Labour Regulations and Growth of Manufacturing and Employment in India: Balancing Protection and Flexibility

Anwarul Hoda
Chair Professor of ICRIER's Trade Policy and WTO Research Programme, New Delhi

Durgesh K. Rai
Research Associate at ICRIER, New Delhi

Abstract

The factors responsible for the lacklustre performance India's manufacturing are well identified in contemporary literature. The important ones are absence of world class infrastructure, complex system of internal taxation, an unpredictable taxation environment, and regulations relating to land and labour. This paper explores the difficulties in the area of labour regulations, focusing on the enactments and provisions that inhibit flexibility of manufacturing enterprises in adapting to swift changes in the conditions of competition in international markets. The regulations in India that impinge on labour flexibility and the related practices are analysed and compared with those prevailing in major developed and emerging countries, before coming to a conclusion on the changes that are needed in the country. The aspects that come in for detailed scrutiny are collective dismissal, fixed term contracts, contract labour, trade unions and unemployment insurance. Although the main aim of the authors is to obtain greater flexibility, the recommendations are designed to ensure that a balance is maintained between labour market flexibility and protection of labour.

***JEL Classification**: J21, J51, J52, J53, L60.*

***Keywords**: Labour regulations, Labour market flexibility, Manufacturing, Employment, India*

***Authors' Email:** anwarhoda@yahoo.com, ahoda@icrier.res.in, raidurg@gmail.com, drai@icrier.res.in*

Disclaimer: Opinions and recommendations in the paper are exclusively of the authors and not of any other individual or institution including ICRIER.

Labour Regulations and Growth of Manufacturing and Employment in India: Balancing Protection and Flexibility[1]

1. Introduction

In February 2014, the then Finance Minister of India characterised manufacturing as the Achilles heel of the Indian economy. After recording an impressive CAGR of about 10 per cent during the period 2005 to 2011, manufacturing output grew by only 0.2 per cent per annum during the years 2012-13 and 2013-14. The share of manufacturing in GDP, which hovered in the range of 15-16 per cent in the past two decades, has edged downwards to 14.9 per cent in 2013-14.[2] In the later part of the 20th century, manufacturing had fallen behind because of the inward looking policies adopted by successive central governments. However, economic reforms introduced in the country in 1991-92 resulted in the rapid liberalisation of the trade and investment regimes and by 2010, great progress had been made in integrating India into the world economy. Why then has India been a laggard in the growth of manufacturing and employment? What are the factors behind the lack of dynamism in India's manufacturing as a result of which the share of the sector in GDP has remained stuck at a level which is half that achieved in other emerging countries like China? India's share of world exports of manufactures is only 1.6 per cent against its share of 2.5 per cent of world GDP. On the other hand, China's share of world's export of manufactures at 17.5 per cent is much larger than its share of 12.5 per cent of world GDP. Similarly Korea's share of world exports of manufactures is 4 per cent against its share of only 1.7 per cent in world GDP.

The reasons behind India's lacklustre performance in manufacturing are well researched (Dougherty et.al 2009, Sen and Srivastava 2011; Hoda and Rai, 2014). China and some other countries in the region have forged ahead, riding on the tide of international production networks. India has not been able to seize the opportunity, as foreign investors who play a key role in the operation of these networks have not found the environment for investment in India as attractive as those in other investment destinations, particularly in East and South East Asia. Domestic investors have encountered the same hurdles and lately, some of them have begun investing in foreign territories.

India lacks world-class infrastructure, particularly logistics infrastructure, necessary for the rapid movement of goods in and out of and within the country, which is the *sine qua non* for international production networks. To make things worse, India is well behind its peers on logistics processes, including customs clearance of goods at the borders. India occupies a

[1] The research leading to this paper was undertaken at ICRIER as a part of the project "Jobs for Development", commissioned by the World Bank in 2014. The authors would like to acknowledge the invaluable comments received from Prof. Sandip Sarkar, Institute for Human Development, New Delhi and Dr. L. Venkatachalam, Madras Institute of Development Studies (MIDS), Chennai. Thanks are also due to the participants of the International Conference on "Achieving Accelerated Manufacturing Growth: The Promise and Challenges" at MIDS, Chennai, 2-3 January 2015, for their valued inputs.

[2] In January 2015, the CSO has changed the base year from 2004-05 to 2011-12 and introduced a number of methodological improvements. In the new series, the share of manufacturing was 18.1, 17.9 and 17.3 per cent in 2011-12, 2012-13 and 2013-14 respectively. For the earlier years the data have not yet been made available in the new series.

lower position than its competitors in the World Bank's Logistics Performance Index, UNCTAD's Liner Shipping Connectivity Index and the World Bank's Air Connectivity Index (World Bank 2011, 2012 and UNCTAD 2011). Another area of deficiency is power, where interruptions and uneven quality of supply constitute a major impediment for investors in manufacturing.

Other important factors that have a negative effect on investor sentiment are the complex system of internal taxation involving taxation of goods within the country, fragmenting the market and impeding the free flow of goods, relatively high corporate taxes in comparison with other Asian countries and an unpredictable taxation environment. Land costs have been high in the country because of population pressure and the procedures for acquisition cumbersome but the Land Acquisition Relief and Rehabilitation Act (LARR), 2013 has compounded the problems. Special Economic Zones (SEZs) and industrial area development schemes have not been ambitious enough and have been bedevilled by bottlenecks. As a result, there is an absence of developed land where entrepreneurs can move in quickly to begin manufacturing activity. Labour regulations are another big turn-off for investors. Downsizing is not possible if it involves directly employed workmen[3] who have a virtual guarantee against being laid off or retrenched in establishments with a strength of 100 or more. Multiplicity in legislation increases the cost of compliance and inspections in the course of enforcement are a source of harassment (Hoda and Rai 2014).

It is imperative for India to step up its GDP growth significantly in order to eradicate poverty and raise the standard of living of its people to a decent level. Since it is the poor rate of manufacturing growth that is dragging down its GDP growth, the revival of this sector has to be on the top of the economic policy agenda. The 'Make in India' initiative of the Prime Minister is very timely in this context. It is manifest that the government will have to address the shortcomings in the investment environment to infuse new life in manufacturing. We have to ensure growth not just in manufacturing output but in employment in manufacturing. The target of 100 million jobs in the next 10 years set by the government in 2011 was perhaps overambitious but there is no doubt that the country needs to create jobs in manufacturing in order to provide space for the large numbers of workers shed off by agriculture and for new workers joining the workforce every year. And for this, labour reforms need special attention. While the present government is addressing the matter it does not seem to be aiming at deep reforms.

Although the complexity of labour regulations raises the cost of compliance generally and impedes manufacturing activity, it is the constraint on the ability to vary the size of the labour force in response to changes in the market situation that constitutes the biggest obstacle to manufacturing enterprises in the globalisation era. This paper is, therefore, concerned principally with aspects of labour regulations on industrial relations which influence the

[3] Labour regulations generally cover workers other than those employed in managerial or administrative capacity. The term workman covers this subset of workers, although there are minor difference in definition of workman in Industrial Disputes Act, 1947 and Contract Labour (Regulation and Abolition) Act, 1970.

performance of manufacturing industries. In this context an area of particular focus is the issue of labour flexibility.

Under the neo classical economic system flexibility is fundamental to a competitive labour market. Government intervention to improve job security may lead to a Pareto suboptimal situation that worsens the unemployment situation compared to the outcome in the unrestricted equilibrium where supply and demand are equal. On the other hand, the legitimacy of labour regulations to protect the interest of the workers is universally recognized. The best policies are those that maintain a balance between the employers' requirement of labour market flexibility and the protection of the interest of workers.

This paper identifies the features of Indian labour regulations that constrain labour market flexibility and hamper the manufacturing sector and also restrict generation of employment, and makes recommendations to overcome the adverse effects. In Section 2, we give an overview of labour regulations and look particularly at those that influence flexibility; in Section 3, we analyse the effect of these laws on employment; in Section 4, we review law and practice in developed and emerging countries in which manufacturing has been buoyant. In the light of analysis in the previous sections, in Section 5, we summarise the conclusions and make recommendations.

2. Labour Regulations in India

Salient Features of labour regulations in India

India has a federal government and the Constitution has demarcated law making authority between the centre and the states through the Union list, State List and the Concurrent List. Regulation of labour is on the Union List but certain aspects such as industrial disputes and social security also figure on the Concurrent List. As a result, both the Parliament and state legislatures have been enacting labour laws and there is multiplicity of such laws. State amendments provide mostly for minor variations, but sometimes for more significant ones, without departing from the main thrust of the central enactment. According to the list given in the Annual Report of the Ministry of Labour and Employment for 2013-14, there are at present 44 extant enactments of the central government. In addition, there are some 160 state level enactments containing supplementary provisions (Papola, 2013). A general comment is that the uncertainty caused by complex, overlapping and out-dated laws is influencing 'labour market outcomes' in India (Dougherty et.al 2009). In order to eliminate the widely perceived deficiencies in labour regulations, the National Commission on Labour (2002) had recommended the clubbing of the laws into five or more groups relating to industrial relations, wages, social security, safety, welfare and working conditions etc.

One of the consequences of multiple legislations is that a large number of registers have to be maintained and periodic returns have to be submitted by enterprises and this raises the cost of compliance and becomes burdensome for medium, small and micro enterprises (MSMEs). Recognising the problem, the central government has enacted the Labour Laws (Exemption from Furnishing Returns and maintaining Registers by Certain establishments) Act, 1988,

which simplifies the procedure for returns and registers under nine Labour Acts for enterprises employing up to 19 workers. This Act has been amended in 2014 increasing the coverage of exemptions from nine to 16 Acts. Likewise the exemptions have been made applicable to establishments employing 10-40 workers, against 10-19 in the 1988 Act. The 2014 Act also reduces the number of returns and registers to be maintained by the MSMEs from five to three. Small-scale enterprises have a persistent grievance of harassment by labour enforcement agencies but the fact is that lack of compliance of most of the labour laws by these enterprises is a big problem (ILO 2014). The response of many state governments to complaints of 'inspector raj' has been to move away from periodic inspections and require that inspections may be undertaken only on the basis of complaints of non-compliance. Some states have even added the additional safeguard of permission by a senior civilian official such as the District Magistrate before an inspection is undertaken. Altering regulations through legislative action is difficult because of opposition by labour unions. So the state governments have taken these initiatives to make the environment more investor friendly, even if the fallout is poorer compliance of labour regulations.

Laws and practices influencing flexibility in labour markets in India

The statutes relevant to industrial relations are the Industrial Employment (Standing Orders) Act, 1946, the Industrial Disputes Act, 1947, and the Trade Unions Act, 1926. To this, we must add the Contract Labour (Regulation & Abolition) Act, 1970, which seems to have transformed the landscape of regulations governing labour flexibility. A few provisions in some other enactments also have a bearing on industrial relations viz. Sections 59 of the Factories Act, 1948 and Rule 25 of the Minimum Wages (Central) Rules, 1950, which govern overtime wages, and Section 19 of the Employees State Insurance Act, 1948, under which unemployment allowance scheme was introduced in 2005.

Industrial Employment (Standing Orders) Act, 1946

The Model Standing Order under the Industrial Employment (Standing Orders) Act classifies workmen as permanent, probationers, badlis or substitutes, temporary, casual, and apprentices (see section 2 of Schedule I of the Model Standing Order). It also provides that a temporary workman is one who has been engaged for work which is essentially of a temporary nature, likely to be finished within a limited period. What is permissible in the case of a workman employed against jobs of a permanent nature is to employ them as probationers but they become permanent after three months.

In the listing of classification of workmen, the category of 'fixed term employment' was added through an amendment dated December 10, 2003. In the same amendment, a new paragraph (h) was added to read as follows:

"(h) A 'fixed term employment' workman who has been engaged on the basis of contract of employment for a fixed period. However, his working hours, wages, allowances and other benefits shall not be less than that of a permanent workman. He shall also be eligible for all statutory benefits available to a permanent workman proportionately according to the period

of service rendered by him even though his period of employment does not extend to the qualifying period of employment required in the statute".

These amendments were subsequently deleted through a notification dated October 10, 2007.

There is one other provision in the Industrial Disputes Act, 1947, which addresses the issue of fixed term employment. Section 2 (oo) (bb) of the Act specifically excludes from the definition of retrenchment "termination of the service of the workman as a result of the non-renewal of the contract of employment between the employer and the workman concerned on its expiry or of such contract being terminated under a stipulation in that behalf contained therein."

The erstwhile amendment to the Model Standing Order, which was deleted in 2007, expressly allowed appointment of workmen on fixed term contract. That provision required fixed term employees to be provided with the same wages, allowances and other benefits as permanent employees but did not impose any restriction on renewal or duration of employment. With the 2007 amendment eliminating explicit mention of this category, the legal position of fixed term employment has become unclear. It is possible that renewal of fixed term employment renders the employer liable to the charge of unfair labour practice under the Fifth Schedule of the Industrial Disputes Act, 1947, on the ground that workmen are being employed as temporaries and continued as such for years, "with the objective of depriving them of the status and privileges of permanent workmen". The 2007 amendment seems to have eliminated one avenue of flexibility from the labour laws of the country.

Industrial Disputes Act, 1947

The Industrial Disputes Act, 1947 is the major legislation in the country that affects labour flexibility. Once a workman has been appointed, the laws give very little flexibility to the employers to downsize the workforce.

If individual permanent workmen have to be terminated for any reason, dispute settlement procedures apply, involving a three-stage process (consultation-conciliation- adjudication or arbitration) but workers normally prefer adjudication. Because of delays inherent in the legal system in India, these procedures take time. The average time taken is 10 years; it would be 20 years if the appellate stage were included. In many cases, the courts decide to grant back wages to employees.

The requirements for notification and compensation with respect to layoff, retrenchment and closure are laid down in the Industrial Disputes Act, 1947. For establishments with less than 50 workmen, there is no liability to compensate for layoffs; establishments with 50 or more workmen are required as a general rule to pay half the basic pay and dearness allowance of the past year for the period of layoff.

For retrenchment or closure, there is a standard requirement of compensation at a 15 day average pay for every completed year of service, except that in the case of closure "on account of unavoidable circumstances beyond the control of employer" there is a ceiling on

compensation of three months' pay. A prerequisite for payment of compensation, whether for retrenchment, lay- off or closure, is that the workman should have one year's continuous service to their credit. A workman is deemed to have worked for one year for this purpose once service is actually rendered for 240 days on a continuous basis. Thus, the period of 240 days is critical for the worker to acquire the right to compensation following termination on account of retrenchment or closure or in the case of lay off.

The notification requirement for retrenchment or closure becomes progressively tougher with increase in the number of workmen, and there is even a prior permission requirement for certain categories of establishments if the number of workmen is 100 or more. For retrenchment, establishments with up to 99 workmen are required to (i) give one month's notice to workmen or pay in lieu of the notice, and (ii) inform the appropriate government in the prescribed manner. For closure, establishments with 50 to 99 workmen have the additional obligation to give sixty days notice to the appropriate government.

In the case of industrial establishments (factories, mines and plantations) with 100 workmen or more, notice and compensation to workmen is not enough nor is prior notice to government. Whether it is retrenchment, layoffs or closure, prior permission of the appropriate government is required. The requirement for prior permission was first introduced for industrial establishments with 300 workmen through an amendment during the Emergency in 1976. In 1982, industrial establishments with 100 workmen were brought within the purview of the prior permission requirement. Since, as mentioned earlier, the Indian Constitution grants concurrent jurisdiction on labour issues to the union and the states, states also enacted legislation, which contained variations from the Central Acts. For instance, in 2006 Andhra Pradesh made the requirement of prior permission applicable only to industrial establishments with 300 or more workmen. Recent initiatives on labour regulations by Rajasthan have been widely welcomed and are likely to be emulated by other states. With regard to Chapter VB of the ID Act the state has adopted the amendment that Andhra Pradesh had done in 2006. The same state has made the CL (A&R) Act applicable to establishments with 50 workmen against 20 foreseen in the original Act. In the Factories Act a critical change has been that the number of workers has been raised from 20 to 40 (from 10 to 20 where power is used) for the Act to be applicable to a manufacturing establishment. An additional element of rigidity in Indian laws is that in making retrenchments, employers are required to follow the seniority rule (last come-first go) strictly. Sec 25G of the ID Act, 1947, provides that during retrenchment, the employer shall retrench the last person to be employed in a category, 'unless for reasons to be recorded, the employer retrenches any other workman'. Although the provision seems to leave room for discretion, in actual practice, the seniority rule has become the norm and departures from the norm are difficult, as they would be exposed to judicial scrutiny.

A number of studies have looked at the effects of the Industrial Disputes Act 1947, in particular the 1976 and 1982 amendments, on manufacturing growth in the country. Besley and Burgess (2004) concluded that these amendments had a negative effect on both the growth of output and employment. The study found that states, which amended the Act in the

pro-worker direction, experienced lowered output, employment, investment, and productivity in the formal manufacturing sector in contrast to those that amended it in the pro-employer direction. This finding has been contested on methodological and empirical grounds by a number of authors but most comprehensively by Bhattacharjea (2006 and 2009). While the debate on the extent of influence the laws introduced in 1976 and 1982 have had on manufacturing has been inconclusive, it has diverted attention from the fact that when entry into manufacturing activity does not require permission, there is no justification for exit requiring government's consent. It is incontestable that the law on prior permission has a chilling effect on new investors, particularly in a situation in which there are many other unfavourable factors inhibiting investment. New investors are daunted by the requirement of permission as they fear that they would be burdened by the need to continue employing the work force even after it has become unprofitable for them to run the business.

In labour-intensive industries like clothing (readymade garments) and leather products (footwear and accessories), the rigidity introduced by the requirement for government permission for retrenchment in industrial units employing more than 100 workers also inhibits the establishment of units with a large workforce, which can benefit from economies of scale. In China, the largest garment manufacturing units have a workforce of 30,000 and even in Bangladesh it goes up to 10,000 while in India, the numbers do not exceed 1,000 in the largest units. When they need to employ more workers, manufacturers prefer to split their workforce into many units. The employers seem to be willing to take the risk of employing up to 1000 workers but are averse to risks involving larger numbers, just in case they are compelled to continue to employ the workforce by an unreasonable denial or delay in permission to close the unit.

The need to obtain government permission to downsize also affects the working of labour-intensive industries in another way. In both garments and leather manufactures, Indian manufacturers depend substantially on export markets in the USA and EU. The market is subject to seasonal fluctuation with much larger volumes of demand in the weeks before Christmas and the New Year followed by a period when the level of exports is much lower. There are other times too when there is an occasional bulge in export demand. The need for government permission before retrenching workers makes it difficult for Indian manufacturers of labour-intensive goods to respond to cyclical or occasional fluctuations in export demand.

In this connection, the following observation made in the 11th Five-Year Plan document appears relevant:

'However, Chapter V-B of the ID Act 1947 does create a psychological block in entrepreneurs against establishing new enterprises with a large workforce and impede attainment of economies of scale. As a result, firms prefer to set up enterprises with a smaller permanent workforce, and these enterprises are unable to cope with large size orders from retail market chains in garments and footwear for instance" (Planning Commission, Government of India 2008).

Even outside the labour-intensive industries, manufacturers in India experience temporary increases in demand originating not from the export but the domestic market. An upturn in the growth rate of the domestic economy usually gets reflected in a rise in demand for all categories of vehicles and vice versa. These industries too would like to have the ability to increase temporarily the size of the workforce whenever needed and they too are constrained by the lack of flexibility in Indian labour laws. An additional aspect is that the temporary requirement of manufacturers in sectors such as automobiles and auto components is not merely of additional workforce but of highly trained workforce. Even when the manufacturing establishments shed trained workmen when there is a slack, they would like the idled workmen to remain linked to the establishment somehow, so that they may be called to duty again when demand increases.

The requirement of prior government permission for layoffs, retrenchment or closure in industrial establishments sets India apart from the mainstream among OECD and emerging developing economies and epitomises the rigidity of the country's labour regulations applying to the manufacturing sector. What makes matters worse is that clear guidelines have not been stipulated in the laws on the circumstances in which permission would be denied when an application has been made by the employers. In the past, permission was invariably denied but the situation has changed in the post-economic reforms period. Surveys carried out in 2004 showed that in about 60 per cent of the cases, permission was granted within the stipulated time of 60 days; in 30 per cent of the cases, additional information was sought and only in 10 per cent of cases was it denied (Papola, 2013).

The Trade Unions Act, 1926

Several features of the law and practice in respect of trade unions are not conducive to the maintenance of harmonious industrial relations in the country.

The multiplicity of trade unions in India is a basic flaw as it weakens the process of collective bargaining. Any seven workmen (10 in the case of enterprises with 100 or more workers) can form and register a union; however, registration is not mandatory. What is even more anomalous is that there is no obligation on the employer to recognise any registered trade union. Collective bargaining settlements can be made even with unrecognised unions but these settlements are binding only on the participating unions. Other trade unions can raise a dispute on the same issues, with the result that unions compete with each other in asking for higher benefits.

There are two other aspects of trade union law in India that lower the efficiency of collective bargaining in the country. First, there is no requirement of voting or secret ballot either for taking decisions on industrial action or for the appointment of office-bearers. Second, considerable latitude is given to non-workers in the appointment of office-bearers. Prior to the amendment made in 2001, Sec 22 of the Trade Unions Act, 1926, allowed 50 per cent of the office bearers of a union to be outsiders (persons other than those 'engaged or employed in an industry with which the trade union is connected'). The 2001 amendment provides that one-third or five office-bearers of a trade union, whichever is less, can be outsiders in

enterprises in the organised sector. The improvement from the perspective of workers is minimal – outsiders can still corner the important posts of president and general secretary of the trade union, thus marginalising the workers by leaving only less important posts for them.

These features of Indian law and practice make collective bargaining dysfunctional, resulting in an inherent bias towards the more time-consuming adjudication process.

The Contract Labour (Regulation & Abolition), Act, 1970

The Contract Labour (Regulation &Abolition) Act, 1970, was intended to regulate the use of labour employed through intermediaries (contractors) and to work towards abolishing the use of contract labour for jobs that are of a perennial nature. Sec 10, which is one of the key provisions of the Act, empowers the central or the state government to prohibit the use of contract labour in 'any process, operation or other work in any establishment' after taking into consideration the conditions of employment of contract labour in that establishment and various factors including whether the work is incidental or perennial in nature, whether it is done ordinarily through regular workmen in that establishment or similar establishments and 'whether it is sufficient to employ considerable number of whole time workmen'. In the initial legislation, the concern seems to have been to limit the use of contract labour to temporary (as distinct from perennial) jobs, but soon, the discourse shifted to the difference that existed between central and peripheral functions. Eventually the debate in the tripartite machinery was about core and non-core functions.

An important development in this context was the 2003 amendment of Section 10 of the Act by Andhra Pradesh, which prohibited contract labour in core activities and listed the non-core activities to which the prohibition did not apply. The list includes sanitation works, watch and ward, canteen and catering, loading and unloading, courier, civil and construction works, gardening, housekeeping, transport etc. Significantly, the Andhra amendment allows contract labour in core activities also in certain circumstances such as 'any sudden increase of (*sic)* volume of work in the core activity which needs to be accomplished in a specified time'.

The laws of most of the other states lack the clarity of the Andhra Pradesh law in respect of activities in which the employment of contract labour is prohibited. Even otherwise, rigour in enforcing these laws, and labour laws in general, is absent. As a matter of fact, employers now argue that 'core and non-core classifications change as technologies, corporate strategies and technologies change (Shyam Sundar, 2012 p 24). This has lead to a blurring of the distinction between 'core' and 'non-core' activities. The result is that the use of contract labour has become widespread in the country, giving employers the opportunity to overcome the constraints of labour inflexibility inherent in other laws to some extent. There is wide support in industry circles for the deletion of Sec 10 of the Act, which gives the government the authority to abolish contract labour in certain activities (AIOE 2013).

Initially, court judgments restricted the extent of flexibility that the Act seemed to provide. In *Air India Statutory Corporation vs. United Labour Union,* the Supreme Court ruled in 1997 that upon the abolition of contract labour, the principal employer was bound on a mandatory

basis to absorb contract workers in position at the time of abolition. Four years later in 2001, in a far reaching judgment in *Steel Authority of India Ltd vs. National Union Waterfront Workers,* the Supreme Court reversed the ruling in the *Air India* case, arguing that they could not perceive in Section 10 of the Act any 'implicit requirement of automatic absorption of contract labour by the principal employer in the concerned establishment on issuance of notification under section 10(1) of the Act prohibiting employment of contract labour in a given establishment'.

While the flexibility resulting from the 2001 pronouncements of the Supreme Court has had a positive effect on employment numbers, as we shall see in Section 3 below, some features of the practice in the country in the employment of contract labour should give cause for concern. The Contract Labour (Regulation & Abolition) Act, 1970, does not contain any provision with respect to wages, allowances and other benefits of contract employees vis-à-vis the permanent employees of the principal employer, but the following condition stipulated in the Contract Labour (Regulation and Abolition) Rules, 1971, for the grant or renewal of licence of the labour contractor seems to indicate that the intention is to ensure wage parity:

'25 (2) (v) (a) in cases where the workmen employed by the contractor perform the same or similar kind of work as the workmen directly employed by the principal employer of the establishment, the wage rates, holidays, hours of work and other conditions of service of the workmen of the contractor shall be the same as applicable to the workmen directly employed by the principal employer of the establishment on the same or similar kind of work:'

However, the following observations of the Supreme Court in *UP Rajya Vidyut Utpadan Board & Another vs. Uttar Pradesh Vidyut Mazdoor Sangh* (Civil Appeal No. 1989of 2002) have rendered the wage parity envisaged in the above rule unachievable:

'Nature of work, duties and responsibilities, attached thereto are relevant in comparing and evaluating as to whether the workmen employed through contractor perform the same or similar kind of work as the workmen directly employed by the principal employer. Degree of skill and various dimensions of a given job have to be gone into to reach a conclusion that nature of duties of the staff in two categories are on par or otherwise. Often the difference may be of a degree. It is well-settled that nature of work cannot be judged by mere volume of work; there may be qualitative difference as regards reliability and responsibility.'

The Supreme Court observations have raised the question of skill differential in determining whether the same kind of work is done by workmen employed through contractors and by the corresponding workmen employed directly by the principal employer. It is extremely difficult to implement the notion of wage parity taking into account the dimension of the level of skills. As a result, wage parity between the two categories of workers is not legally enforceable. It is this legal lacuna that has led to the wide gap between the wage levels of contract workers and those directly employed by the principal employers.

Other Indian laws and schemes having a bearing on industrial relations

The statutory requirement for minimum overtime premium compounds the problem faced by manufacturers in labour-intensive industries in responding to occasional or cyclical increases in demand. In India, Sec 59 of the Factories Act, 1948, entitles a worker to receive wages for overtime at a rate twice the normal rates if they work for more than 9 hours a day or more than 48 hours a week. Rule 25 of the Minimum Wages (Central) Rules, 1950 also stipulates that overtime wages have to be paid at double the normal rates. The requirement that the overtime wages be 200 per cent of the normal is well out of line with international practice. Some countries viz., Germany, the UK and China have not set a minimum statutory rate at all. In France and Japan, the statutory requirement is set at the minimum standard recommended by the ILO, which is 125 per cent of the regular rate, while in the USA, Korea and Brazil, it is at a higher rate of 150 per cent.

Although the Employees State Insurance (ESI) Act, 1948 is concerned with providing medical services for the benefit of workers in the country, Section 19 of the Act empowers the ESI Corporation to undertake additional measures to promote the health and welfare of workers coming under its purview. Pursuant to this provision, in 2005 the Corporation introduced the Rajiv Gandhi Shramik Kalyan Yojana (RSKY) providing for unemployment allowance for insured persons. The allowance provided under RSKY covers unemployment due to retrenchment or closure as defined under the ID Act, 1947, as well as permanent invalidity (of more than 40%) arising from non-employment injury. According to the scheme in force at present, in order to be eligible for the allowance the insured workers have to have at least three years of employment to their credit. The allowance is payable for a maximum period of 12 months during the life time of the insured person. The rate of allowance is 50 per cent of the last wage drawn.

Two other features of the RSKY need to be taken note of. First, the ESI scheme is being implemented area-wise by stages and does not cover all parts of the country geographically as yet. The assessment is that more than half of the factories and other establishments (shops, hotels, restaurants, cinemas, private medical and educational institutions etc.) have been covered up to the current year. The employees contribute 1.75 per cent of wages and the employers 4.75 per cent to finance the ESI Corporation. For unemployment allowance separate contribution is not required.

3. Effects of Labour Regulations on Employment in the Manufacturing Sector in India

Labour regulations can be expected to affect employment mainly in the organised sector in manufacturing, i.e., units registered under the Factories Act, 1948, and employing 10 or more workers (where power is used) and 20 workers where power is not used. It is principally these establishments that come under the ambit of these regulations; smaller units, which fall in the unorganised sector, escape the rigours of these regulations and are largely unaffected by them.

Data on employment in organised manufacturing is collected in the Annual Survey of Industry (ASI) conducted by the Central Statistical Organisation of the Ministry of Statistics and Programme Implementation (MOSPI). Data on employment in the unorganised sector is

compiled in the Reports of National Sample Survey Office (NSSO), also of the same Ministry. The NSSO datasets comprise data relating to own account manufacturing enterprises (OAME), which are run without hired workers, directory manufacturing establishments (DME), which employ six or more workers and non-directory manufacturing establishments (NDME), which employ less than six workers.

Effect on firm size distribution

Table 1 tabulates the data on manufacturing/factory employment in the organised and unorganised sector.

Table 1: Number of employees (in millions) in manufacturing sector/factory sector in India

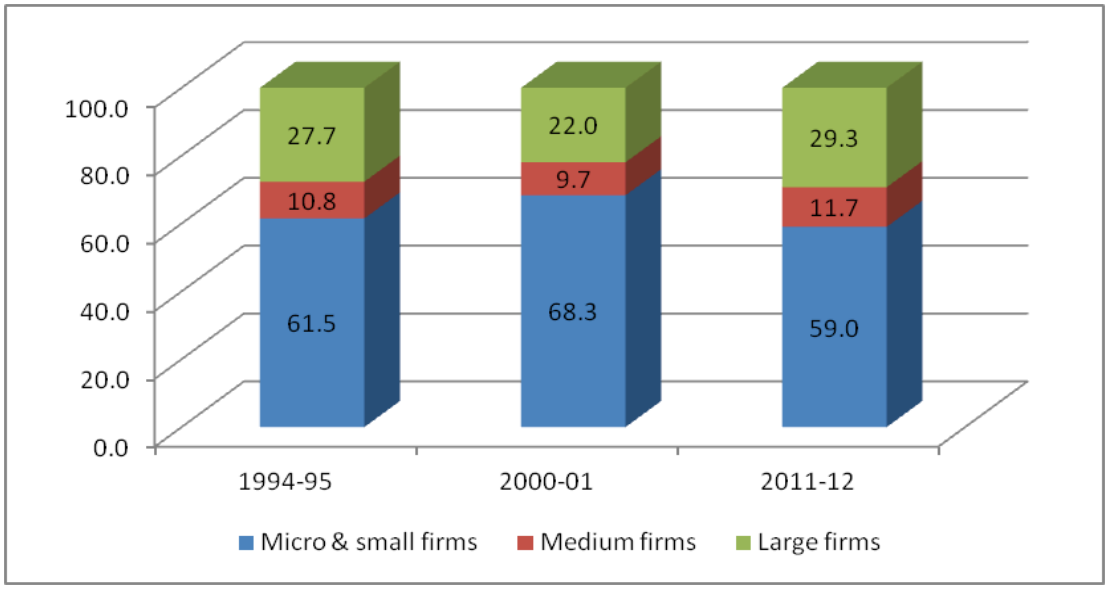
		1994-95	**2000-01**	**2005-06**	**2011-12**
Organised manufacturing		9.10	7.91	9.04	13.34
Unorganised manufacturing		33.20	37.08	36.44	34.88*
	OAME	22.65	25.06	23.68	20.84*
	NDME	4.89	5.56	5.77	14.04*
	DME	5.65	6.46	6.97	

Source: ASI and NSSO Reports

Note: * this data is for 2010-11

It would be seen that while employment in organised manufacturing remained pinned down at the level of a little above 13 million even after the impressive increase in recent years, employment in unorganised manufacturing was nearly three times as much, even though it accounts for only one-third (Economic Survey, 2013-14) of manufacturing output. Analysis of data on the numbers employed by firms of different sizes brings out some significant aspects (See Figure 1). Micro and small firms, that is those with employment from zero to 49 (a category that includes ASI units with employment in this range as well as all DMEs and NDMEs from the NSSO datasets) have a disproportionate share of employment. Large firms, with employment of 200 and above come second in the numbers employed and medium firms (50-199) have the lowest share, a phenomenon designated as the 'missing middle'.

Figure 1: Distribution of employment according to employment size of firm in manufacturing/factory sector



Source: ASI and NSSO Reports

Note: In the unorganised sector, for 2011-12 we have taken data of 2010-11. Micro and small firms are defined as firms with employment size of 0-49+NDME+DME, medium firms are defined as firms with employment size of 50-199 workers and large firms are defined as firms with more than 200 workers.

Hasan and Jandok (2013) have carried the investigation further. They find that in India the shares of micro and small enterprises, medium and large enterprises in manufacturing employment were 84, 5.5 and 10.5 per cent respectively in 2005, if workers in OAMEs are included. The corresponding shares of Korea stood at 46.5, 23.9 and 29.6 and of China at 24.8, 23.3 and 51.8. The authors recognise that industrial composition may affect the employment size of enterprises, as manufacture of some products (such as automobiles) may be more capital intensive than others (such as apparel). Hence, they compare employment intensity in the same product (apparel) to demonstrate the effect that labour regulations in comparator countries (India and China) may have on employment. While, in India, more than 80 per cent of employment is concentrated in enterprises with less than eight employees, in China, firms with strength of more than 51 employees account for more than 80 per cent of the employment. The authors also examine whether labour regulations have any effect on firm size and its distribution and conclude as follows:

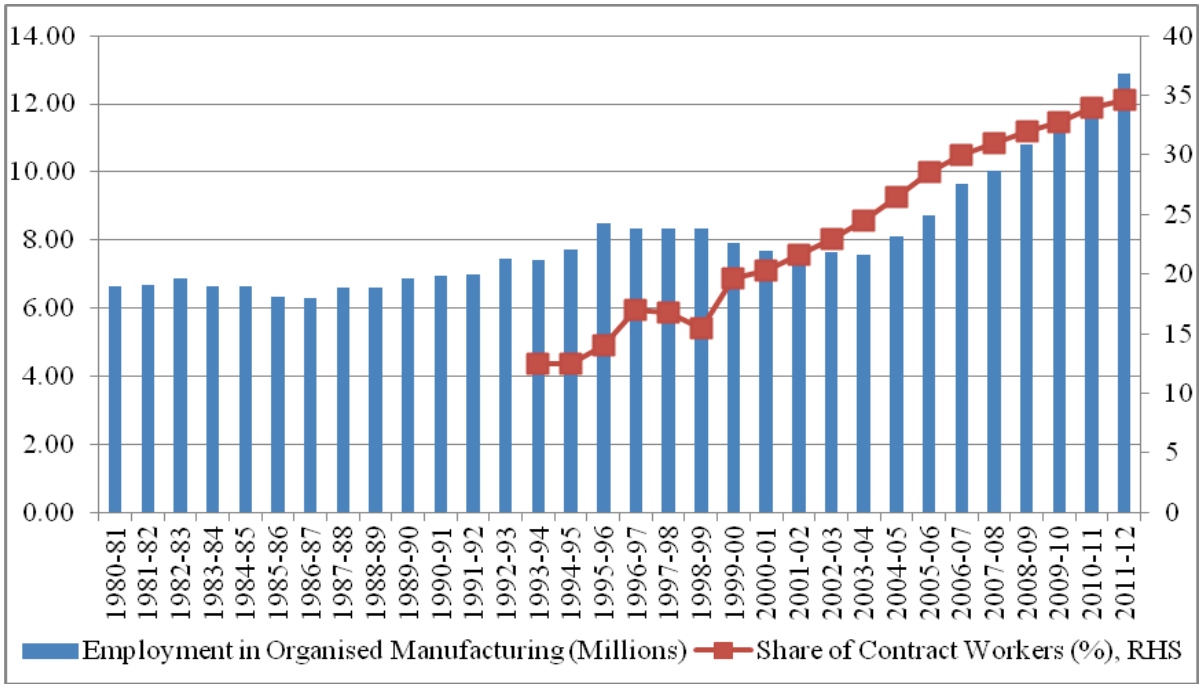
'Using available measures of labor regulations across Indian states, we find that as far as labor-intensive industries are concerned, states with more flexible (inflexible) labor regulations tend to have a greater share of employment in larger (smaller) firms. Moreover, this is more evident among firms established after 1982, when an amendment to the IDA – perhaps the single most important piece of legislation affecting labor-related issues for Indian manufacturing – required firms with one hundred or more workers to seek permission from the government to lay off or retrench employees. Taken together, the results are suggestive of a link between labor regulations and firm size distribution.'

Since it is widely recognised that both labour productivity and wages are higher in larger firms, the conclusion is inevitable that labour regulations are driving down both productivity of enterprises and wages in India. Thus, they serve the interest neither of the labour nor of the economy.

Increase in employment of contract labour

Figure 2 shows the evolution of employment in manufacturing from 1980 onwards.

Figure 2: Employment in Organised Manufacturing Sector in India



Source: ASI Reports, various years

It is seen that employment in organised manufacturing stagnated in the range of 6-7 million for more than a decade before the introduction of economic reforms in 1991-92. Thereafter, it grew slowly before starting to decline in 1998-99. However, after 2001-02, employment in this segment has shown strong growth and reached the high of 12.88 million in 2011-12, registering an increase of 5.43 million from the 2001-02 level.

ASI data show that much of the increase in employment in organised sector in recent years has been accounted for by contract labour. The use of contract labour in organised manufacturing has increased from about 1.21 million in 2000-01 to about 3.40 million in 2011-12. The share of contract workers in manufacturing as a whole has increased rapidly, from 20.28 per cent in 2000-01 to 34.63 per cent in 2011-12. In a recent ICRIER survey, a substantial number of manufacturing units also reported the use of contract labour. As Table 2 shows, the rise in the share of contract workers has taken place across the board and has affected almost all industrial segments.

Table 2: Share of contract workers in all workers in major manufacturing industries 2011-12

NIC (2008) Code	*Product description*	*Share of contract workers (%)*		
		2000-01	*2005-06*	*2011-12*
131	Spinning, weaving and finishing of textiles	08.26	11.45	13.38
239	Manufacture of non-metallic mineral products n.e.c.	34.45	51.05	58.15
107	Manufacture of other food products	09.00	10.59	17.29
141	Manufacture of wearing apparel, except fur apparel	05.76	13.32	15.21
241	Manufacture of basic iron and steel	23.74	33.63	45.94
293	Manufacture of parts and accessories for motor vehicles	12.68	31.61	46.27
120	Manufacture of tobacco products	63.39	68.36	65.51
210	Manufacture of pharmaceuticals, medicinal chemical and botanical products			43.93
259	Manufacture of other fabricated metal products; metalworking service activities	20.38	30.87	37.73
222	Manufacture of plastics products	16.30	28.26	30.42
202	Manufacture of other chemical products	17.77	29.87	29.79
106	Manufacture of grain mill products, starches and starch products	34.80	42.99	41.41
281	Manufacture of general purpose machinery	11.93	24.11	34.54
282	Manufacture of special-purpose machinery	09.80	21.0	34.80
201	Manufacture of basic chemicals, fertiliser and nitrogen compounds, plastics and synthetic rubber in primary forms	17.77	29.86	46.33
Manufacturing sector		20.42	28.58	34.63

Source: ASI Reports, various years

Although the Contract Labour Regulation & Abolition Act was enacted in 1970, the Supreme Court judgment in the *Air India* case in 1996 had created uncertainty on employment of contract labour and the reversal of the ruling on compulsory absorption by the Supreme Court in the *SAIL* case in 2001, served to create a feeling of comfort among employers and led to freer recourse to such labour. The magnitude of employment in manufacturing by the unorganised sector and the increase in employment by the organised sector, taking advantage of the flexibility offered by the Contract Labour (Regulation &Abolition) Act, give a measure of the constraining influence of the rigidity inherent in the Industrial Disputes Act, 1947, and the Industrial Employment (Standing Orders) Act, 1946.

However, it would be misleading to draw the conclusion that greater use of contract labour is necessarily a welcome development from the perspective of sound labour and employment policy, which still needs to strike a balance between protection of labour and flexibility in

labour markets. The conditions of employment of contract labour in India do not give confidence that such balance has been struck in the country.

In actual practice, a wide gulf has developed between the wage levels of contract employees and workmen of principal employers doing the same or similar work. Calculations made on the basis of Labour Bureau data (Table 3) show that contract workers in the organised sector (ASI units) were paid on an average about 70.98 per cent of the wages of directly employed workers per workday worked during the period 2008-09 to 2011-12.

Table 3: Labour Costs per Manday Worked on Wages/Salaries (in Rupees)

Year	Directly employed workers	Contract workers	Contract workers wage as proportion of directly employed workers
2008-09	235.16	160.53	68.26
2009-10	261.94	193.87	74.01
2010-11	308.82	218.76	70.84
2011-12	347.79	246.20	70.79
Average			70.98

Source: ASI Reports on Absenteeism, Labour Turnover, Employment and Labour Cost, various years

Not only are the wages of contract workers lower but the conditions of employment are far inferior to those of regular workers who are directly employed. In order to avoid any problem arising from contract workers claiming continuous service of 240 days, contractors and principal employers adopt strategies to ensure that there is no fixity in employment of individual contract workers. The contractors do not assign the same worker to a particular principal employer for a period exceeding the cut-off period and principal employers rotate the contractors themselves. The contract workers thus do not have even a semblance of the employment security enjoyed by regular employees directly employed by principal employers. Furthermore, the situation of contract workers is such that neither the contractor nor the principal employer has any incentive to invest in their training for better productivity. Contract workers are thus condemned to remain indefinitely without any employment security and with lower wages as compared to directly employed peers and have no prospects of improving their skills through training. Lack of training for prolonged periods of a major segment of workers is detrimental to the interest of employers as well and they would be much better served in a system that provides for an automatic system for upgrading human capital resources.

As a result of these practices resulting from the Contract Labour (Regulations and Abolition) Act, 1971, two classes of workers have emerged in manufacturing industries – one with higher wages who also benefits from employment security and the other with lower wages and without any form of employment security. Conflict between the two classes of workers has been a contributory factor in the extreme forms of industrial unrest in the country (Shyam Sundar, 2012, p 27; FICCI and AIOE 2014). Although the number of industrial disputes (strikes plus lockouts) has fallen drastically from the peak of 3048 in 1978 to 439 in 2012,

there has been an increase in violent incidents resulting in a number of deaths in recent years (Graziano Transmissioni India - September 2008; Pricol - September 2009; Allied Nippon - November 2010; Powmex Steel - March 2011; and Maruti Suzuki India Ltd. - July 2012 (AIEO 2013).

4. Labour Regulations in Emerging and Developed Countries

Taking into account the features of regulations in India governing flexibility in labour markets, we consider below the main features of corresponding regulations in selected emerging (Brazil, China, and South Africa) and developed countries (France, Germany, Japan, Korea and the US). On collective bargaining and trade unions we also look at the law and practice in the U.K. and Malaysia, as they provide insights that could be helpful in resolving the problems that are endemic in India, such as multiplicity of trade unions, domination of outsiders in trade unions and industrial action being initiated without the support of the majority of workmen.

The specific aspects we deal with are collective dismissal (downsizing or closure of firms for economic reasons), contract workers, fixed term employees, and collective bargaining. In our review, we dwell on the key features of these regulations while underlining those aspects in which our regulations depart from international practice. The review is based on the document 'Detailed Description of Employment Protection Legislation, 2012-13' in the EPL Database of the OECD, information on national industrial relations on the website of the European Trade Union Institute (ETUI) and, wherever necessary, the laws of the concerned countries (Trade Union and Labour Relations Adjustment Act 1997, Korea; Trade Union and Labour Relations (Consolidation) Act 1992, UK; Trade Unions Act 1959, Malaysia and Labour Union Act 1949, Japan).

In all major industrialised and many emerging countries, workers have access to some form of unemployment insurance, providing them financial assistance during periods when they do not have jobs. The assistance enables beneficiaries to maintain their standard of living temporarily while they look for new employment opportunities and undertake training to enhance their employability. We, therefore, also give an outline of the main features of unemployment insurance in developed and emerging countries on the basis of information contained in the ILO document titled 'Comparative review of unemployment and employment insurance experiences in Asia and Worldwide'.

Downsizing or closure (collective dismissal)

Industrialised countries have laid down the procedures that need to be complied with before firms can take steps to dismiss employees in substantial numbers on economic grounds, some more detailed than others. Indian laws are unique in requiring employers faced with redundancies to obtain prior permission of government for downsizing. Other jurisdictions require only notification to public authorities and lay much greater emphasis on employers notifying and consulting with staff representatives and labour unions and reaching an understanding with them before proceeding with retrenchment, layoffs etc. The requirement

regarding detailed consultations with staff representatives and labour unions are missing from the regulations in India.

Another feature of the laws in some emerging countries is that there is no rigidity in the selection criteria for retrenchment like the seniority rule in India. The requirements are simple, such as that these criteria be rational and fair or that preference be given to the retention of employees with open-ended contracts.

In France, the procedures vary with the number of employees affected and the size of the enterprise but the employer is required to notify and consult with staff representatives and also inform the administrative authority in all cases. The notification to administrative authorities has to be made following the first meeting with staff representatives and, thereafter, there is a waiting period of 30-74 days before the employer can proceed to send the notification of dismissal to the employees by registered post. If more than 10 workers are affected and the enterprise has at least 50 employees, the employers are mandated to put in place an employment preservation plan, which may include measures to limit redundancies and encourage deployment.

In Germany, collective dismissals require notification of employee representatives as well as public authorities and consultation with the Works Council. There is provision for two weeks of negotiation before notification to the public authorities and a four-week delay thereafter before dismissal notices are issued. In negotiations with the Works Council, alternatives to redundancies have to be explored and ways to mitigate the effects as well as selection criteria have to be discussed.

In Japan, collective dismissals require notification to the public employment service one month prior to the last dismissal. Additionally, employers have to submit a re-employment assistance plan and obtain approval of the public employment service one month before the first dismissal. Employers are required to discuss the plans with the unions or workers' representative and listen to their opinion.

In Korea, the employer is required to inform the Ministry of Labour 30 days in advance in case of dismissal of 10 workers in firms with less than 100 employees, 10 per cent workers in firms with 100-999 employees and more than 100 workers in firms with more than 1000 employees. In all cases, the employer is mandated to hold sincere consultations with workers' representatives on efforts to avoid dismissal and on criteria for selecting workers to be dismissed. There are no specific requirements on selection criteria but it is provided that they should be rational and fair.

As in other industrialised countries, collective dismissals require notification to workers or labour unions as well as to state and local authorities in the US. The notice period is 60 days except in the case of layoffs when there is threat of bankruptcy. There are no legal requirements regarding negotiations but collective agreements guide the selection criteria.

In Brazil, there are no regulations requiring notification or negotiations prior to collective dismissals. However, court judgments have mandated that mass dismissals must be preceded by negotiations with social partners.

China allows employers to proceed with collective dismissals necessitated by economic circumstances after consulting with the labour unions or workers 30 days in advance and informing the authorities. On the selection criteria, the Chinese law is not only rational but has a human touch as well. In carrying out the dismissals, priority is to be given for the retention of employees with long term FTC or open-ended contracts or those who do not have employed persons in the household.

A feature of South Africa's legislation on collective dismissals is that on request of either the employer or the employees' representatives, the Commission for Conciliation, Mediation and Arbitration must appoint a facilitator within 15 days of the notice of retrenchment. When a facilitator has been appointed, the employer is required to delay termination by 60 days.

Temporary work agency (TWA)

Temporary agency employment, whereby an agency or contractor employs workers and hires them out to user companies, is a widely prevalent practice across the world. In India, it is known as contract labour employment and in the OECD countries as temporary work agency (TWA) employment.

As in India, most other jurisdictions regulate temporary work agencies through licensing and reporting requirements. But there are variations in law and practice on some aspects. The Indian law contains a serious intent to abolish the use of contract labour for jobs of a perennial nature and gives authority to the government to prohibit such use. However, the authorities have not shown any zeal in this direction for a long time. In fact, for many years, employers have had a sense of immunity from the potential rigour of the law against the use of contract labour for perennial jobs and are using contract labour for all types of jobs, perennial and incidental, core or non-core, without any restraint.

In most OECD countries, there are no restrictions on the vocations or the type of jobs in which temporary work agency can be used. Except in France, where TWAs are strictly regulated and limitations imposed on the duration of contracts, other OECD countries have fairly relaxed regimes, with no limit on renewal, prolongation or cumulated duration (the total period for which renewal can be granted for the same position). In emerging countries, however, the pattern of legal provisions generally is to allow their use only for temporary, intermittent or ancillary work as in India, although in actual practice there is some amount of freedom, again as in India. Brazil is an outlier among emerging countries in requiring the cumulated duration of use of TWAs to be limited to three months.

France is the strictest in regulating the use of TWA : specific authorisation is required to set up a TWA; following the initial contract, a new contract may be entered into for the same

position only after the lapse of a stipulated period; the cumulated duration of the assignment with the user firm cannot in principle exceed 18 months.

In Germany, TWAs need the permission of the labour authority to operate and there are reporting requirements as well. However, there is at present no bar on the use of TWAs in any vocation, nor is there any legal limit for renewal or prolongation of TWA assignments, or on the cumulated duration, except when there is a collective agreement, as is the case in the metalworking sector, in which the maximum length is fixed at 24 months. .

In Japan, the setting-up of a TWA requires authorisation at the outset and annual reporting thereafter. TWA is allowed for most occupations except port transport services, construction work, security services and medical related work. There is no restriction on renewal or prolongation of TWA assignments. TWA assignments are not regulated but the TWAs require a licence.

In Korea, TWA employment, in principle, is allowed in 32 occupations, but can be used in others as well for temporary or intermittent work. It is prohibited in construction and some other occupations. The maximum cumulated duration in 32 occupations is two years and in other cases six months.

In the US, TWAs are required to obtain a licence from the state governments but otherwise, the employment of TWAs is not regulated.

Brazil regulates TWAs strictly, requiring that the employment of such agency be limited to meet a temporary need and stipulating that the cumulated duration must not exceed 3 months, unless authorised by the government.

In China, the law permits TWA employment only for temporary, ancillary and substitute positions but in practice, such employment is widely used. There is no time limit on the employment of TWA.

South Africa requires a TWA to register with the Department of Labour but there is no stipulation regarding the types of work in which it can be employed, period of contract, number of renewals or the total cumulated duration.

Fixed term contracts (FTCs)

At present, India does not have an explicit provision in its laws authorising the use of fixed term contracts while most OECD and emerging countries allow its use, albeit with conditions. The critical aspect in such contracts is the number of renewals or the cumulated duration of such renewals, before the workers get the right to enter into an open-ended contract. The practice varies considerably – at one extreme, the employer has complete flexibility and at the other, the maximum duration is limited to 18 months. A review of the law and practice on FTCs in the OECD and emerging countries provides guidance for considering the introduction of such contracts in Indian laws as an instrument of labour flexibility. There is once again great variation in regulatory rigour among the laws of various

countries and France is at the strict end of the spectrum while the USA is at the liberal end among OECD countries. Among emerging economies, Brazil has adopted a restrictive approach.

France bars the use of FTC to fill on a long-term basis jobs that are related to a company's regular business. FTC can be entered into only for a limited period for a temporary assignment. Renewal is permissible only once, except in some situations such as for replacement of an employee who is absent, but the maximum duration allowed is in principle only 18 months.

Germany is more relaxed than France in regulating FTC. Such contracts are permissible for two years, and in the case of new businesses, for four years; there is no need to specify objective reasons for their use. Normally, four renewals are permitted with a maximum cumulated duration of two years. Where there are objective reasons, successive FTCs can be used without any time limit.

Japan is even more liberal in regulating FTCs. Contracts can be generally for up to three years, and up to five years for highly skilled employees or those above 60 years of age. There is no legal limit on the number of renewals but after repeated renewals, the employer must have a just cause for refusing renewals. Successive contracts cannot exceed the duration of three years at a time. Korea allows FTCs for a maximum of two years. The US imposes no restrictions at all on fixed term contracts.

Among emerging countries, Brazil regulates FTCs moderately, permitting one extension and stipulating that the cumulated duration must not exceed two years. China has no restriction on the type of work for which FTCs may be concluded. However, after two fixed term contracts or after working for 10 years in succession, the worker gets the right to enter into an open-ended contract. In South Africa, the use of fixed term contracts is prevalent, without any limit in law on the number of renewals or cumulated duration. However, renewal of an employee's contract three or four times may give rise to a reasonable expectation for renewal in future, and non-renewal may constitute dismissal.

Collective bargaining and trade unions

There is considerable divergence in practice among important industrialised and emerging countries with respect to collective bargaining. In some countries, collective bargaining is done at the enterprise level, as in India, while in some others, such as European countries, industry level bargaining is the norm.

In Germany, collective bargaining for setting wages and working conditions takes place industry-wise and agreements are concluded generally at the regional level between the employers' federations and unions. An agreement between an individual company and the trade unions, such as the one involving the auto company Volkswagen, is atypical. The current law makes it possible for the government to extend the applicability of collective agreements beyond the parties to the agreement in an industry if a number of conditions are

met, including the requirement that the agreement should cover at least 50 per cent of the workforce in the industry. At the workplace level, the practice is to have works councils, with representatives of workers, in which local problems are resolved.

In France, collective bargaining can take place at three levels – national, industry or company – but recent legislation has enhanced the importance of national level agreements. National level agreements can be valid only if they are signed by a confederation or confederations with at least 30 per cent support nationally and if they are not opposed by other confederations that have the support of a majority. Company level agreements can depart from industry agreements in areas in which this is not specifically prohibited by the industry agreement. In company level agreements, the new rules require that an agreement should have at least 30 per cent support to be valid and that it should not be opposed by unions with a majority support.

The European countries in which industry level collective bargaining predominates do not provide a model that may solve the problems that arise in India. We need to look at the law and practice in leading manufacturing countries in which the enterprise level collective bargaining prevails as in India.

In the U.K., company level bargaining is the norm in the private sector and industry level bargaining in the public sector. The laws allow multiplicity of trade unions but collective bargaining can be entered into only by recognised unions. A trade union may seek recognition either by voluntary or statutory means but, in order to obtain statutory recognition, the union must establish that it has the support of a majority of workers. Where there is more than one union, they may make a collective bargaining arrangement whereby the unions act together on behalf of the workers. The trade union law requires the support of a majority of the members of the trade union before industrial action is initiated by it. Election of office bearers such as president, secretary and members of the executive is also mandatory.

In Japan too, collective bargaining takes place at the level of the enterprise and a unique feature of the process is that the employer and enterprise-based union have complete autonomy. Although the law makes it possible for more than one union to exist in an enterprise, the practice in Japan is generally to have only one labour union in an establishment. The law requires office bearers in an enterprise union to be elected by direct secret vote of the union members. Similarly, industrial action can only be initiated by a majority decision made by secret vote either of union members or of delegates elected by union members.

Since 2011, labour laws in Korea have provided scope for multiple unions to exist at the enterprise level. However, Korean labour law requires that when more than one union exists, the unions must co-operate to present a unified bargaining position so that the collective bargaining results in a single agreement. The other key aspect of the law is that union officials must be elected from among union members. It also requires that no industrial action can be taken unless the majority of union members have decided in favour of such action by direct, secret and unsigned ballot.

In Malaysia too, the practice is for collective bargaining to take place at the enterprise level. Registration of a trade union is compulsory and the Director General has been given wide powers to limit the number of trade unions. Section 12 of the Trade Unions Act, 1959, empowers the Director General to refuse to register a trade union if 'he is satisfied that there is in existence a trade union representing the workmen in that particular establishment, trade, occupation or industry and it is not in the interest of the workmen concerned that there be another trade union in respect thereof'.

The law prohibits trade unions from going on strike without first obtaining by secret ballot the consent of at least two-thirds of its members. A secret ballot is also required for election of an executive of a trade union. Further, a prerequisite for election is that the person must be a worker of at least one year standing in the establishment, trade, occupation or industry with which the trade union is connected.

Unemployment insurance

Unemployment insurance is a key labour welfare measure that exists in all major developed and many developing countries. The pattern in unemployment insurance schemes generally is to have a wide coverage and to identify not inclusions but exclusions. The schemes need to be financially sustainable and financing is usually shared by employers and employees, with the government making a contribution in some countries. Involuntary unemployment and willingness to work in case employment opportunity is offered are generally applicable primary conditions for grant of benefit in all jurisdictions. In addition, there is the requirement of a minimum duration of contributions. The duration of benefit depends upon the length of unemployment insurance contribution and the age of the beneficiary. The scale of benefit is linked to the mean wages drawn during the period of employment and in some countries the level of income and the age factor are also taken into account.

5. Conclusions and Recommendations

What are our conclusions on the features of India's labour regulations that affect labour market flexibility and what are our recommendations to remedy these shortcomings? We summarise our findings below, based on analysis and comparison with international practice. Our suggestions are based on the practice in emerging economies as well as those in the OECD countries. Although our main aim is to obtain greater flexibility, our proposals are designed to ensure that a balance is maintained between labour market flexibility and protection of labour.

The Industrial Disputes Act 1947

In the procedures governing collective dismissal (layoff, retrenchment and closure), India is clearly not in the mainstream of major developed and emerging countries. While the requirements of prior notification (to the workers' representatives and public authorities) and consultation and negotiations with workers' representatives are common in the comparator countries, India is alone in mandating government permission for firms with a workforce of

100 or more. The requirement of prior permission is not only devoid of any rational justification but is incompatible with a market economy. Economists differ on its effect on existing enterprises but there is no disagreement on its chilling effect on foreign investment in manufacturing in which sector employers have to be fleet-footed in responding to competitive pressures. Foreign investors are daunted by the requirement, particularly because no principles are laid down on the basis of which permission would be granted. Chapter VB of the Act, introduced through amendments in 1976 and 1982, should be repealed.

Even if Chapter VB of the Act is totally incongruous with the principles of a market economy, which were introduced in the country, slowly but surely, by the economic reforms of 1991-92 and subsequent years, it may be politically difficult to do away with this provision at one stroke without significant steps to alleviate the impact of the reform on workers. Labour unions regard the extra protection afforded by this Chapter as an acquired right, which they would be loathe to see extinguished. One aspect, which deserves to be looked at in this connection, is that of compensation to the workmen in the event of retrenchment or closure. As mentioned earlier, at present the ID Act, 1947 stipulates that as a rule the compensation should be the average pay for 15 days for each year of continuous employment. In the Draft Labour Code on Industrial Relations Bill, 2015, circulated for stakeholders' consultation by the Ministry of Labour & Employment, Government of India, the proposal is to raise the compensation to 45 days. However, in a globalised world it is important to ensure that India remains competitive as a destination for foreign direct investment, and on such matters our laws should not be out of line with the practice in other countries, particularly emerging countries. In both China and Korea the norm for compensation for retrenchment is 30 days for each year of employment. In Thailand, it is the same if the service rendered is 10 years or more, although it is somewhat more generous if the employment is between three and 10 years. In Malaysia, 20 days' wages are payable for employment of five years or more, and the yardstick is lower if the period of employment is less. Among the major industrialised countries, in Japan and the US, the laws do not prescribe the level of separation payment, and in the UK, France and Germany, they stipulate payments at a rate lower than or at best equal to the current rate in India. Having regard to the practice in major economies around the globe, and the need to keep the Indian economy competitive for foreign direct investment, we recommend that the compensation for retrenchment and or closure be increased from the current level of two weeks for each completed year of employment to four weeks. The ceiling on compensation of three months' pay when closure is due to circumstances beyond the control of the employer needs to be continued.

Another flexibility that needs to be introduced is with respect to the seniority rule on retrenchment (Sec 25 G). It would be appropriate to replace 'the last come first go' rule by a requirement couched in general terms such as that the selection criteria for retrenchment should be rational and fair.

The Trade Unions Act, 1926

We have seen that multiplicity of labour unions, the possibility of fragmentary settlements that are binding only on participating unions, and the lack of requirement of voting or secret

ballot for appointment of office bearers or for approving industrial action such as strikes impair the efficiency of collective bargaining in the country. Another adverse feature of the laws is that outsiders are permitted to be office bearers of unions. When office bearers are not workers themselves there is a danger that their participation in union activities would be coloured by the interests of their other affiliations and pursuit of workers' interest would not be the sole consideration.

These shortcomings need to be eliminated through amendments in the trade union law in order to ensure that collective bargaining contributes effectively in the maintenance of harmonious industrial relations.

Registration of trade unions needs to be made obligatory, but international practice does not provide the basis for recommending that the law should provide for a high benchmark of membership as a prerequisite for registration. What is required for efficiency in collective bargaining is a provision for recognising the bargaining agent. As suggested by FICCI and AIOE (2014), either a single union with a membership of more than 51 per cent, or two or more unions, whose membership jointly comes to that level, should be recognised as the bargaining agent for the purposes of collective bargaining.

Further, India should fall in line with international practice and trade union law should provide that a majority of workers endorse any industrial action that is contemplated. Elections should also be made obligatory for office bearers, with the stipulation of a maximum term of three or five years. It is necessary to also limit the role of outsiders (non-workers) in trade union affairs. It is not enough to limit the proportion of outsiders to one-third or one-half: it should be provided additionally that out of the two key posts of president and general secretary, only one can go to non-workers, as suggested by FICCI and AIOE (2014).

Fixed-term employment

The Model Standing Orders embodied in the Industrial Employment (Standing Orders) Central Rules, 1946, classifies six types of workmen and the category 'fixed-term employees' does not find a mention. We have seen that an amendment made in 2003 was deleted by a government order in 2007.

Fixed-term contracts (FTC) are prevalent in several countries, including major developed and emerging countries, although there is wide variation in regulatory rigour. There are some countries like the US in which there is no requirement regarding the circumstances under which such contracts can be offered and the number and the total duration of renewals. On the other hand, France has strong restrictions on all these aspects. Countries that are strong in manufacturing, such as China and Germany, regulate FTCs lightly.

India too needs to introduce the practice of FTCs in the manufacturing sector to give employers more flexibility in employment. This can be done by reintroducing the amendment in the Model Standing Orders in the Industrial Employment (Standing Orders) Central Rules,

1946, that was deleted in 2007. The amendment should be expanded to provide that back to back fixed term contracts would be permissible for a cumulated duration of at least five years. Equality of treatment of fixed-term and permanent employees with regard to pay, allowances and other benefits is also imperative. Giving FTC employees, with a minimum length of service of say 6 months, the right to be members of the trade union will be an important safeguard for this purpose.

Fixed-term contracts will provide an additional avenue of flexibility to manufacturers to cope with cyclical and occasional increases in demand especially in foreign markets. Additional workers may be employed for the period for which they are required and their services dispensed with thereafter. If a manufacturing establishment wishes to ensure that workmen employed against one term of fixed-term contract remain linked to it with an obligation to be available for the next term of such contract, the proper route is to consider making ex gratia payment to the worker for the idle period. Management practice rather than the introduction of a legal provision should be the preferred alternative.

The Contract Labour (Regulation and Abolition) Act 1970

The use of contract labour has spread rapidly in the country and has provided employers with a modicum of flexibility; as a result, manufacturing employment has expanded in recent years. However, we have seen that contract labourers suffer from very poor conditions of employment, with no security of service and lower wages as compared to workmen engaged by the principal employers for the same or similar work. Ideal labour regulations are those that strike a balance between labour protection and flexibility. While Chapter VB of the Industrial Disputes Act, 1947, errs on the side of protection, the Contract Labour (Regulation and Abolition) Act 1970, as implemented, errs on the side of flexibility. The wide gulf between the levels of wages and job security of regular and contract workers has become a source of violent industrial unrest and needs to be addressed. AIOE's call for deletion of Section 10 of the Act, which gives the government the authority to abolish contract labour in certain activities, cannot be supported as such a step is likely to perpetuate the difference in wage levels between regular and contract workers and the industrial unrest that this difference triggers in the country. The law should permit contract labour only for temporary or intermittent work and should not provide the route for lowering wages and other conditions of service in employment for carrying out the main line production activities in the long term. If India is to become a manufacturing power and is to acquire a name in producing quality products, only trained workmen should be employed in such activities.

What needs to be done is for state governments to clearly define non-core activities that are covered by the prohibition under Section 10 of the Act, as has been done in Andhra Pradesh. A similar enactment in all states is a prerequisite for effective enforcement of the law. However, the use of contract labour has been so pervasive in the recent past and has provided the route to flexibility in mainline production activities for such a long time that an abrupt ban may prove disruptive of industrial activity. Employment of contract labour in core activities has been found useful in situations of cyclical or occasional increases in demand, particularly in labour-intensive manufactures. Over time it is expected that FTCs will enable

employers to cope with such ad hoc increases in demand, but initially there may be difficulty as the labour market phases in this new channel of employment and gets accustomed to it. It is proposed that to enable employers to tide over any transitional problems, for a limited period of say 10 years, they may continue to have the flexibility to hire contract labour for main line production activities. As in the case of the Andhra Pradesh amendment, the exception should be tightly defined, and recourse to contract labour for core activities should be permissible only in situations of increase in volume of work to be accomplished in a specified time. It has been gathered from representatives of employers that, in actual practice, in situations of sudden increases in demand for products, scarcity conditions develop in the market for trained labour and they have to pay higher rather than lower wages to contract workers. The transitional flexibility, therefore, may not be against the interest of workers.

Other laws and schemes

In a globalised world, the law on overtime wages also needs to be brought on par with international practice. Section 59 of the Factories Act, 1948, and Rule 25 of the Minimum Wages (Central) Rules, 1950 need to be amended to reduce the overtime wages to the level of 125 per cent recommended by the ILO. Such a step will enable our labour intensive industries to be competitive in international markets.

The RSKY unemployment allowance is broadly comparable with such schemes in emerging countries and its elements need no major change. However, in order to consolidate the scheme, it should be delinked from the ESI Corporation and, even more importantly, it should be made applicable to all units in the country in the covered sectors.

References:

All India Organisation of Employers (AIOE). 2013. *Industrial Relations & Contract Labour in India*, New Delhi. Accessed on April 30, 2015 at http://www.ficci.com/spdocument/20189/Industrial-Relations-and-Contract-Labour-in-India.pdf

Annual Survey of Industries. 1994-95. *Report on Employment & Labour Cost* , Vol. II, Ministry of Statistics and Programme Implementation, Government of India.

Annual Survey of Industries. 2005-06. *Report on Absenteeism, Labour Turnover, Employment and Labour Cost,* Vol. II, Ministry of Statistics and Programme Implementation, Government of India.

Annual Survey of Industries. 2005-06. *Report on Employment & Labour Cost*, Vol. I, Ministry of Statistics and Programme Implementation, Government of India.

Annual Survey of Industries. 2011-12. *Summary Results for Factory Sector*, Ministry of Statistics and Programme Implementation, Government of India.

Annual Survey of Industries. 2011-12. *Report on Absenteeism, Labour Turnover, Employment and Labour Cost,* Vol. II, Ministry of Statistics and Programme Implementation, Government of India.

Besley, Timothy and Robin Burgess. 2004. 'Can Labor Regulation Hinder Economic Performance? Evidence from India'. *The Quarterly Journal of Economics,* Vol. 119, No. 1 (Feb. 2004), pp. 91-134.

Berg, Janine. 2009. 'Brazil: Unemployment Insurance. *ILO Notes on Crisis*, accessed on December 15, 2014, at http://www.ilo.org/wcmsp5/groups/public/---americas/---ro-lima/documents/article/wcms_limd3_5_en.pdf

Bhattacharjea, Aditya. 2006. 'Labour Market Regulation and Industrial Performance in India'. *The Indian Journal of Labour Economics*, 49(2), pp.211-32)

Bhattacharjea, Aditya. 2009. 'The Effects of Employment Protection Legislation on Indian Manufacturing'. *Economic and Political Weekly*, Vol. 44, No. 22 (May 30 - Jun. 5, 2009), pp. 55-62.

Carter, John; Michel Bédard and Céline Peyron Bista. 2013. 'Comparative review of unemployment and employment insurance experiences in Asia and worldwide'. ILO, Bangkok, Thailand. Accessed on November 15, 2014, at http://embargo.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/publication/wcms_229985.pdf

Dougherty, Sean M., Richard Herd and Thomas Chalaux. 2009. 'What is Holding Back Productivity Growth in India? Recent Microevidence'. *OECD Journal: Economic Studies,* Volume 2009.

Economic Survey. 2013-14. Ministry of Finance, Government of India, accessed on December 10, 2014, at http://indiabudget.nic.in/survey.asp

Federation of Indian Chambers of Commerce and Industry (FICCI) and All India Organisation of Employers (AIOE). 2014. *Suggested Labour Policy Reforms*, New Delhi.

Hasan, R and K Jandoc. 2013. 'Labour Regulations and Firm-Size Distribution in Indian Manufacturing', in Bhagwati, J and A Panagariya (eds.), *Reforms and Economic Transformation in India*, Oxford University Press, New York, NY, 15-48.

Hoda, Anwarul and Durgesh Kumar Rai. 2014. 'Trade and Investment Barriers affecting International Production Networks in India'. *ICRIER Working Paper* No 181, July

ILO. 2014. *Labour Laws and Growth of Micro and Small Enterprises: India-Country Report,* New Delhi, accessed on July 14, 2015, http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---sro-new_delhi/documents/publication/wcms_344397.pdf

Ministry of Labour and Employment. Government of India. 2014. *Annual Report for 2013-14*, Government of India, accessed on December 15, 2014, http://labour.gov.in/content/reports/annual-report.php

Ministry of Labour & Employment, Government of India. Government of India. 2015. *Draft Labour Code on Industrial Relations Bill, 2015,* accessed on August 25, 2015, http://www.labour.nic.in/upload/uploadfiles/files/latest_update/what_new/55407530d3bf5DraftCodeonIR28.04.20151.pdf

National Commission on Labour. 2002. *Report of the National Commission on Labour*, Volume1, Ministry of Labour, Government of India, New Delhi.

National Sample Survey Office. 1994-95. *Unorganised Manufacturing Enterprises in India: Salient Features,* NSS Fifty-first Round, Ministry of Statistics and Programme Implementation, Government of India.

National Sample Survey Office. 2000-01. *Unorganised Manufacturing Sector in India 2000 - 2001: Input, Output and Value added*, NSS 56tth Round, Ministry of Statistics and Programme Implementation, Government of India.

National Sample Survey Office. 2005-06. *Operational Characteristics of Unorganised Manufacturing Enterprises in India: Input, Output and Value Added*, NSS 62nd Round, Ministry of Statistics and Programme Implementation, Government of India

National Sample Survey Office. 2010-11. *Key Results of Survey on Unincorporated Non-agricultural Enterprises (Excluding Construction) in India*, NSS 67th Round, Ministry of Statistics and Programme Implementation, Government of India

National Sample Survey Office. 2010-11. *Operational characteristics of Unincorporated Non-agricultural Enterprises (Excluding construction) in India*, NSS 67th Round, Ministry of Statistics and Programme Implementation, Government of India

OECD. 2013. *Detailed Description of Employment protection Legislation*, 2012-2013, OECD EPL Database, update 2013. Accessed on December 22, 2014 at http://www.oecd.org/els/emp/All.pdf

Papola, T.S. 2013. 'Role of labour regulation and reforms in India – Country case study on labour'. *Employment Working Paper No. 147*, ILO, Geneva

Planning Commission, Government of India. 2008. *Eleventh Five Year Plan (2007–2012): Agriculture, Rural Development, Industry, Services and Physical Infrastructure*, Volume III, Oxford University Press, New Delhi

Shyam Sundar, K.R. 2012. 'The Contract Labour in India: The Battle between Flexibility and Fairness'. in *Contract Labour in India: Issues and Perspectives*, edited by K.R.Shyam Sundar, Daanish Books, New Delhi.

Sen, Rahul and Sadhana Srivastava. 2011. 'Integrating into Asia's International Production Networks: Challenges and prospects for India'. in *Studies in Trade and Investment 75.* India: A New Player in Asian Production Networks?, Edited by Witada Anukoonwattaka and Mia Mikic, UNESCAP.

UNCTAD. 2011. UNCTAD Liner Shipping Connectivity Index. *Review of Maritime Transport 2011*. The UNCTAD Secretariat. Available at http://unctad.org/en/docs/rmt2011_en.pdf (accessed November 3 2013).

World Bank. 2011. The Air Connectivity Index: Measuring Integration in the Global Air Transport Network. *Policy Research Working Paper 5722*. World Bank.

World Bank. 2012. *Connecting to Compete 2012: Trade Logistics in global Economy- The Logistics Performance Index and Its Indicators*. Available at http://siteresources.worldbank.org/TRADE/Resources/239070-1336654966193/LPI_2012_final.pdf (accessed November 10 2013).