

By Invitation

Rethinking Labor Law Reforms

Arun Maira

Indian labor laws must be improved. The improvements required must emerge from a dialogue between representatives of employees and employers. The failure to make any significant improvements in the laws so far, in spite of demands for over twenty years from both employers and unions, suggests that the processes used so far to try to change the laws have not been able to produce the required outcome. The paper also outlines the India Backbone Implementation Network, a Planning Commission initiative, conceived along with the 12th Five Year Plan by the Steering Group for Manufacturing.

Arun Maira is Ex-Member, Planning Commission.
E-Mail: arun.maira@nic.in

Introduction

“If you don’t know where you are going, you will end up somewhere else”, warned Casey Stengel, a famous baseball player. India needs to create more jobs. For that, it needs to build a competitive manufacturing sector. The drumbeat of (mostly right-wing, free market) economists and employers asserting that India must change its labor laws to permit easier firing of workers is misdirecting the country from its goals.

Do we want a sustainably strong manufacturing sector, or do we merely want to change our labor laws? We must stay focused on our goals of a competitive manufacturing sector and more jobs and not get distracted by a rather shallow presumption that easier firing of workers will lead to growth of competitive manufacturing enterprises. Let us understand the relationship between these two objectives: one supposedly the means to the other.

At the outset, it must be admitted that change in Indian labor laws is overdue. Many are very old and must be up-dated to suit present conditions. There are too many laws and regulations, sometimes contradicting each other. And the laws

are not implemented properly, perhaps because many cannot be implemented in practice, or because the government machinery to implement them is inadequate. Not only are employers demanding improvements in labor laws, unions are too. We will return to the questions of what the thrust of changes should be and how to bring them about. First, let us examine what is required to grow India's manufacturing sector to create more employment.

Constraints on Growth

Labor laws are not the principal constraint, or even amongst the top three or four constraints on the growth of India's manufacturing sector. Many surveys in the past few years, conducted by several industry associations, consulting organizations, and government commissions have revealed this. The principal constraint, for both large and small enterprises, is the quality of the business regulatory environment. India ranks towards the bottom of the World Bank's rankings of countries for ease of doing business and its position has been slipping. Implementation of business regulations is more corrupt, confused, and tardy in India than in other countries. This deters investments from abroad and from Indian investors too. It especially saps the productivity of small enterprises where the owner has to personally respond to the regulators when he is also the manager of the business to which he must give more attention. Since small enterprises are the largest creators of employment in the manufacturing sector (and account for a large share of its produc-

tion and exports too), political and bureaucratic capacities (which are constrained too) should be applied to address this number one constraint on the productivity and growth of manufacturing enterprises, and not be distracted towards lower order constraints such as the ostensible difficulties in firing workers.

The second, almost equally large impediment for the productivity and competitiveness of manufacturing enterprises in India is inadequate physical infrastructure for transportation and power supply. Indian IT enterprises are not handicapped by these shortcomings and so many have grown to be world-class competitors. However, manufacturing enterprises have to convert stuff and move stuff, and this requires energy and physical transportation. They are severely handicapped by the poor infrastructure: it adds to costs and delays and reduces their international competitiveness.

The third constraint is the availability of skilled manpower. Since the country's objective is to employ more people in manufacturing, and since skilled persons can also improve the productivity and competitiveness of enterprises they work in, this constraint must be relieved very vigorously. A national skills mission has been launched with impressive targets. It needs much more participation of employers for development of requisite skills: more about this later.

Large enterprises and MSMEs have different constraints. In fact, one of the greatest constraints on the growth of small enterprises in India is the availabil-

ity and cost of credit, whereas large enterprises do not have a problem obtaining loans from banks and at lower rates than MSMEs (though the cost may be higher than in other countries). The distinction between the needs of large enterprises and SMEs must be always remembered while devising strategies to grow India's manufacturing sector. Too much of attention of policy-makers is given to the views of large enterprises, who get the attention of policy-makers through powerful business associations and directly too, rather than the perspectives of SMEs.

Some economists have pointed out that India's manufacturing sector has a 'missing middle'.

MSMEs and larger enterprises have different issues with labor laws. Many MSMEs are in the informal sector. Many of those in the formal sector fall below the threshold limits of industrial relations' laws. They do not need more freedom to legally hire and fire: their contracts with employees are informal and flexible. It is the large enterprises who say they are impeded by laws that make it difficult for them, legally, to fire their employees. They have got around the restrictions by employing large numbers of contract workers, always at lower costs than permanent employees. Therefore, in practice, the labor laws have not come in the way of their hiring more people. So, if these enterprises have not grown and have not hired even more people, the constraint has not been the labor laws. Other constraints, mentioned before, have

restrained their competitiveness and growth.

Some economists have pointed out that India's manufacturing sector has a 'missing middle'. There are too many MSMEs, and some large companies, and too few in the middle. They point to a barrier that MSMEs do not wish to cross to become bigger. According to some of these economists, the barrier is the onerous restrictions on firing people once the enterprises become larger. However, as suggested here, this may not be as much of a restriction as it is made out to be. Other factors impede growth even more.

Such an architecture has been mooted by the NMCC and MSME ministry. This would give incentives to MSMEs for a fixed number of years.

The MSMEs themselves point out that the architecture of incentives to MSMEs induces them to stay small. Incentives are given to enterprises below a threshold size. Therefore, when they cross that threshold, they lose the support. So they would rather multiply numbers of small units, each of them getting the incentives, than grow a large one and lose them. An alternative architecture of schemes to assist MSMEs is required if the objective is to help them grow stronger and larger. Such an architecture has been mooted by the NMCC and MSME ministry. This would give incentives to MSMEs for a fixed number of years, during which they must make all efforts to improve their productivity and grow,

because they will lose the incentives thereafter. This will motivate small enterprises to learn and improve faster and cross into the zone of the presently 'missing middle'.

The strategy to grow Indian manufacturing enterprises must be to improve their competitiveness, rather than to provide them with protection against larger and stronger competitors. To improve their competitiveness, enterprises must be faster learning than others. The only resource in a manufacturing enterprise that has the ability to learn and improve its capability and productivity are its employees. The capability of all other resources—machines, buildings, materials—depreciates with time, inevitably. Far-sighted employers understand that employees are the only 'appreciating assets' of a manufacturing enterprise. Motivated and enabled employees can also improve the capability of the enterprise's manufacturing processes and the productivity of its machines.

People, Skills, Jobs

India has the world's largest pool of young persons seeking jobs. Human beings are a trainable resource. Manufacturing enterprises in India, wanting to compete with enterprises in other countries should design their manufacturing systems to use more human beings and less capital. A manufacturing enterprise in India that has the ability to improve employee skills can count on a continuing supply of trainable people, and thus have a sustainable competitive advantage over enterprises elsewhere.

The Planning Commission asked Bain and Company to do an independent, objective evaluation of the co-relation of competitiveness of Indian manufacturing enterprises and their industrial relations' practices. Bain connected the economic performance (growth, profits) amongst Indian enterprises in several manufacturing sectors with their orientation towards employees. The study confirmed that enterprises in which employees were treated as 'appreciating assets' produced better economic results over the long run than their competitors who took a more short-term, 'cost' oriented view of employees.

Enterprises in which employees were treated as 'appreciating assets' produced better economic results over the long run than their competitors.

Economists who wish India well would want manufacturers in India to employ more people and pay them better too. More employment and more earnings will give a boost to economic growth. However, this win-win solution is not being realized because owners of enterprises are facing problems with employees. Employees do not have the requisite skills, they say. When employees are dissatisfied they can create industrial relations problems. Therefore the general response of employers, with a few notable exceptions, is either, use machines instead of people if they can afford them (the cost of capital is high in India, and SMEs cannot raise it easily) or, hire more temporary/contract workers, who do not

yet have the ability to organize themselves (though they are beginning to), and are easier to fire legally.

Such tactical manoeuvres are diametrically opposed to the strategy to make India a globally competitive manufacturing hub. There is little incentive to train temporary/contract workers, so skill development is constrained when India is crying for more skill development. Moreover, contract workers are paid much less than others, leading to industrial relations disputes. Thus employers' relationships with people in their enterprises are becoming fraught. With this trend, manufacturing may be in a downward spiral, at a time when, for improvement in competitiveness of Indian manufacturing enterprises, people (and more of them) must be at the heart of enterprises' strategies.

To build a globally competitive manufacturing sector, India must expand the scope of its vocational skills program. More technically skilled workers are required of course. Even more than that perhaps, employers in the garments and other labor-intensive sectors say they need good supervisors who can manage work and people well. Productivity improvements and skill development happen on the shop floor and good supervisors are critical for these.

Above all, the country needs very good systems' and people managers who will improve competitiveness of manufacturing enterprises by managing the interplay of the many systems that interact to create faster learning enterprises.

These systems include material flows, information flows, processes for quality, productivity improvement, and very importantly, the human side of the enterprise.

Manufacturing management must become an attractive vocation for India's best engineers.

India's massive vocational skills program must address the need for better manufacturing managers too. 'Manufacturing management' must become an attractive vocation for India's best engineers, whereas they have been gravitating to the IT industry, building its international competitiveness, at the cost of India's manufacturing sector. Churning out more skilled workers can be a socio-economic fix that will back-fire if these skilled workers do not find jobs. To create jobs, the competitiveness of Indian manufacturing enterprises must be rapidly improved. To improve the enterprises' competitiveness, better manufacturing managers with skills to nurture human assets and manage complex systems will be required in much larger numbers than what India is generating at present.

It is not surprising that countries such as Germany, Japan, and Sweden, which have maintained (and even increased) the competitiveness of their manufacturing sectors, even as wages increased and their currencies became stronger, have a long term orientation towards human assets. In these countries, there is much greater commitment to the continuity of

employees in service. To them, 'flexibility' in employment is the ability of employees, supported by employers to learn new capabilities, rather than the flexibility of employers to quickly dispense with employees' services.

For India to reach its goal, of creating 100 million additional jobs in manufacturing, which it must, owners and managers of manufacturing enterprises in India must treat human beings as their core asset and not a problem to be avoided.

What about Labor Laws?

We return now to the question of labor law reform. Labor laws must be examined by keeping in mind the goal we want to achieve. Which is to grow India's manufacturing sector and employment in it. Whatever reforms are to be made in the labor laws must be assessed with this goal in mind and must support the strategy required to reach it.

Relations between employers and employees must become co-operative, not confrontational.

The strategy has to be to build rapid learning enterprises with employees at their heart. Relations between employers and employees must become co-operative, not confrontational. Together, enlightened employers and responsible unions must establish processes that will build trust within enterprises. Together, they can determine what changes in labor laws are required. Industrial relations

will be damaged if Government forces any changes in labor laws that are not founded on an understanding between unions and employers about what changes are required to ensure fairness to employees and enable faster learning and improvement of competitiveness in enterprises. It is not politically feasible for Government to change the laws without the support of both unions and employers. The lesson from France is instructive. The productivity and growth of France's manufacturing enterprises have been hampered by rigid labor laws. Last year, the French government changed the laws without too much contention. The minister-in-charge explained that the Government was able to make the changes because the unions and employers, following the German example of cooperation, came to an agreement about the changes required which they put to the Government to implement.

The World Bank's annual World Development Report, 2013 focused on 'Jobs'. The need to create good quality jobs has become a major challenge for policy-makers in many countries, including developed ones where youth unemployment is over 25%. The Report points towards approaches that policy-makers should adopt to create jobs. It says: "A careful review of labor policies in developing countries yields a mixed picture. Most studies find that impacts are modest—certainly more modest than the intensity of the debate would suggest. Across firm sizes and country levels of development, labor policies and regulations are not among the top three constraints that formal private enterprises face."

“There is no consensus on what the content of labor policies should be. Views are polarized, reflecting differences in fundamental beliefs. To some, labor market regulations and collective bargaining are sources of inefficiency that reduce output and employment, while protecting insiders at the expense of everyone else.....To others, these policies provide necessary protection to workers against the power of employers and the vagaries of the market.”

The Report says, “The challenge is to set labor policies on a plateau—a range where regulations and institutions can at least partially address labor market imperfections without reducing efficiency.”

The ‘plateau’ is a coherent combination of regulations, processes, and orientations amongst the stakeholders—employers, workers and their representatives, and regulators. The plateau (or the edge) between too rigid regulations and too little regulation, and between sclerotic institutions and no legitimate institutions, has to be found in each country, within each region, and even within enterprises. Within the same country and the same national labor laws, some regions and some enterprises have more harmonious human relations and thereby more competitive enterprises.

The discovery of the plateau requires deliberations amongst the stakeholders at regional, state, and enterprise levels. Changes in labor laws may be necessary, and in India some changes are required. However, the discovery of what these

changes will emerge from the stakeholder engagements that will address the composite of processes, orientations, and regulations. The changes required in laws cannot and must not be debated in isolation of these grounded, multi-stakeholder engagements. Reforms in processes are critical; not merely reforms in laws.

Improving Trust & Co-operation

Indian labor laws must be improved, as mentioned before. However, the improvements required must emerge from a dialogue between representatives of employees and employers. We must find our own ‘plateau’. The failure to make any significant improvements in the laws so far, in spite of demands for over twenty years, from both employers and unions, that something should be done suggests that the processes used so far to try to change the laws have not been able to produce the outcome required.

The tripartite Government-led process (the Indian Labor Conference) has not been able to overcome the trust deficit between unions and employers.

The India Backbone Implementation Network (a Planning Commission supported initiative, about which more will be said later) has examined several processes that have been applied so far. The examination revealed that the tripartite Government-led process (the Indian Labor Conference) has not been able to overcome the trust deficit between unions and employers. Agreements supposedly

reached at its meetings are not followed through. On the other hand, bi-lateral processes, such as those facilitated by the ILO, do enable better dialogue. But they are not able to convert discussions into enforceable decisions because Government seems a reluctant participant in them.

The India Backbone Implementation Network was conceived along with the 12th Five Year Plan by the Steering Group for Manufacturing. The Group had agreed, at the outset, that a plan to create 100 million additional jobs in the manufacturing sector, by improving the competitiveness of enterprises and accelerating the growth of the sector (which has been languishing at below 16% of GDP) will not be sufficient. The root causes for the country's failure to implement its previous plans to grow manufacturing must be analyzed and addressed too. The root causes for slow implementation, it was found, were (1) unresolved contentions amongst stakeholders on a variety of issues (land requirements, environment clearances, industrial relations, etc) and (2) confusion in implementation of solutions even when there was agreement. For these reasons, infrastructure is not being built fast enough, projects are stuck, skills are not being developed adequately, etc.

The Planning Commission set about finding ways to convert contention into collaboration, confusion into coordination, and thereby convert intentions into implementation. Processes and techniques for this were searched for in countries that have good track records for building

sustainably strong manufacturing sectors by cooperation amongst stakeholders. The India Backbone Implementation Network (IbIn) was created to promote the use of such approaches in India to accelerate the growth of employment in India's manufacturing sector.

IbIn has brought national unions and employers' federations together to consider some fundamental questions for cooperation:

- Do 'we' seriously want to improve industrial relations?
- What is required to be done by us 'together' to enable improvement of industrial relations?
- Are we willing to try a better method to achieve our objective?

Several meetings have been held amongst the stakeholders. There is agreement that both unions and employers want better industrial relations, and for this the trust deficit between them must be reduced. This will require a greater willingness to listen to each other and co-create solutions. Both sides have agreed that they must follow a systematic 'IbIn' process which will move along two tracks:

1. Resolve issues that have not been resolved so far, systematically, with a better process (For the record here: the principal, urgent issue in large enterprises is contract labor, and for MSMEs it is social security. The right of employees to form unions is the other important issue.)

-
2. Pay explicit attention to the quality of the process of dialogue, and strengthen it to increase trust and create a stronger platform for the stakeholders' dialogue for solutions

The second objective, the building of a strong platform for purposeful dialogue, is essential to achieve the first objective. A strong platform will produce several benefits:

- The root causes of poor productivity and competitiveness of manufacturing enterprises will be analyzed, and can then be addressed
- Better practices for addressing these root causes and improving industrial relations will be discerned and disseminated
- There will be agreement on what changes are required in the content and in the implementation of labor

laws to improve competitiveness of manufacturing enterprises, grow the manufacturing sector, and increase employment

An understanding of what changes should be made in the labor laws will be an outcome of a process of cooperation between unions and employers' federation. Attempts to force a change in labor laws to enable easier firing of employees, which is being demanded by some employers and some economists, will decrease trust which is insufficient amongst employees and employers, when there is need to increase trust.

A stronger platform for dialogue is required. Using this platform the stakeholders in India can discover the 'plateau'—the combination of practices, processes, and laws—that the World Bank report on Jobs has analyzed as the policy solution for accelerating growth of employment in manufacturing in all countries.