The Future of Work: Democracy, Development and the Role of Labour

Theme: Labour Regulation

Impact of Labour Regulations on Employment Conditions in Indian Manufacturing

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One of the major problems that plagues the Indian economy is its stagnating manufacturing sector – contributing only 16 per cent of GDP and employing merely 12 per cent of its workforce (much lower than the manufacturing base of its major competitor in the world market, China). There is a pervasive view in literature that India's low and stagnating manufacturing base is *primarily* due to its rigid labour laws (Besley and Burgess 2004). This has generated a heated debate in the Indian policy circle, with strident calls for reforming its allegedly inflexible labour laws.

In this paper we first document the proposed changes/amendments in labour laws and assess their likely impact on workers' lives. Analysis of these amendments show that they will adversely affect a large array of working conditions; ranging from wage bargaining, security of employment, ability to form trade unions, legalizing child labour, discouraging women from joining workforce and safety at workplace, among others. However, it is noted that these laws affect only a small fraction of Indian manufacturing (namely, organized manufacturing) and analysis of its unorganized segment shows that, labour laws possibly cannot explain the overall stagnation afflicting the manufacturing sector.

However, the most important piece of legislation that has occupied the centre stage of debate on labour reforms in India – partially because other forms of social security benefits like paid holidays, pensions, written job contracts etc. are largely non-existent – is the law governing dismissal of workers. This law protects workers against arbitrary firing and stipulates that, *prior* government permission is *necessary* to retrench even a single worker from an establishment, employing 100 or more regular workers, engaged in manufacturing activity. This employment protective legislation, it is alleged, is at the root of India's stagnating manufacturing sector (Fallon and Lucas 1993). In this paper, we empirically examine the validity of this claim and do not find evidence in support of the conventional claim that, employment protective legislation deters employment and output growth in the Indian manufacturing sector. We also found evidence on firms facing no difficulty in adjusting their workforce in the event of fall in output demand.

Immediately the question arises how could firms adjust workforce if prior permission from government is a necessary condition to carry out retrenchment? In the final section, we show that firms took recourse to contract workers (*not* governed by employment protection law) to get around the law and this has major implications for wage bargaining – which is reflected in the

growing gap between real (and product) wages and labour productivity. This phenomenon is likely to aggravate since government has introduced fixed-term employment (basically short-term job contracts) in *all* manufacturing activities. Thus, the paper concludes that unless the regulatory regime monitors and strictly restricts the use of contract/fixed-term workers, *both* security of employment and wage bargaining is likely to take a hit.