and create more jobs. If India

is to realize its full growth potential, it will need to reform its heavily regulated labor market by ushering in more flexibility and scaling up security for workers. Currently, 93 percent of workforce that is employed in the informal sector where productivity is low and wages are small, stands to benefit from such reforms. However, resistance from vested interests and lack of political capital in New Delhi has contributed to six decades of impasse on this issue.

This paper identifies the most ideal reform scenarios in order of political sensitivity. This ranges from re-writing the IDA and other restrictive laws; to moving labour legislation from the Concurrent to the State list; to seeking Presidential assent for State-initiated changes. However, the paper lays out detailed and easier policy reform options to pave the way for bigger reforms in future.

The best way forward is to engage all major stakeholders – businesses, employees, and bureaucrats – to bring about smaller reforms by plucking the low-hanging fruits. The paper identifies procedural reforms undertaken by different states that spur flexibility and clarity in labor laws to facilitate the ease of doing business. Examples from states like Gujarat and Andhra Pradesh show initiatives to simplify compliance processes and also connect skilling programs to the needs of industry. Similarly, the last section argues for ways to scale up social security coverage in the informal sector and making bargaining unnecessary. Inciting competition between social security schemes, organizations to match

workers, and improving work conditions can bring more security to workers and encourage good quality unionism.

Interim reforms outlined in this paper from successful practices are intended to help push labor market dynamics. Regulatory practices need to adapt to evolving structures – as otherwise welfare cannot be advanced. In the face of a slowing growth rate, attempts to tame the deficit and inflation, and a forthcoming demographic dividend, India's political elite must remember that boosting good quality jobs is a matter of top priority.

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