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Making India's Labour Market More Flexible

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EXECUTIVE SUMMARY

Since the 1991 economic reforms, growth rate in India quadrupled but the rate of good quality jobs remained stagnant. For India to realise its true growth potential and create good quality jobs faster, it has to reform its heavily regulated labour market. Roughly 400 million informal employees make up 93 percent of the total workforce, and they stand to benefit from incremental changes in labour market regulation and improve productivity. However, resistance from those with a vested interest in an inflexible labour market has made reforms impossible.

With six decades of deadlock on labour reforms, it is time to find a more workable approach that could be acceptable to all parties – employees, trade unions and ministries – in the hope that marginal progress now will ease the transition to bigger reforms in future. Small tweaks to social security coverage and administration for employee welfare, increasing state freedom for business friendly regulation, and engaging meaningfully with trade unions can build momentum on reforming India's informal sector.

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RATIONALE

Historically, reforms suggested by analysts and businessmen have been drastic in nature, mainly pertained to the formal sector, and failed to consider stakeholders with vested interests in an inflexible labour market. While those interests are not entirely unreasonable, it is worth collating a few reforms – the unpicked low-hanging fruit – that have a workable 'go-between' approach for most stakeholders. Such an approach could further this decades-long impasse assuming that marginal progress is better than a stalemate.

Why is marginal progress important? In India, economic growth has not necessarily brought about job creation. To the extent that even when jobs are added to the economy, they have been mainly in the informal sector. A growing informal sector often affects potential for business productivity and workforce security, highlighting the shifting relationship with economic growth. This situation is worrying considering falling growth rates, rising fiscal deficit, and a slow shift to manufacturing jobs.

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 and further to around 1 percent during 1993-00, when growth rose to an average of 6 percent.[1] The situation improved in 2000-2005 when India's GDP growth rate averaged at 7 percent: employment went up by 1.6 percent.[2] But as a U-turn, in 2005-2010 when growth averaged higher at 8 percent, employment dropped by 5.4 percent.[3]

While employment rate increased slowly, the rate of good job creation is 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.[4] Overall, employment in India increased by 92.7 million during 2000 – 2005 and a mere 2.2 million during 2005 – 2010.[5] Even the small increase in aggregate employment of 2.2 million during the low job growth period of 2005-2010 was due to a massive increase in informal jobs.

A combination of slow and poor quality job creation has resulted in a bloated informal sector with poor productivity and security. The immediate reasons for a growing informal economy are increased taxes and social security contribution burdens, intensity of regulations, and low quality of public sector services.[6] Policy considerations drafted below thus attempt to bring forth a workable approach – or a middle ground – by taking into account the perceived short-term interests of those in favour of status quo and those who tend to favour immediate reform.

REFORM OPTIONS

1. EMPLOYEES & THE LABOUR MARKET

Encouraging competition and choice to boost social security and livelihood opportunities.

Policymakers must force the Employees' Provident Fund Organisation (EPFO) to reform by introducing competition in the form of the National Pension System (NPS) and empowering a third party monitoring mechanism to improve performance and bring down costs. Currently, only about 7 percent of the Indian workforce is covered by social security measures in the inflexible formal sector. Such reforms would not only expand social security to the rest of the 93 percent, but also reduce the formality-informality trade off. Setting up organisations to help match worker skills and ensure a fair wage can accelerate the transition.

Bottlenecks to social security scale-up: Although informal workers, especially contract employees, are supposed to be covered by social security schemes under the EPFO, implementation is often a problem. First, the administrative burden of the employing providing EPFO is already high. Second, the actual cost of the different contributions under the scheme also leaves low-wage informal employees with only over 50 percent of their monthly salary, making the EPFO almost 10 to 20 times more expensive than any other average public or private government securities mutual fund in the world.[7] Third, the perceived value for money is also fairly less for low-wage workers as the EPFO has often been criticised for poor customer service. Collusion between businesses and labour inspectors and time consumed in opening bank accounts also add to the burden of poorly managed social security schemes. Perverse incentives also drive informal unregistered firms to not return their ex employees contributions to the PF office.[8]

Encouraging competition and third party monitoring: To resolve the above problems, competition in the pension sector is key. With the extension of the National Pension System (NPS) to all Indian citizens, including the unorganised sector – and the Pension Fund Regulatory and Development Authority (PFRDA) as regulator of the pension sector – employers should be encouraged to allow 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 percent under EPF. The NPS is web-enabled and removes the human interface that could invite rent-seeking, thereby inviting choice and contestability, and incentivising EPFO to reform alongside.[9] The government should look into investing and encouraging formal sector organisations modelled after private companies, like TeamLease Services, Ma Foi Randstad, Manpower, in the informal sector, to help match contract labourers and also get a fair wage for them.

Boosting livelihood opportunities and transition to formalisation: Reducing the formality-informality trade off that force businesses to remain small and employ informal workers needs immediate attention. Two major determinants of formalization, entry and operating costs, are relatively higher than costs of remaining informal, including penalties and corruption, limited access to public services, missed opportunities on expansion, limited access to finance and cooperation with formal enterprises. [10] Small firms (and their employees) can only be incentivised to formalise when statutory costs decline and service quality of social security mechanisms improve. Some states like Gujarat have already exploited state freedoms to create interim livelihood opportunities in the informal sector with some provision of social security.[11]

2. STATE FREEDOM & BUSINESS

Boosting federal freedom to encourage friendlier regulation for businesses and their employees

Some flexibility could still be brought about by plucking the low-hanging fruit, that is, while keeping within Union decree, there is some space for individual states to make amendments and contextualise labour market laws in a way that increases livelihoods, boosts productivity, and maintains security. Positive results could attract informal workers to transition to the formal sector.

Move legislation from Concurrent to State List: Labour is a subject in the Concurrent List, which enables both Union – and to some extent – State governments to enact and amend legislation. However, this creates confusion and lethargy on part of States to do anything at all, but it also creates opportunity. States could easily exercise small reforms by amending the Seventh Schedule (Article 246) of the Constitution to the State List. The 2012 Labour Bureau survey clearly showed inter-state differences: reform-minded states increased labour force participation and reduced unemployment rates, but states that enacted pro-worker legislation did not perform well. However, if the survey went into further detail, the differences could be important in teasing out what worked and what did not, to inform better policymaking and also spur a competitive spirit.

Increased state competition: Some evidence of dynamism through competition can be reflected on Teamlease's labour ecosystem index. Aggregating labour demand, supply, and regulation this index shows Andhra Pradesh and Karnataka beating Delhi and Gujarat for top spots in overall labour ecosystem, but also shows how several other states are improving in sub-indices that include strikes and lockouts prevention, labour participation rate, and inspector raj – showing state initiatives to make amendments to improve on flexibility for employers and job opportunity for employees. Moreover, continuous changes in rankings on this index show how the context of political economy coupled with competition could drive state governments to do better or worse.

Evidence of successful state initiatives: Some states, like Andhra Pradesh, Maharashtra, Gujarat, Karnataka and Madhya Pradesh, actively wish to make labour laws more flexible allow choice and opportunities for employees.[12] This includes small amendments like flexibility in work hours, allowing night shifts for women, or freedom to fix minimum wages. Simultaneously they have adopted the same for employers; for example, initiatives to reduce the number of inspectors. While the Union government was debating to introduce Voluntary Self-Certification (VSC), Gujarat had already gone ahead with it.[13] Gujarat also amended the IDA to allow retrenching workers but at a higher compensation of 45 days.

3. TRADE UNIONS & WELFARE

Making reforms reasonably acceptable to trade unions

Several reform initiatives, especially to simplify business practices, have often met with strong resistance from the trade unions as they see it as a way of diluting their rights. Policymakers need to find ways of making reforms more palatable including higher compensation and notice periods in exchange for flexibility. Conditions should also be created to incentivise bargaining for reasonable issues should be used as a means to an end – of making bargaining unnecessary.

Balancing trade unions and flexibility: Though 'flexibility' is a threatening term for unions, their perceived severity could be reduced by unbundling different degrees of flexibility clearly and enforcing them. For instance, layoffs and retrenchment are more palatable to the trade unions and political parties than closures thereby making it easier to sell reforms.[14] Though 'flexibility' is a threatening term for unions, their perceived severity could be reduced by unbundling different degrees of flexibility clearly and enforcing them. For instance, layoffs and retrenchment are more palatable to the trade unions and political parties than closures thereby making it easier to sell reforms.[15]

Encouraging better-quality unionism: Trade unions comprising of similar industry units are more credible and easier to engage with. On the other hand, unions with members from differentiated industries and varied interests gives way to unchecked multiplicity whereby demands made by members result from herd mentality, and lack credibility. Amendment Act 2001 to Trade Unions Act 1926 was channelled towards this goal. In West Bengal, 10,274 registrations cancelled in 2001 – filtering out those registrations, which probably did not meet the criteria of the Amendment in terms of industrial homogeneity.[16] 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 organisation and the economy."[17] Moreover, state unions comprise 89 percent of the total pie, informal unions are growing, lockouts are more common strikes, and employers also have unions. These patterns summon the increasing need to shift reform narrative to the states and the informal sector.

Making bargaining unnecessary: Employer strategies of union avoidance by providing incentives that could make unionising unnecessary in the first place. In fact, many large companies especially in the construction business in India tend to avoid unions altogether.[18] Three successful approaches include community development, work benefits, and timely breaks – to keep employees happy and satisfied thereby eliminating their need to join unions or spend time bargaining. Moreover, state unions comprise 89 percent of the total pie, informal unions are growing, lockouts are more common strikes, and employers also have unions. These patterns summon the increasing need to shift reform narrative to the states and the informal sector.[19]

CONCLUSION

This is not a laundry list of reforms. This brief should be treated as a starting point to think about labour market reforms as a way to break into six decades of impasse, rather than a "big bang" approach. These ideas could help push the dynamics in the labour market to force regulatory practices to adapt to evolving structures to inspire reform winners but also gradually compensate reform losers; as without adaptability welfare cannot be advanced any way.

In the face of sluggish growth rates, a rising fiscal deficit, and a forthcoming demographic dividend, India's policymakers must remember that boosting good quality jobs is a matter of top priority. On the other hand, simply discussing reform aspects of the labour market in terms of 'labour laws' has not brought any results over the last six decades.

Policymakers can do their part, but the political elite must also play a role in selling these reforms attractively. If India is to realise its true growth potential, we need to start a nuanced discussion on developing the labour market: to think about small, politically sensitive but economically smart reforms, devolve more power to states, include the informal sector in the reforms dialogue, and discourage vested interests by sensible incentive mechanisms.

This policy brief accompanies the research report:

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It can be read online at http://takshashila.org.in/wp-content/uploads/2013/08/TPR-labour-reforms-hemal-shah-2013-S01.pdf

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