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**Labour Market in India
Current Concerns and Policy Responses
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Labour Market in India Current Concerns and Policy Responses

In 2004-05, Indian labour force consisted of about 430 million persons, growing annually at about 2% (*Economic Survey*, 2007). Slightly less than 3/5th of it is employed in agriculture, mostly residing in rural areas and producing a little over 1/5th of the domestic product. Cultivators form about 2/3rd of the rural workforce, the remaining are agriculture workers. Industry (mining, manufacturing, construction and utilities) employs around 18% of the workforce, producing about 27% of the domestic output.¹

Worker-population ratio in the economy has remained stable at around 40% over a long period, while it is about 28% for women (probably an underestimate). Child labour, as a proportion of the workforce, has steadily declined with rising school enrollments though it are still large – 1.3 million in 2001 – with high visibility, as it is concentrated in selected industries and locations, often producing goods for export.

A little over 30% of the population is urban, mostly residing in the metropolitan cities. Migration is relatively low in India, largely to the metropolitan cities – moderating urban wage growth, causing considerable open (as well as disguised) unemployment, and adding to the size of the urban informal sector. Migration across the states is estimated to be declining over the decades.

Institutionally speaking, Indian labour market consists of 3 sectors: at one end of it lays the rural labour mostly in agriculture, and at the other end is the organized sector.² Urban informal (unorganized) sector lies between these two, engaged in industry and services. With shrinking organised sector and structural transformation of workforce out of agriculture, urban informal sector represents the growing segment of the labour market.

In 2004-05, unemployment rate – measured by the “usual status” defined as whether a person was employed at all during the last one year – was 3.1% (*Economic Survey*, 2007). Intuitively, low unemployment rate suggests that few can afford to be unemployed in a poor country with no other source of livelihood. Evidently, it is a spurious measure of “full employment”. As is widely known, much of the problem in the underdeveloped countries is not of unemployment but of underemployment, or disguised unemployment.

Section I Employment and Wages

Acceleration of economic growth in India since the early 1980s is accompanied by the (much delayed) structural transformation of the workforce in the 20th century, as agriculture’s share in

¹ For brevity, sources of many statistics and evidence cited in the text are not reported. For details see Anant *et al* (2006).

² Organised sector employs about 8 per cent of the workforce, producing about 2/5th of the domestic output public sector and private corporate sector account for most of the organized sector.

the workforce has declined by 10 percentage points over two decades (1980-2000), along with 20 percentage point decline in its share in the domestic output. In 2004-05, agriculture's has fallen further to 55% (*Economic Survey*, 2007). However, majority of the workers found employment in services, not in industry – unlike in the advanced economies in their comparable stage of development, or, as in the fast growing Asian economies more recently.

Industry's share in the workforce rose by about 2 percentage points over the last two decades (1980-2000), mostly in construction; manufacturing employment has not increased perceptibly, though its contribution to domestic output has increased by about 3 percentage points during the same period.

Since the early 1980s, real wage rates in agriculture have steadily risen across the country, though with considerable interregional variation in the levels and growth rates – perhaps consistent with the land productivity. Yet they remain lower than the official minimum wages, and are too low to overcome the absolute poverty. Therefore, one is not sure if the real earning per agricultural worker has gone up on a sustained basis. Although rural economy has diversified into non-farm activities, no sustained reduction in unemployment rates is discernible, however measured.

While the agricultural wages have gone up, the proportion of permanent farm servants in rural areas has declined suggesting that employment contracts have become less secure and casual. Casualisation of workforce has also occurred in the organised and urban informal sectors, as the proportion of permanent and secure jobs have shrunk. Proportion of wage employment probably has increased, and that of self employment declined. Economy-wide decline in employment elasticity of output is clearly discernible, with the fall more pronounced in industry and services.

Between 1997 and 2004, organised sector shed 1.8 million (6.3%) jobs, mostly in manufacturing (1.2 million jobs or 18%) (*Economic Survey*, 2007). In the registered manufacturing earnings per man hour, has grown at about 1.5 per cent per year between 1980-81 and 1997-98. As gross value added in manufacturing grew at much faster rate than employment, labour productivity rose by a multiple of wage increase, indicating a secular decline in unit labour cost.

Earnings per employee in public sector, however, have grown at over 3% per year over the last 3 decades, partly representing higher return for education, skill and experience, as well as the workers' superior bargaining power. But the wage share has declined over the decades, though perhaps to a lesser extent than in other sectors.

Wages in the urban informal sector are probably marginally are higher than those in rural areas but much lower than those in the organised sector, varying significantly across skills, occupations, experience and location. Relatively speaking, this sector has better access to education, health care and sanitation facilities. With the spread of infrastructure, growing (input and product) market based relationships between the organised and urban informal sectors are discernible that could potentially lower the entry barriers in labour intensive industries and services, giving rise to opportunities for acquisition of skills, for self-employment, and hence, for limited vertical mobility.

Section II Current Concerns

While providing gainful employment to the growing labour force remains the long term (and elusive) goal of the development policy, the main concerns currently on the labour market performance are: (i) the declining employment elasticity of output and (ii) the alleged rigidities in the organized labour market.

Despite the acceleration of economic growth close to 6% on a trend basis over the last quarter century – up from 3.5% per year during the first 3 decades of post independence period – employment growth has remained tardy. While it implies rapid labour productivity growth, it has also meant inadequate spread of employment opportunities to make a serious dent into mass poverty and deprivation – surely a matter of concern in an economy with huge back log of underemployment.

More recently the problem seems to have got accentuated with the deceleration of agricultural output growth during the last one and half decade (1990-05), coinciding with the initiation of the liberal economic reforms. As Figure 1 shows, for major crops and crop categories, trend growth rate of agricultural output (in physical terms) has slowed down since the early 1990s. Deterioration in rural employment situation has (i) reportedly increased seasonal out-migration (though credible evidence is yet unavailable), (ii) contributed to the agrarian distress (as evident from farmers' suicides across the country), and (iii) perhaps fueled political extremism that is said to have paralyzed local administration and law and order in about 50 (1/6th of all the total) districts.

In response to these distressing signals a new law promising 100 days of productive employment in rural areas – National Rural Employment Guarantee Scheme - has been passed. Though the bill was diluted in its legislation, and its implementation has been patchy so far the scheme seems to hold considerable promise.

Inadequate labour absorption in industrial sector is believed to be the result of policy induced rigidities in the organized sector that restricts employers' freedom to use labour in a flexible manner. The rigidity is mainly evident in employers' inability to freely hire and fire workers. Such a restriction is also argued to be holding up establishment of large factories to produce light manufactures – a deemed prerequisite to effectively compete in labour intensive manufactures with low wage countries, especially China (Kochar *et al*, 2006).

While the organised workers enjoy rising wages, improving working conditions and above all, job security, it leads to excessive capital intensity. Unorganised workers, on the other hand, suffer from below subsistence level of wages, and abysmal working conditions with practically no income or social security. In short, wages are “too low” and employment too scarce and insecure in the rural and in the unorganised sectors to mitigate poverty and deprivation, while wages are rising and employment secure in the organised sector.

This tiny, yet powerful, segment of the organized workers reportedly enjoys privileged status by its growing economic and political standing. The alleged rigidity in this segment is widely believed to be holding up much of the policy reforms to encourage greater inflow of foreign direct investment, and the growth in export of labour intensive manufactures (as has happened in much of Asia). Therefore, the central problem seems to be, how to augment employment opportunities, provide a minimal social and income security for the unorganised workers

(including agriculture), and how to induce greater flexibility in the organised labour market that is could contribute employment growth.

Section III Labour Market Institutions

Labour is a concurrent subject under the Indian constitution, bestowing rights to the centre and the state governments to legislate on this subject. Expectedly, there are many laws – at times with overlapping jurisdiction – intending to protect and promote the interests of labour. Moreover, law making has also been influenced by the seeming desire to follow many international conventions. However, most labour laws in India are applicable only or mainly to the organised sector. There are many laws setting the minimum wages and regulating conditions of work in the unorganised sector, including in agriculture, but there is no national minimum wage. India does not have a publicly funded social security scheme.

The Factories Act, 1948 is the corner stone of labour regulation in industrial sector; Shops and Establishments Act, a state legislation, for the services sector. The Factories Act is intended to protect the safety and working conditions; it mandates registration of all factories employing 10 or more workers using power on a regular basis (20 or more workers without using power); and, the mandated benefits for workers – provident fund, gratuity, provision of canteen in the work premises and so on – increase with the factory size.

As per the Trade Union Act, 1926 any seven workers can form a union, and seek registration to take part in the collective bargaining negotiations. However, formation of a union does not guarantee the right to participate in negotiation with the management in the absence of clear rules to decide the bargaining agent on behalf of the workers.

Industrial Disputes (ID) Act, 1947, is the principal legislation for resolving conflicts at the work place, wherein the state intervenes in any dispute between employer and employees, in the interest of the economy - popularly called the tripartite dispute settlement mechanism. Employers or employees are expected to inform the labour commissioner before declaring a lock out or going on a strike. In all such disputes, labour commissioner is, in principle, a party to the decisions. On the face of it, the rules of the dispute settlement mechanism are very stringent. For instance, in principle, to retrench even a single worker, an employer has to seek the permission of the labour commissioner if the factory employs 100 or more workers – a clause that is at the heart of the current dispute on the labour market rigidity.

In the organised sector, workers are entitled to severance pay at the rate of ½ month's salary for every year worked. Since the early 1990s, voluntary retirement schemes are offered to induce workers to leave their permanent jobs. Effects of the scheme on the labour market performance and the workers' welfare are, however, not known.

Evidence on enforcement of labour laws:

Like in many developing economies, in India too, labour legislations tend to be aspirational with limited effectiveness, in the absence of a credible enforcement mechanism. Ambiguity in the legal system leaves considerable discretion to the administration and to the judiciary that could be detrimental to the smooth function of the labour market.

For instance, the Factories Act – the corner stone of all labour legislations – is widely violated: in 1990, 58% of all manufacturing enterprises employing 10 or more workers did not get registered

under the Act. This figure grew by 5% between 1980 and 1990. The extent of the under-registration is likely to have gone up sharply in the 1990s as the enforcement of many legal provisions was given a go by under the liberal regime. The fact that the law has been so widely (and increasing) violated suggests how easy (and inexpensive) it is for employers to ignore the labour laws.

Similarly, basic categories such as the definition of a worker vary across legislations that form the genesis for much of judicial wrangling, adversely affecting the weaker party in the bargaining process, which could be detrimental to efficient functioning of the labour market.

In agriculture, as the production is decentralised and geographically dispersed, government has little ability to effectively administer the minimum wage laws. Even where it is possible (as in urban industrial sector), enforcement of the laws is not easy, as most of the employment contracts are informal, difficult to be verified by courts. Moreover, due to illiteracy, workers have little knowledge of their rights; even if they do, they are too poor to seek redress from administration or courts.³ In a situation of excess labour, possession of a job is probably of far greater value than to seek officially mandated minimum wages for it.

Smaller factories, say employing up to 100 workers, usually do not have the presence of durable trade unions, given poor bargaining power of workers vis-à-vis their employers. Considering the poor record of enforcement, both by administration and the courts, and given the surplus labour situation, workers have very little protection against non-compliance of contracts or labour laws. There could however be exceptions in some states and industrial cities.

Apparently, political support for the organised labour has also declined in recent years as the organised workers have lost their significance in the electoral arithmetic. Hence, the centralised industry or region-wide collective bargaining mechanisms have declined. Though hard evidence is difficult to gather – in part, due to deteriorating quality of labour statistics – there is a growing tendency towards decentralised, company based independent unions, and collective bargaining arrangements. It is a moot point if such a tendency has improved industrial relations.

Section IV

Economic Reforms and Labour Laws

Bringing about a greater flexibility in the labour market is important item in the agenda of the structural reforms. But, as yet, lack of political consensus has prevented changes in the labour laws. However, there has probably been “reform by stealth” by administrative means to dilute the strength of laws that seem to have contributed to the weakening of the bargaining power of trade unions, permitting employers a greater freedom in their industrial relations practices. Moreover, government’s refusal to intervene in industrial disputes or simply over look the violation of the laws has perhaps dented the credibility of the legal system. This is evident from the fact that since the late 1980s in the organized manufacturing sector the number of man days lost due to lockout

³ In a small, but carefully conducted, survey of about 60 unorganised industrial workers in Bangalore city in 1983, I had found that none of them were even aware of minimum wages act. Wage rates they were getting were a fraction of the officially stipulated minimum. Given their poverty and illiteracy, they were uninterested in knowing about it, let alone seeking enforcement of the law, for fear of loosing their livelihood.

has been greater than that due to workers' strike.⁴ Moreover, as mentioned earlier, 1.8 million jobs were lost in the organized sector without a policy change, and without a murmur of protest or resistance by workers.

On the face of it, the opposition to the rationalisation of labour laws suggests their stringency. But, such a view may be naïve, especially in a fractious democracy like India, where law making is a complex political process. One would hypothesise that the existing legal system represents a complicated (low level?) equilibrium of political forces whose outcome may not be simplistically in favour of the organised labour, as is widely believed.

Nevertheless, the reforms seem to have had some effect on the labour market practices. For instance, the introduction of the National Renewal Fund (more aptly retrenchment fund!) meant for voluntary retirement scheme in public sector signaled the government's tacit approval of a similar initiative in the private sector. Therefore, reportedly, there has been a sizable retrenchment in private sector, especially in older industries and locations, though quantitative dimension of this change, and its impact on workers' living conditions, are not known.

Though in principle, it hard to fire permanent workers, it may not be so in practice – an issue has been a widely debated in India. Based on a facile reading of the IDR Act, Fallon and Lucas (1993) showed that the demand for labour in manufacturing industries has fallen after the enactment of the job security law in 1976 (and its further tightening in 1982). More recently, Besley and Burgess (2004) have sought to demonstrate that the Indian states that have implemented labour reforms have witnessed faster employment growth, leading to reduction in poverty.

The rigidity hypothesis is a widely debated issue on factual grounds, mostly using information on registered manufacturing. Some of the recent evidence is at variance with the widely held view:

1. There is no evidence of nominal or real wage rigidity.
2. Unit labour costs have steadily gone down since around the mid-1970s (Figure 2). This is true of public sector manufacturing as well (Figure 3).
3. Evidence on the adverse effects of job security legislation on labour demand is widely contested (Ghose, 1994; Bhalotra, 1998; Dutta Roy, 2002).
4. No evidence exists that workers oppose productivity linked wage agreements. Much of wage bargaining takes place on nominal terms, with focus on absolute levels of earnings.
5. Decline in the strength of trade unions by all the standard measures over a long period (Nagaraj, 1994).
6. Lockouts are more wide spread than strikes over the last two decades (Figure 4).
7. A steady shift in manufacturing employment into smaller sized factories within the organised sector, and decline in the share of registered manufacturing and the rise in informal sector employment – thus weakening workers' bargaining power (Nagaraj, 1994).
8. Over the last quarter century, the ratio of wages to cost of capital (wage-rental ratio) has steadily declined, suggesting a relative cheapening of labour vis-à-vis capital (Figure 5).

⁴ Lock out is a temporary closure of plant by managements when their negotiations with workers unions fail. It is a mirror image of strike by workers. In labour economics, lockout is a proxy for employers' offensive against workers.

9. Fallon and Lucas's reading of the law appears simplistic, as IDR Act not mainly or entirely governs industrial relations. For instance, there are many qualifications to this law that can permit retrenchment.
10. Apparently Besley and Burgess's classification of states as market friendly is flawed. For instance, they find Maharashtra and Gujarat as most employee unfriendly states, while West Bengal and Kerala as the most employer friendly states – a classification is inconsistent with the reality. Moreover, most of the changes that they identify as significant were minor alteration in the rules for specific industries made much before the economic reforms were initiated. Therefore, their evidence is open to question (Bhattacharjea, 2006).

The debate on the labour market flexibility is valuable from an analytical and policy perspective. But the preoccupation with this issue seems to have blinded a cross section of policy makers to the more vital concern, namely creation of large scale, productive employment in rural India that seems to be reeling under distress.

Thus, broadly speaking, two competing concerns and perspectives are currently discernible on the labour market, and more generally on development policy. Arguing the limited possibility of labour absorption in agriculture (as its share in the domestic has fallen to 1/5th), one view advocates speeding up employment in non-agriculture especially export oriented activities by dismantling the legal framework of the labour market – taking it perhaps close to what seemingly exists in China. The alternative perspective favours initiating employment oriented development strategy (as the principle vehicle for its delivery would be the recently enacted employment guarantee scheme), and for regeneration of agriculture to make a serious dent in to mass poverty and growing inequality.

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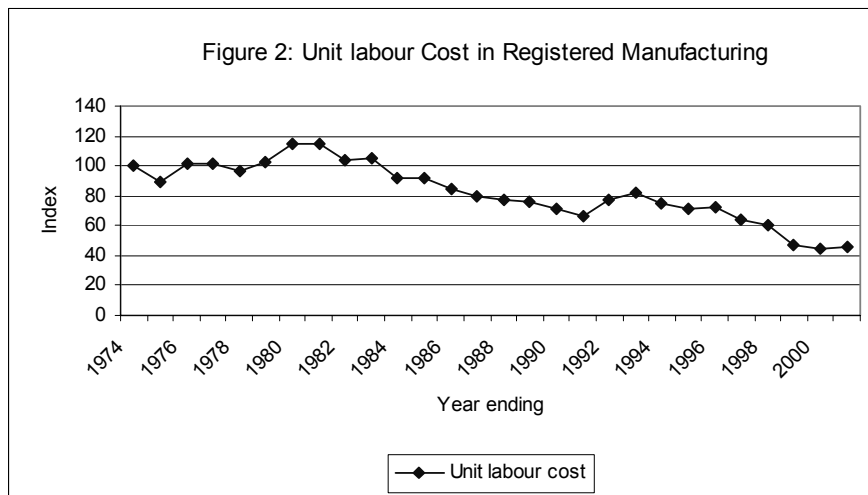
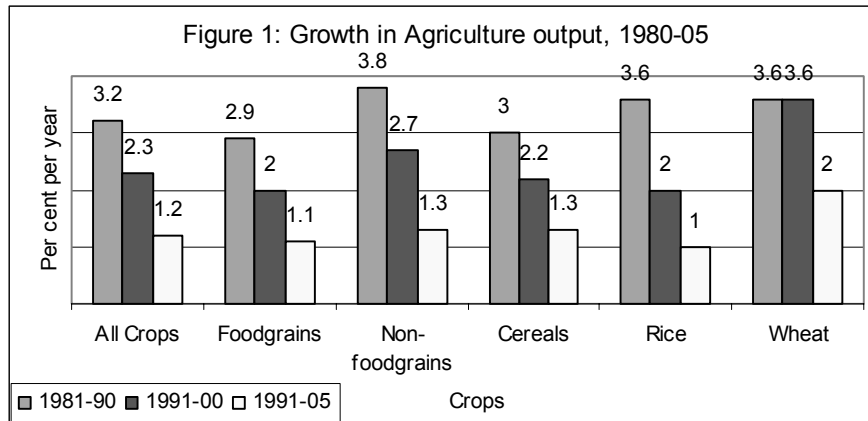


Figure 3: Unit labour cost in public sector
Excluding electricity

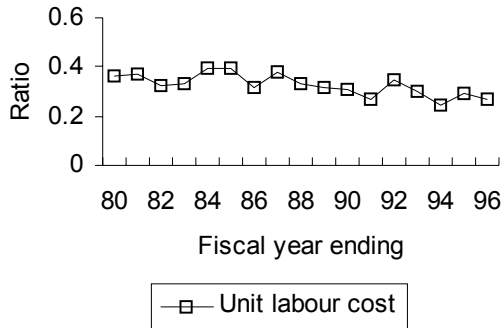


Figure 4: Mandays Lost by Disputes

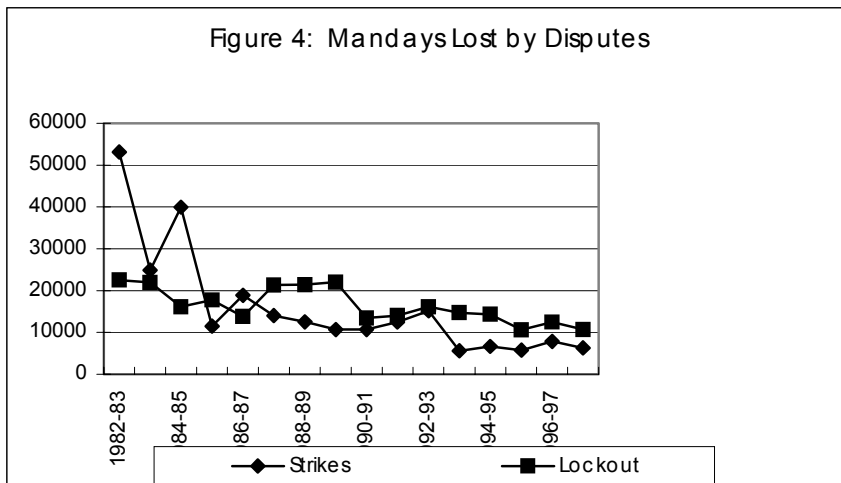


Figure 5: Wage-rental ratio

