

# Recent Changes in Labour Laws

## An Exploratory Note

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This article explores the possible implication of amending the Contract Labour Act, 1970 and questions the rationale behind amending the Industrial Disputes Act, 1947.

After the Bharatiya Janata Party (BJP) government in Rajasthan passed bills to amend four key labour legislations – the Factories Act, 1948, the Apprentices Act, 1961, the Contract Labour (Regulation and Abolition) Act (CLRA), 1970, and the Industrial Disputes Act (IDA), 1947 – the Government of Madhya Pradesh has announced similar plans. The Congress government in Haryana is reported to have followed suit. Parliament also approved in the Budget Session some amendments of the first two Acts mentioned above. It appears then that the day of labour law “reforms” has finally arrived. With explicit support from the centre, states are expected to compete with each other in offering the most lucrative labour regime to attract industries.

Against this backdrop it becomes necessary to evaluate the possible implications and rationale for such far-reaching changes in labour laws. The discussion here seeks to do this by focusing on the amendments to the CLRA and IDA.

The amended CLRA in Rajasthan would now be applicable only in establishments employing 50 or more workers, instead of the current 20. This move would have the implication that all permanent jobs in establishments having less than 50 workers (but above 20 workers) could be abolished. This employer-friendly move would also implicitly encourage the use of contract workers more liberally in establishments employing more than 50 workers.

However, the amendment to the IDA is the most controversial of all labour law reforms. The industry lobby has long demanded its amendment and trade unions are expected to resist it the most. Precisely due to this reason, it appears that the union government has not as yet proposed amending this piece of legislation but left it to the states (labour being in the concurrent list of the

Constitution) to individually amend the IDA – with clear signals of providing tacit support to them.

In its present form Chapter VB of the IDA necessitates firms to obtain prior government permission to retrench, lay off workers (and close down factories) in an establishment employing 100 or more workers. The Rajasthan amendment raised the employment threshold to 300 workers. In the rest of the article we shall investigate the rationale behind such a move.

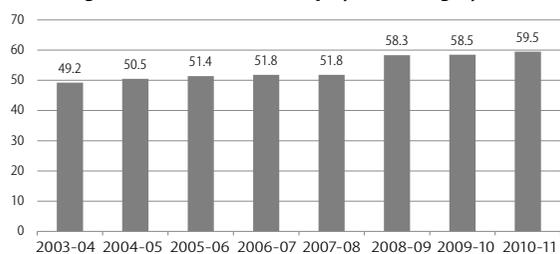
### Rationale behind Amending the IDA

Chapter VB of IDA, it is argued, creates obstacles in adjusting the workforce of an establishment (and its closure) to market conditions and consequently hinders employment creation. This piece of legislation is applicable to the organised manufacturing sector (with plantation and mines). India’s inability to build a proper manufacturing base (unlike China) is largely explained in terms of the supposedly rigid labour laws. Hence, the call for labour market flexibility by amending IDA.

But how protective really is the employment protection law in India? Now, prior government permission to carry out retrenchment and lay-off of workers is necessary only in the case of permanent workers of an enterprise. Any enterprise, even if it crosses the (current) threshold of 100 workers, need not take prior government permission to dismiss its contractual workers. Thus, the contractual contingent is out of the purview of IDA and in 2010-11 constituted around 34% of the workforce in organised manufacturing sector.

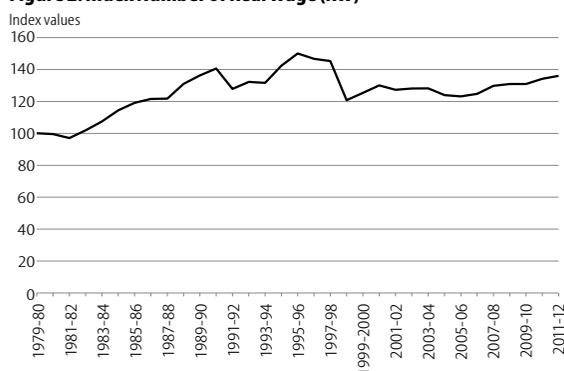
However, the share of contract workers in total workers is an underestimate of the proportion of workers not covered by Chapter VB. This is because even the permanent/regular workers employed in establishments employing below the employment threshold are out of the ambit of law. Thus, if we add the number of regular workers in the 0-100 category to the contract workforce, then, in 2010-11, the proportion of workers for whom no prior permission from the government is necessary for dismissal stood at 59.5%

**Figure 1: Share of Workers Not Covered by Labour Laws – Contract (All) + Regular Workers in (0-100) Employment Category (in %)**



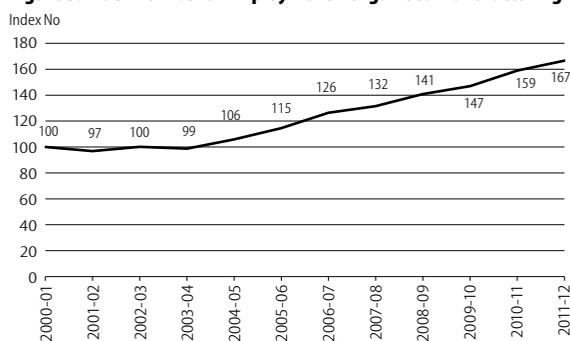
Source: ASI, various issues.

**Figure 2: Index Number of Real Wage (RW)**



Source: Same as Figure 1.

**Figure 3: Index Number of Employment – Organised Manufacturing**



Source: Same as Figure 1.

(Figure 1). Therefore, with almost 60% workforce not covered by the IDA, to argue that the organised manufacturing sector is crippled by stringent employment protection law is not valid.

Further, there is a good deal of ambiguity in the literature – as to exactly how employment protection law operates in restraining employment growth in the organised manufacturing sector. This confusion arises precisely because the whole debate on labour market flexibility in India has been carried out in the empirical terrain without clearly stating its underlying theoretical foundation. The lack of theoretical comprehension seriously impairs our understanding of the route through which rigid labour laws are said to hold back employment creation. Even the two most cited empirical

papers in policy circles, by Fallon and Lucas (1993) and Besley and Burgess (2004), underscoring the necessity of undertaking labour market flexibility in India, have been widely criticised in the literature.<sup>1</sup>

However, one possible channel that has been identified in the literature, through which employment protection law could have a negative impact on employment growth is through the real wage route. As Ghose (2005: 238) puts it, “(T)he sharp rise in real wage in the 1980s could be conceivably be attributed to the introduction of strict job security regulations in 1982” with the following result, “...the faster growth of real wages in the 1980s indeed did play an important role in slowing down employment creation” (World Bank 1989: 110). Although this typical neoclassical view of employment determination assumes away any role played by technological progress or aggregate demand in influencing employment outcome (see Roychowdhury 2013 for a critique), even its empirical validity (in the 1980s) has been challenged by Nagaraj (1994).

Let us now see whether this could have possibly contributed to withholding employment growth in more recent times. For this we plotted the index number of real wages<sup>2</sup> in Figure 2.

Notice that although real wages were rising (albeit with some fluctuations) up to 1995-96, subsequently there was an absolute decline in real wages (more sharply after 1997-98 as the sector was afflicted by an economic downturn that year). Most remarkably, real wages almost stagnated for the next 14 years up to 2011-12. Therefore, it can hardly be argued that the dilution of employment protection law is essential for restraining real wage growth

which in turn is supposed to give a fillip to employment growth.

### Employment Trend in the 2000s

Let us now investigate the employment experience in the organised manufacturing sector in the 2000s. From the index number of workers plotted in Figure 3 it can be seen that although employment stagnated in the first four years of the decade, it however started to rise from 2004-05 onwards. The employment index which stood at 99 in 2003-04 attained the value 167 by 2011-12. Of course labour laws had not been amended in between. This evidence raises serious doubts about the necessity of introducing labour market flexibility for employment expansion in India. (However, it may be argued that since real wages almost stagnated between 2004-05 and 2011-12, employment therefore zoomed; but this begs the question as to why employment stagnated between 2000-01 and 2003-04 when real wages showed a similar stagnation.)

However, there is genuine concern about India's capacity for job creation in the manufacturing sector. In the 10-year period between 1999-2000 and 2009-10, the net increase in the number of workers in the manufacturing sector was only 5.9 million. Can employment protection law be held responsible for this?

In order to answer this question, we calculated manufacturing employment separately for the organised and unorganised sectors (keeping in mind that employment protection law governs only the organised manufacturing sector). From Table 1 (p 16) it can be seen that although employment growth in the organised manufacturing sector between 1999-2000 and 2004-05 was meagre and substantially lower than the unorganised segment, this cannot be identified as the sole reason for low labour absorption in the sector as a whole over the decade. This is confirmed by the employment experience of the next five years. While employment in the organised manufacturing sector increased by 7.14% a year, it turned negative in the unorganised segment. In fact employment in both segments of manufacturing showed robust growth for the next two years between 2009-10 and 2011-12 (although it should be kept in mind that the high growth rate

in the unorganised segment happened on a low base). The reasons for such fluctuations in employment in both segments of manufacturing require detailed examination and must await another occasion. But given these employment trends, identifying employment protection law as the major cause for inadequate job creation (hence demanding its dilution) is clearly unjustified.

**International Competitiveness**

There is a view that the labour laws at present are hampering India's competitiveness in the world market. India essentially being a labour abundant country has comparative advantage in labour-intensive manufacturing commodities (which could give a thrust to employment growth). However, this advantage is not fully exploited, it is said, due to the rigid labour laws. This sentiment is captured in the following statement:

India's labour laws have evolved in a manner which has greatly reduced the flexibility available to the employers to adjust the labour force in the light of changing economic circumstances. In a globalised world, persisting with labour laws that are much more rigid than those prevailing in other countries only makes us uncompetitive not only in export markets but also in domestic markets. Some changes in the laws are therefore necessary if we want to see rapid growth (Planning Commission 2001: 171).

Let us see how far the allegedly rigid labour laws have made Indian manufacturing uncompetitive. Now international competitiveness is normally measured in terms of cost competitiveness and it is routine to compare unit labour cost<sup>3</sup> (ULC) in production, which is recognised as the key measure of competitiveness in the international market (Ark et al 2008). Figure 4 depicts the ULC of some developing countries (taking the ULC of the US as unity)<sup>4</sup> and compares it with the ULC of India.<sup>5</sup> For the 15 years under observation it is clear that India's ULC is way below the ULC of its competitors throughout (even compared to China, the ULC of India is lower for the

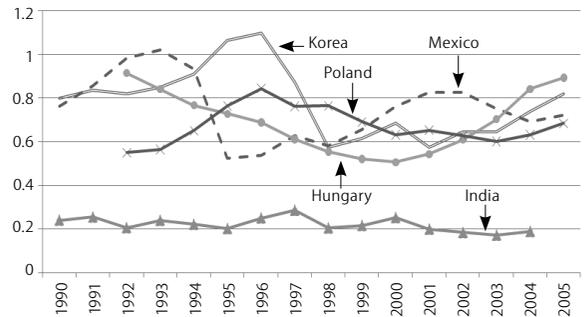
two-year comparison that Ark et al 2008 makes). Therefore, it is simply wrong to argue that Indian manufacturing is becoming uncompetitive in the world market due to high labour costs and then blame labour laws for such high costs.

Further, competitiveness in the external market is sought to be achieved through cost cutting – in turn made possible by diluting employment protection law. But cheapening of domestic products in the international market can also be brought about by depreciation of the real effective exchange rate (REER). The REER for India has in fact depreciated in the recent past – between April 2011 and April 2013 it depreciated around 7.5%. From Figure 5 it can be confirmed that the real depreciation continued unabated between April 2013 and March 2014, when rupee in real terms depreciated in six out of twelve months (taking the yearly average it depreciated by 3.7%). Thus, the cost competitiveness of Indian industry must have increased manifold by such persistent real depreciation of the currency.

Therefore, if lack of cost competitiveness was the primary factor holding back manufacturing growth, then we would expect manufacturing growth to zoom during this period. However, we find in Figure 6 that manufacturing output captured by the Index of Industrial Production (IIP) actually shrunk in 19 out of 36 months under consideration – when the rupee depreciated in real terms. Additionally, periods of a positive growth are almost invariably preceded by a fall in the absolute index value (signifying

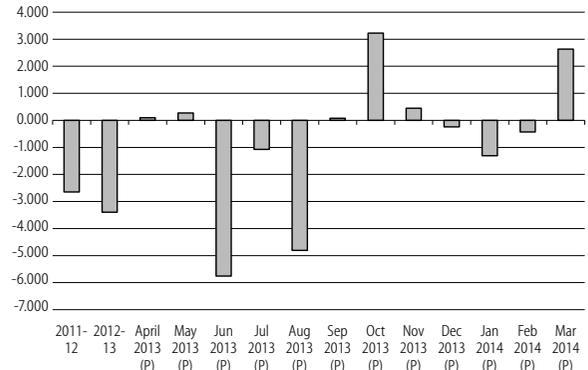
negative growth) – which means that on average there was hardly any growth. This shows that there are factors other than simple cost competitiveness that are responsible for the poor performance of

**Figure 4: Comparative ULC of Selected Countries, 1990-2005 (USA=1)**  
(Unit Labour Cost)



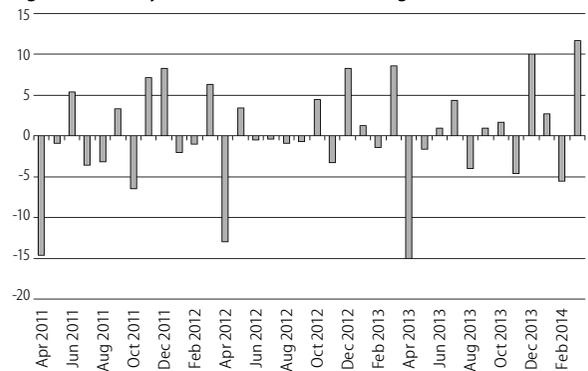
Source: Ark et al (2008).

**Figure 5: Movement of Real Effective Exchange Rate**  
(% change in REER)



(1) (P) denotes provisional figures; (2) The REER Index is the one based on six currency trade-based weights; (3) (+) appreciation/(-) depreciation.  
Source: Economic Survey (2013-14).

**Figure 6: Monthly Growth of IIP: Manufacturing Sector (in %)**



Source: CSO website.

the manufacturing sector. This also shows that labour market flexibility is hardly the silver bullet for removing output and employment stagnation in the manufacturing sector. From the foregoing discussion it follows that amendments to labour laws in Rajasthan and elsewhere are not based on sound economic logic.

**Table 1: Employment Growth – Manufacturing Sector (in %)**

Period	Compound Annual Growth	
	Organised	Unorganised
1999-2000 to 2004-05	0.65	5.70
2004-05 to 2009-10	7.14	-2.90
2009-10 to 2011-12	6.76	8.70

Source: Author's calculations.

## NOTES

- 1 Shortcomings of Fallon and Lucas (1993) are pointed out by Bhalotra (1998). For criticisms of Besley and Burgess (2004) see Bhattacharjea (2006 and 2009).
- 2 Real wages are obtained by deflating nominal wages by CPI(IW).
- 3 Obtained by dividing the compensation rate of employees by labour productivity.
- 4 This simply means dividing each nation's ULC by the US's ULC.
- 5 For detailed methodology, see Ark et al (2008).

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