

By Invitation

Labor Market Flexibility & Trajectories of Development: Lessons from Brazil, India & China

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In China, labor policy first diluted employment security rights to facilitate re-allocation of labor to the private sector. When new labor problems emerged, policy shifted to re-regulate the labor market. Brazil's success in achieving economic growth and social progress simultaneously is unparalleled: informality, income inequality and unemployment decreased. India needs macro-level flexibility in re-allocating labor from informal to formal work, from rural to urban areas, and from the unskilled to the skilled. Micro-level flexibility through termination of employment must be coupled with stronger social security programs for adequate severance pay and re-training for other employment and also stronger protection for workers in the informal sector.

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Introduction

The debate around labor reforms in India became prominent once again with the election of a majority BJP government in May 2014. This change in government came when despite much debate in the past, the previous Congress-led governments had failed to undertake any significant reform. Great expectations now await the new government for reforms in labor policy. It is in this context that we examine the labor and employment system in India with particular attention to the issue of labor flexibility.

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Recent research in India has richly documented the dysfunctions of the Indian industrial relations system to establish the case for substantive reforms in a number of areas (Shyam Sundar, 2012; 2011; Sharma 2006; Sodhi, 2011). However, when one considers potential solutions there is an alarming lack of con-

sensus on possible directions for reform. It is arguably one of the reasons why previous governments found themselves stymied into inaction. The analysis in this paper explores possible avenues for reform around which parties to the employment system could converge. It can be useful to look for relevant lessons from both inside and outside India in a search for better ideas. It is in this spirit, that we compare the labor and employment systems in India, China and Brazil. These insights can be useful in breaking the gridlock around labor reforms, which in turn, could contribute to sustained economic development.

Why compare India with China and Brazil? Despite significant differences, these three countries face many similar challenges. They are striving to reduce poverty, improve education and health, and to become full employment economies. All three are among the biggest countries in the world in terms of population, landmass and total GNP. Together with Russia they became known as BRIC, a moniker for investors looking to profit from high growth emerging economies.

China and Brazil also share many of India's challenges in making their labor and employment systems more skilled, productive and flexible. For example, in moving its 450+ million workforce from the public sector to the private sector, China faced a challenge unprecedented in history in scale and scope. Labor regulations needed to be changed dramatically. This transformation of the labor market is far from being perfect or complete but a substantive set of regulations was put in place to facilitate this large-scale re-allocation of labor. Brazil, al-

ready a middle-income country, faces the challenge of moving its labor and employment system to the next higher level from its current plateau. Most skilled labor is in short supply despite a large labor pool that is largely unskilled or semi-skilled. Labor regulation is designed to protect workers and jobs but its large informal economy leaves many workers unprotected. So, improving the skills of its workforce and reducing informality in the labor market are significant challenges.

In the next section we provide a brief comparative sketch of the main characteristics of the three countries. This is followed by an overview of the Indian case for labor reforms. Lastly, we review the lessons that policymakers in India can draw from the experiences of China and Brazil for developing a consensus around much needed labor reforms.

BIC: A Comparative Overview

India and China are the only countries in the world with a population in excess of one billion each. Although Brazil is much smaller with a population approaching 200 million, it is the dominant economy in its neighborhood much in the way that India dominates South Asia and, China, the global economy. There are other similarities. Although China has been able to sustain its high growth rate over a much longer period, both India and Brazil are also considered to be emerging economies that boosted their historically anemic growth rates to new highs in the most recent decade. High rates of growth have generated more jobs, reduced poverty and raised the aspirations for a better life. Scores of enterprises from these three

countries have confidently expanded at home and overseas.

income countries (USD 11,208), India at the low end (USD1,499) with China near the middle of this range (USD6,807) (Table 1).

In terms of per capita GDP in 2013, Brazil was at the higher end of middle-

Table 1 A Comparative Look at Brazil, India, China

	Year	Brazil	India	China
Population (millions)	2013	200.4	1,252.0	1,357.0
GDP per capita (US\$)	2013	11,208	1,499	6,807
Av Annual GDP Growth Rate (%)	5-yr: 2009-13	3.6	7.0	10.1
	10-yr:2004-13	4.6	6.7	8.9
Average Annual Inflation Rate (%)	2006-13	5.2%	9.3%	3.7%
Human Dev Index (HDI)	2012	0.73	0.554	0.699
HDI Rank	2012	85	136	101
Adult Literacy Rate	2010	90.0%	62.8%	94.0%
Male Life Expectancy (yrs)	2010	70.7	64.4	72.1
Female Life Expectancy (yrs)	2010	77.4	67.6	75.6
Doctors per 1000 pop.	2010	1.8	0.6	1.4
Fertility Rate (Per Woman)	2010	1.8	2.5	1.6
Workforce in Agriculture (%)	2011	15	47	35
Labor Force Participation Rate - Total	2012	70.0	56.0	70.7
Labor Force Participation Rate - female	2012	50.1	29.0	64.0
Trade Union Density (%)	2010	17.8	2.4	NA
# of Strikes & Lockouts	2008	411	423	NA

Sources: www.wdi.worldbank.org

Trade Union Density and Strike data from www.ilo.org

There are a number of similarities and differences in factors relating to workforce development and the resulting flexibility of labor. First, India has the youngest workforce while Brazil has the oldest of the three countries. The population pyramid for Brazil has been shrinking now for many years already. In China, the pyramid has just begun to shrink while in India it is still expanding at the base. These trends suggest that

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India has the largest share of its population still living in rural areas and dependent on agriculture. This share is the lowest for Brazil, which has become a largely urbanized country in recent decades. But despite such urbanization Brazil's workforce is underutilized in the north and the north-east while southern Brazil experiences critical labor shortages. Brazil is also a large landmass with relatively poor infrastructure that makes it hard to relocate the workforce and jobs.

India is the smallest of the three countries in terms of area but poor infrastructure creates problems of mobility with attendant adverse consequences for flexible allocation of labor. China is also a large land mass and has experienced uneven development between the fast developing north and coastal areas on the one hand and the less developed regions of central and western China on the other. Large investments in coastal infrastructure have made China an export powerhouse but its challenges in managing migrant labor resulting from the uneven development remain substantial.

In terms of inequality, Brazil has the highest degree of income inequality of the three countries. Its Gini coefficient, a measure of inequality, was 54.7 in 2009 compared to 33.9 in India (measured in 2010) and 42.1 in China (also measured in 2010). But, whereas inequality increased in both China and India since the 1990s, Brazil is among the few countries that have managed to reduce inequality in recent decades. Its Gini coefficient declined from an exceptionally high level of 63.3 in 1989 to 54.7 in 2009. For India, the Gini increased relatively moderately from 30.8 in 1994 to 33.9 in 2010. In China, inequality rose more significantly from 32.4 in 1990 to 42.1 in 2009.¹

¹To put these coefficients in perspective, it may be noted that among the developed countries, Norway (26), Sweden (25) and Germany (28) are relatively more equal while the U.S. (41) is at the high end with Australia (35 in 1994), Canada (33), France (33 in 1995) and the UK (36 in 1999) falling in the middle of the range. Unless otherwise noted Gini coefficients were measured in the year 2000. All Gini coefficients accessed from wdi.worldbank.org

Both China and India have followed a trend that Piketty (2014) contends is a law of development itself: the rate at which wealth becomes concentrated in a few hands, i.e., rate of rising inequality, exceeds the rate of economic growth. So, even as countries grow economically, they inevitably contribute to rising inequality. This is a challenge for all societies but for developing nations it poses a specially difficult challenge: how to sustain growth that would raise living standards for all without increasing inequality or even better, while reducing inequality?

Flexibility Debate

The labor flexibility debate is often framed within the narrow context of the workplace or the level of the firm. In India, a major demand of those advocating for greater labor flexibility is to ask the government to spell out an “exit” policy that would make it easier for employers to terminate employment for workers who are no longer needed because of changes in technology or in demand for its products or in its financial ability to sustain a workforce. By itself this is not an unreasonable demand. Schumpeter’s concept of “creative destruction” captures well the dynamics of economic growth in our era of globalization. No job or workplace or firm can remain unaltered for forever. The need to restructure, reorganize and refocus the enterprise is forever present in the global economy and it needs to be facilitated by domestic policy for sustained growth.

This approach to flexibility has been criticized by a number of scholars for

various reasons that are discussed in the next section. The purpose here is to put this debate in the larger context of development so that we can look beyond India's borders for lessons on how best to facilitate flexibility. The narrowly-framed flexibility debate loses its moorings if it is not embedded in the larger context of India's developmental needs. When one examines the larger context for human resources in India, a number of issues become apparent.

First, India has a much larger share of its population in rural areas. In 2013, 68% of India's population lived in rural areas while in China, this proportion was 47% and shrinking rapidly. In Brazil, less than 15% of the population is rural. The generally accepted wisdom is that it is extremely difficult to raise incomes, provide a decent level of education and health services, and create a full employment economy if a large share of the population lives in rural areas. It is for this reason that China has embarked on an ambitious program to urbanize its population (Yusuf & Saich, 2008; Davis, 2013; China Development Research Foundation, 2013). Urbanization does not necessarily mean that there has to be a shift of rural population to existing cities, which would be a huge challenge in itself given that Indian cities are already overcrowded. Rather, it implies that more areas need to be urbanized by developing smaller towns into cities. Any new labor policy initiatives need to carefully weigh the implications for future urbanization. Labor policies need to create the kind of flexibility that would smoothen the path to urbanization. An urbanization

strategy would involve massive investments in construction of urban infrastructures. From this perspective, it can be argued that India needs not only labor flexibility at the micro level but also help urbanize its population.

India's skill development infrastructure lags behind its aspirations for ambitious and sustained economic growth.

Second, India's skill development infrastructure lags behind its aspirations for ambitious and sustained economic growth. The skill development infrastructure includes the basic education system, the post-secondary and post-graduate university level institutions, on-the-job workplace training, and research institutions. Drèze and Sen (2010) emphasize several key ideas about basic education in India. First, basic education has been neglected by all elites including the government, employers and unions. They speculate that this neglect may be related to the potential of education to challenge power and privilege vested in the status quo. Second, basic education has been limited in its reach. Literacy levels, even according to government supplied and somewhat inflated statistics, remain low compared to China and Brazil. The adult literacy level in 2010 was 62.8% compared to 90% in Brazil and 94% in China (Table 1). Female literacy levels are reportedly even lower although reliable estimates are hard to find. Third, there are large variations in primary school attendance and achievement within the system across provinces, gender, family

income and the urban-rural divide. Fourth, although some gains have been made in literacy levels in the last two decades, the system remains far short of even the modest goal of achieving universal primary education up till the age of 14. Moreover, school attendance, the most common measure of education, says little about the level of learning taking place. Numerous surveys have found public schools largely understaffed and underfunded, often lacking the most basic facilities such as a separate toilet for girls, let alone qualified and dedicated teachers (Drèze & Sen, 2010).

India has some excellent post-secondary and post-graduate educational institutions. The Indian Institutes of Technology and the Indian Institutes of Management have acquired national and international prominence in post-secondary education in technology and management respectively. A few dozen other universities and research institutions have similar reputations for excellence. However, for many other hundreds of thousands of qualified students, world-class higher education remains out of reach. The RUSA² initiative launched in October 2013 by the Government of India is an ambitious effort to improve the share of high school graduates going on to post-secondary education from 19.4% in 2012-13 to 30% by 2020 (Deloitte, 2013). A similar initiative for vocational education was set up in 2009. The National Skill Development Mission set up a three-tier structure with

the goal of bringing industry-relevant vocational education to 550 million people by 2022 (Sodhi, 2014). These campaigns seek to improve the quality of higher education through a series of administrative reforms, coordination with states, and improved targeted funding to institutions based on meeting performance targets. Although it is too early to tell if these campaigns are yielding the desired results, these initiatives provide a clear signal that policymakers are taking note and tackling the education deficits at the highest levels of policymaking.

Labor Flexibility Argument & Evidence

The argument for labor flexibility is that workplace level labor flexibility allows for efficient allocation and re-allocation of labor to fit the demand pattern for products or services. This flexibility allows the enterprise to operate at optimal efficiency that, in turn, makes it competitive. The ensuing efficiency and competitiveness would then attract new investments and lead to growth in output and, ultimately, in jobs. Although intuitively appealing, this argument needs to be placed within the industrial relations context and validated by evidence.

Several studies have examined the empirical evidence for the hypothesized effects of labor flexibility on efficiency and welfare outcomes. An ILO study is worth mentioning because of its scope and comparative focus. Sharkh (2008) examined evidence from a number of countries that span the spectrum in terms of both labor flexibility and social security programs. The

²Rashtriya Uchchatar Shiksha Abhiyan (RUSA) in Hindi translates approximately to: National Higher Education Campaign.

underlying hypothesis comes from the notion that system performance is enhanced not simply by making labor flexible but by combining labor flexibility with a safety net, the so-called “flexicurity” principle (Keller & Seifert, 2002; Sarfati & Bonoli, 2002). The study concluded that the relationship between labor flexibility and system outcomes is more complex than suggested by proponents of labor flexibility. Moreover, a system could do well on some outcome measures such as employment but that outcome may be associated with other less desirable outcomes such as greater inequality. In other words, there is no magic bullet. Within those qualifiers, the study did find that countries that were high on labor flexibility but poor on the safety net were not the star performers. Equally, countries that were low on labor flexibility but high on the safety net also performed sub-optimally. However, an optimal middle ground on the flexibility-rigidity scale where a basic form of social insurance when combined with moderate dismissal protection, yielded better results across a range of outcomes. The message for policymakers is that simplistic notions of creating labor flexibility by removing protections for labor can be self-defeating particularly for developing countries. Rather, countries hoping to improve system outcomes ought to combine labor flexibility with enhancements in the safety net if they are to achieve goals of economic growth and of increasing worker welfare at the same time.

Flexibility Debate in India

Certain facts and trends concerning labor flexibility in India have become clear in the evidence and the debate that

has occurred in recent years. First, India has one of the strongest legal regimes of employment protection. Second, the legal regime suffers from a proliferation of regulations that often overlap and are not easy to follow. Most writers on the subject acknowledge this complex web of laws and advocate the kind of simplification that would lead to better understanding of the regulations and thereby, better compliance (Sharma, 2006).

Bhirdikar, Paul and Murthy (2011) analyzed industry data to examine the link between labor market flexibility and employment over 1999-2006. They found that formal employment shrank even as contract and informal employment grew significantly. It suggests that employers have increasingly resorted to contract labor and to informal work to cut labor costs. Employers have effectively bypassed the formal legal protections that make re-allocation of labor rather inflexible. Within the organized manufacturing sector they found a trend towards hiring contract labor and a rise in flexible work arrangements. In services, economic growth boosted employment but the bulk of it was in informal employment. Importantly, they found that states with stronger worker protection laws, accounted for more workers hired on contracts. Another study examining the effect of external shocks (in this case, average rainfall) on employment found that states with more pro-employer legal regimes did show relatively higher employment effects compared to states with more pro-labor regulations (Adhvaryu, Chari & Sharma, 2013). These findings suggest that the strong worker protec-

tion laws do not necessarily correlate with more (and secure) employment.

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The evidence from such studies suggests that flexible regimes do result in greater employment but even these jobs are often contract jobs or in the informal sector. Labor protection laws appear to have been largely by-passed by employers to create *de facto* labor flexibility given that there have been almost no changes in legal regulation (Sharma, 2006, Shyam Sundar, 2012; Maiti, 2013). The labor market has been rendered flexible despite restrictive labor laws due to the large informal sector and casualization of employment in the formal sector.

Economic Growth & Labor Regulation in China

China is currently closing the gap between the world's largest economy, the U.S., and itself at a fast rate. It is expected to be the world's largest economy sometime in 2014 if GDP is measured in purchasing power parity (PPP) terms and by 2025 in exchange rate terms, if current trends in GDP growth rates continue for another decade. China's scale and the enormous transformation of its economy within a generation, provide a unique opportunity to learn about the inter-related dynamics of economic and social development. When China began to liberalize its economy in 1977-78, it faced two huge

challenges in terms of its labor force. First, it needed to shift some 450+ million people from the state sector to the private sector. Second, a huge migration was to occur from rural areas to the urban centers. Labor and employment policies were continually adjusted over the last thirty-plus years to facilitate these transitions. Although some of these policy initiatives did achieve desired results, many gaps persist in both policy and outcomes that need to be addressed through further reforms. To facilitate the transition to the private sector, policymakers in China had to first undo the employment and wage laws of the previous era when the "iron rice bowl" defined a system of lifelong employment security and state-fixed wages. So, a *de facto* deregulation of employment security and wage fixing was instituted. Before 1978, all workers in China were assigned to jobs by the state after completion of education. Wages were also fixed by the state. Employers could not fire workers, which resulted in lifetime employment for all. This employment system reduced mobility and incentives, and led to inefficiencies due to overstaffing, low morale, and low productivity (Meng, 2000).

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Reforms first took root in the rural farm sector where effective deregulation of prices led to rapid mechanization, rising yields and increasing incomes. It was not until the mid-1990s that the government began restructuring state-run

enterprises. The largest state-owned enterprises would remain with the state while smaller ones were cut loose from state finances to compete in the marketplace on their own or go bankrupt. To accomplish this transition, labor policy was revised in 1986 to allow employers to hire on a contractual basis. Wages were also deregulated in the emergent private sector. Lastly, workers were encouraged and supported, financially and with requisite training, to become self-employed in their own small business. Within a few years of such deregulation, millions of state sector workers were laid off with some compensation, who then began to swell the ranks of the private sector (Meng, 2012; 2004; Appleton, Knight, Song & Xia, 2002; Giles, Park & Cai, 2006). Known as the *xiagang*, they numbered over 40 million by 2002 (Betcherman, 2005).

China's system of *hukou*, i.e., a permit that defines residency as rural or urban, played an important role in the transformation. It allowed the government to control allocation of labor first within the urban system and later from rural to urban areas. Brazil and India have no equivalent system which effectively makes the allocation of labor more market-driven but it also fuels the growth of the informal labor market with all its attendant problems of worker protection. Although China continues to ease its restrictions on rural-urban migration, a majority of the population still holds rural *hukou*. Meng (2012) puts it at 72% of the population based on the 1% Population Survey of 2005 and other NBS data.

Even as state enterprises were shedding employment more than 100 million rural workers moved into cities by 2002. What rural migrants could get were sometimes referred to as 3D jobs: dirty, dangerous, and demeaning. Rural workers were generally less educated but more likely to be employed because of their willingness to accept jobs that urban workers would refuse. Their numbers have continued to rise with the rapidly growing economy. By 2012, there were more than 260 million migrant workers, with an average monthly salary of 2,290 yuan (\$374.09), according to a report by the National Bureau of Statistics of China (Song, 2013).

These two large-scale mobilizations, i.e., state sector to private sector and rural to urban, encapsulate both the triumphs and the trials of China's strategy to restructure its labor market. The deregulation of wages and employment facilitated the movement but at a considerable human cost. Policy responses to the problems created by these mobilizations can be divided into two parts: an earlier stage of providing immediate relief to dislocated workers and a later stage of re-regulation to address long-term problems of a freer labor market. Each of these is discussed in turn.

When a worker lost her (or his) job with a state-owned enterprise, she also lost with it the social protection and services that came with these jobs. In 1998, the government under pressure to provide some relief, introduced a new labor adjustment policy requiring state-owned enterprises to provide a living allowance

and maintain social services for laid-off workers for up to three years while the worker searched for reemployment. If after three years, a worker was not re-employed, he would finally separate from the enterprise and seek unemployment benefits from the state. A centralized unemployment program was established in the early 2000s. However, its coverage and operation fell short of expectations at least in its early years. There were numerous cases of labor protests erupting because workers had not received payments and/or benefits as promised or provided for in formal regulations. In many cases, local or state governments have had to assume the financial burden of these regulations. Where layoffs were particularly large and could not be met by the local or state governments, the central government stepped in to ensure that workers were paid (Betcherman, 2004).

Even as the private sector grew it gave rise to new labor problems from non-payment of wages and violations of work hours requirements to unsafe working conditions. The policy response was to introduce new legislation to regulate in emerging areas while reinforcing already regulated areas. In particular, two laws exemplify this phase of re-regulation. In 2004, a special regulation on minimum wage was issued which was a revision of the “Enterprise Minimum Wage Regulation” of 1993 (Cooke & Rubery, 2002). It did not set a national minimum wage but rather created rules under which state governments could set minimum wages for cities or municipal-level aggregations after consulting unions and

employers at the local level. Further, the Labor Contract Law came into force beginning January 1, 2008. This legislation laid down the fundamental framework for the employment relationship. It spells out the terms that must be included in every employment contract from initial appointment to rules for termination of employment and severance pay. For many workers who had enjoyed absolute employment security in the pre-reform era this law was a final notice that the old system was now permanently replaced by a new regime that allows employers to lay off workers and terminate employment under certain conditions. For many others who had experienced the turmoil of the transition era after reforms with confusion over their rights as an employee, this was a welcome wind blowing in greater order and clarity over rules of the employment game. The Labor Contract Law was followed up with the Labor Disputes Mediation and Arbitration Law (LDMAL) which specifies how disputes are to be resolved including arbitration. It is an integral part of ensuring that workers’ rights under the Labor Contract Law are protected when disputes arise.

Two challenges stand out that are now shaping labor regulations in China: first, a significant growth in the informal economy, and second, the rising level of labor unrest.

By 2012, the private sector in China accounted for over 60% of the national output (Yiyuan, 2013). China now shares some of the same problems that other

developing countries with a market economy face. In particular, two challenges stand out that are now shaping labor regulations in China: first, a significant growth in the informal economy, and second, the rising level of labor unrest.

Informalization

Informal markets were relatively controlled in their size under the older socialist when almost everyone lived and worked within a defined work unit, the so-called *danwei*. But when the deregulation of the 1980s and the 1990s took hold, millions of workers had to find their own employment. Inevitably, this mobilization has given rise to increasing numbers of workers being employed (or self-employed) in the informal economy (Cooke, 2011). By 2009, according to some estimates, nearly 30% of the urban labor force, and 65% of the 150 million rural migrant workers in urban areas were employed informally (Cai & Chan, 2009).

From a labor and employment perspective, the informal labor market is an unregulated zone where workers end up involuntarily or voluntarily. Demand for such labor is so great especially in the urban service sector that for many workers there is no choice but to become informal. Informality occurs due to a number of factors. Some are casual or contract workers needed for temporary work such as repair and construction in formal establishments. Others are employed by small and medium size establishments that are themselves unregistered and hence maintain no payroll nor pay any

taxes. Another category of informal workers may be employed by informal organizations that supply labor on a casual basis to other organizations. Xu (2007) notes that in Shanghai alone more than 400,000 workers were employed in such arrangements including nearly half of that number in local public services such as street cleaning and garbage collection, etc.

As may be expected, most informal workers take these jobs because they have few other options given their level of education and, frequently, the lack of an urban *hukou*. This leads to widespread exploitation and violation of existing laws and protections. By all accounts, the problems of labor exploitation are well recognized by the government in Beijing but the Central Government needs the support of provincial and local governments to enforce labor laws designed to protect workers.

Labor Unrest

The All China Federation of Trade Unions (ACFTU) is the only recognized trade union in China. Although it is not completely independent of the government and the Communist Party, most writers suggest that the ACFTU has come under increasing pressure to speak up for workers who have become powerless against the tide of privatization. Much of this pressure comes from labor protests that have been breaking out spontaneously in recent years. In fact, employers have been signing collective agreements that are permissible under the Labor Contract Law. According to

ACFTU data cited in Liu (2011), there were 1.4 million establishments that had signed 2.438 million collective agreements covering 184.6 million workers. Although reliable data on the number of disputes or work stoppages are not available, some idea of the extent of unrest can be gleaned from the official (and likely understated) numbers. According to the China Statistics Yearbook, there were 589244 labor disputes “accepted” by the official labor dispute arbitration committees (LDACs) in 2011 of which 6592 were classified as collective disputes covering 174,785 employees (as cited in Liu, 2014). Though these numbers look small compared to the size of China’s labor force it should be noted that official reporting greatly underestimates the actual number because most disputes would be either unreported or not “accepted” if they did not follow certain criteria.

The policy response so far has involved the Labor Contract Law and associated laws and regulations. But, policy remains unclear in many areas of collective disputes, which leads to a large variety of responses depending on the choices made by state and local authorities. The possibility remains that the government could introduce new legislation in the future that would address collective disputes and their resolution more specifically and directly.

Brazil’s Policy Challenges

Brazil’s economy enjoyed resurgence under the democratic rule after many decades of slow growth and military rule.

After conquering hyperinflation in the 1990s, economic reforms under Presidents Cardoso and Lula led to higher growth in the 2000s. The economy began to embrace globalization, albeit gradually and cautiously. The gradual opening up of the economy brought increasing pressures on the labor market to adopt reforms. It has led to significant changes in the Brazilian employment relationship justified, rightly or otherwise, by the perceived need to be competitive in a global market. One prominent challenge is to invest in the education and skills of its workforce. The other challenge is increasing labor flexibility even as the size of the informal economy is reduced.

Education & Skill Development

Despite being a middle-income country, Brazil’s investments in developing a skilled workforce have lagged behind the pace of capital investment in the country. The inadequacy of its investment in basic education is well demonstrated by the performance of its pupils on standardized international tests. In the OECD Pisa (Programme for International Student Assessment) study, Brazilian students ranked 52nd-54th out of 65 countries in reading and 57th-60th out of 65 in science and mathematics (OECD, 2012). While Brazilian students performed below the OECD average, their scores in mathematics have improved since 2003 from 356 to 391 score points, making Brazil the country with the largest performance gains since 2003. Significant improvements are also found in reading and science. Between 2003 and 2012,

Brazil also expanded enrolment in primary and secondary schools, with enrollment rates for 15 year olds rising from 65% in 2003 to 78% in 2012.

An earlier study had found that Brazilian teachers are often poorly educated and teach on subjects they know little about, while no federal program exists to better train and monitor their performance (JBIC, 2005). The government of President Rousseff initiated a series of measures to strengthen the skills of Brazilians including better funding of schools for teachers, equipment and infrastructure. Another ambitious initiative is the Science without Borders program, which is sending 100,000 students on scholarships to study science and technology at leading foreign universities. In return, Brazil is hosting students from other countries on an exchange basis. Brazilian students spend up to a year abroad studying with well-known professors abroad. The hope is that they will return to Brazil with new knowledge and inspired passion for further learning. Eventually, they are expected to meet the continuing demand for skilled labor needed for sustained development.

Informality, Flexibility & Policy Responses

After the crisis in the 1990s, the country's economy has been on a recovery path: unemployment reached a low of 7.1 % in the first trimester of 2014 (IBGE, 2014:5) and in almost all the regions, job growth occurred through formal employment. Informality – workers who lack registration or are working in

an irregular way or are self-employed, with no formal links to the social security system or the FGTS³ — has been in a continuous decline since the 2000s. Between 2000 and 2012, formal work increased from 44.6% to 56.9% of the workforce (IBGE, 2013:142). Informality declined further from 38% in 2010 to 33% in 2013 (IPEA, 2014:14). Berg (2010:12) cites the following reasons for the decrease of informality: more inclusive macroeconomic policies that promote the demand for formal workers; demographic shifts in the Brazilian population; educational policies; micro-level policies that promote the formalization of small enterprises including ones that employ only one worker.

The broad concept of informal economy – based on the production unit – includes different forms of informality: e.g., tax evasion, small enterprises, street trade, illegal work, temporary work, domestic work, precarious work, etc. (Cacciamali, 2000:153). According to Cacciamali (2000:164), there are two major elements present in informal labor markets: the subordinated labor and self-employed work. Their relationships share common traits: high job mobility; low and highly variable earnings; absence of social protection and labor regulation;

³ Fundo de Garantia por Tempo de Serviço is Severance Indemnity Fund, a mandatory fund created by the Law #5.107, in 1966. Only employers contribute to it and the current rate of contribution is 8% of the wage, which is paid by the employer into a state-managed fund. It can be used by the individual in case of being dismissed without cause, to cover expenses during illnesses, or to build or buy one's first primary residence.

flexible and unpredictable hours and duties; and generally lower qualification. Pochmann (1999) argued that the legal ease of hiring and firing combined with an abundant supply of low-skill workers and the lack of workers' organizations in the workplace gave employers excessive power in the employment relationship. The combination of these factors places Brazil among the countries with the highest firing rates – 64% in 2012 (DIEESE, 2014: 12). Prior to 1966, workers acquired lifelong employment security under Brazilian law after ten years of continuous employment. A new regime was introduced in 1966 with the creation of the FGTS, a fund that would pay compensation to workers who lost their jobs. This regime gradually replaced the old system of lifelong employment security. The old system was fully replaced by the 1988 Federal Constitution, which permits firing workers but requires indemnification from the FGTS. Brazil has not ratified ILO Convention 158 on termination of employment and still lacks rules on the procedure for and limits on termination of employment.

Besides the traditional types of informal work – in small production units, domestic work, and illegal work – there are newer types of informal work that have become more prominent in recent years. These jobs result from the adoption of more flexible work relations. Globalization and the search for labor flexibility constitute the framework within which new types of informal work has grown. Formal employees were turned into consultants, cooperative members, outsourced workers or partners. These

new relations can be found not only in the more disadvantaged segments of the labor market, but also among the more qualified and traditional segments, e.g., health, education, management, and law. No longer does informal work limit itself to any specific sector, demographic group or region.

This picture indicates that informality is not a transitory problem. Even though informality has been decreasing in Brazil, it is unlikely to disappear any time soon. It is important to identify an appropriate labor policy response to promote formalization and thereby provide protection to the most vulnerable workers. For example, laws can help increase the cost of informality and, at the same time, the benefits of formalization. Previous research has found that the main reason for choice of informality is to avoid taxes and the cost of social security (Neri, 2002:4). For example, healthcare access is universal in Brazil. However, access to private healthcare is much higher among formal workers with a labor registration card (42.9%) than among other groups such as the self-employed (15.3%), employees with no labor registration card (16.3%), agricultural workers (18.4%), domestic workers (15.9%) and unpaid workers (24.3%) (Neri, 2002: 4). Informal workers do not have any income guarantee protection in case of accident, sickness or unemployment. However, they are covered by the public pensions system, even though they do not make any contributions. The value of their pension is based on the minimum wage – R\$724,00, approximately US\$316 per month. Many informal sector employ-

ers and workers are reluctant to contribute to the social security fund because they will receive the public pension regardless of whether they contribute or not. Guaranteeing a low pension without the obligation of any contribution to the social security system has a negative effect on formalization. The problem here is that this guarantee makes the cost of formalization higher without increasing its gains. Thus, we disagree with Chen (2007:11) that one policy goal should be to “decrease the cost of working informally”. Since formality is an important way to guarantee social protection, the real policy challenge is to increase the benefits of formalization and to increase the costs of informality (e.g., with inspections, fines, etc.) “without necessarily increasing or reducing informality’s benefits” (Carmargo & Reis, 2005 :277).

Brazil: Trends in Labor Flexibility

During the economic crisis in the 1990s, the Brazilian government began to modernize by embracing some degree of labor deregulation and flexibilization. One important argument in this discourse was that the rigidity of the labor market was one of the reasons of informality. An inflexible formal labor market drove both employers and workers to subscribe to the informal labor market. Some minor alterations were made in the Brazilian labor code – the CLT⁴— had the objective of creating jobs and to ease access of informal workers to formality.

⁴ The CLT (Consolidação das Leis do Trabalho) was promulgated by the Federal Decree-law # 5.542 on 1 May 1943, joining all the legal texts covering individual and collective labor relations.

The main changes in the law were the approval of a temporary contract,⁵ suspension of the labor contract,⁶ and compensation of hours.⁷ These were piecemeal reforms that ended up not having a significant impact on the labor market. No comprehensive labor reform has been undertaken in recent years. Looking at the Brazilian case, the most important examples of *de facto* flexibility are labor outsourcing and employment cooperatives. These practices did not come from legal reforms, but from fraudulent practices and by escaping trade unions.

Labor outsourcing (*terceirização*)⁸ is allowed by the Superior Labor Court - SLC, rulling #331, in the case of intermediary services, when there is no direct subordination and the work is performed by the individual specified in the labor contract. The SLC requirements have not been enough to effectively regulate this practice, which disguises the *de facto* employment relationship by making a non-employment contractual arrangement with a third party to avoid the costs of a bilateral employment relationship. According to Pochmann (2007:12-14), who examined the period between 1985 and 2005 in the state of São Paulo, the number of workers in these triangu-

⁵ Law 9.601 of 1998.

⁶ *Consolidação das Leis do Trabalho (CLT)*, Decree-law nr. 5452, art. 476 (promulgated 1 May 1943).

⁷ Law 10.101 (enacted 19 December 2000).

⁸ “Triangular employment relationships occur when employees of an enterprise (the “provider”) perform work for a third party (the “user enterprise”) to whom their employer provides labor or services.” ILO, 2003 at 39.

lar relationships increased from 60,400 to 423,900; indeed, 12.1% of the formal jobs created during this period consisted of these relationships. As well, the number of enterprises that provide triangular services went up from 257 in 1985 to 6,308 twenty years later. In 2005, almost a third of these enterprises had no employees, only “partners” in the enterprise (another term used to disguise the employment relationship). There has been some ongoing discussion in National Congress to regulate labor outsourcing. The main points of this debate is whether to allow labor outsourcing both in intermediary and final activities of the enterprise and on who bears the liability for violation of labor rights. There is still no consensus on these issues and labor outsourcing remains largely unregulated and widespread in the labor market.

The employment cooperatives also act as “providers” of workers (*cooperativas de mão-de-obra*). In the case of the disguised cooperatives (the ones that act only to provide labor for employers), the workers are deemed to be full members of a cooperative, and not eligible for the benefits that come with employee status. Employment cooperatives were regulated by the law #12.690 from 2012, establishing new conditions for their functioning and rights for their member. The law aims to decrease the incidence of fraudulent employment cooperatives.

Both practices (labor outsourcing and employment cooperatives) are not illegal *per se*. They become illegal only if fraudulent practices disguise the actual employment relationship in the eyes of

the law by resorting to outsourcing or the use of worker cooperatives. Therefore, there is a gray area in which even big enterprises can comfortably hire workers through those relations behind a thin veil of legality. Only if the case goes to a labor court, the employment relationship can be identified and recognized by law, but this remedy is not so efficient. Usually, workers will go to the court only after dismissal, since there is no protection against dismissal before deciding to sue the enterprise. Also, there are time limits on when legal questions can be taken to court. Complaints can not be taken to court after an absolute limit of 5 years after the event, or during the employment relationship, or after 2 years of the end of the relationship.

Informality and flexibility

There has been a strong movement in recent years advocating more flexibility in the labor market, arguing that labor rights make the employment relationship expensive and rigid, and thus not accessible to informal workers. The cost of an employment relationship then has been the object of a sharp debate. Calculations of “rollup” costs over and above base pay for payroll taxes, mandatory benefits and the like vary from 19.4% to 101% (Gomes, 2001:109-10). There are different ways of making the assessment, and no clear consensus over any of them. Because many labor rights have direct implications for money paid to workers, directly or indirectly, rights are seen as an added cost factor, which seems to be a good reason to many for abolishing them.

In this context, labor regulation has been associated more with the problems in the labor market than as a solution to the challenges brought by globalization. For example, although there was a decline in the informality rate in the last decade, Ramos (2006:34) calls attention to the fact that sometimes informality is seen as a solution to the lack of opportunities in the labor market. However, as the author emphasizes, informality is generally a survival strategy when the labor market is not able to produce enough jobs with acceptable standards. It is in the informal market that we find the most excluded segments of the Brazilian population: 51.3% of poor Brazilians are in families whose principal earners are informal workers (Neri, 2000:5).

The experience of the 1990s and 2000s did not support the claim that labour regulations caused growing informality”.

Recent trends in informality have been analyzed by a number of studies. Berg (2010) reviewed all evidence available at the time to conclude that, “the experience of the 1990s and 2000s did not support the claim that labour regulations caused growing informality”. Among other evidence, she cites the strong growth in formal jobs in the 2000s, a period during which the minimum wage nearly doubled in real terms. In a growing economy, labor regulation *per se* is not necessarily an impediment. In fact, some labor policies, such as the minimum wage, can stimulate growth and job creation by increasing the income of the poorest segments.

Instead of just deregulating or creating more flexible labor relations, Brazil has developed social policies that create social and economic opportunities to the more excluded segments of the population and, in some cases, introduced more regulation aiming to formalize some sectors of the labor force characterized by high informality, as was the case of the employment cooperatives law and the more recent domestic workers constitutional amendment (Constitutional Amendment 72 of 2013). Brazil’s experience suggests that governments, rather than focusing on deregulating the labor market, should tackle issues of labor flexibility and informality by encouraging firms “to register their businesses and their workers, either through simplifying registration, lowering taxes or providing incentives to develop high-road competitiveness strategies” (Berg, 2010).

Policy Priorities for India

Recent policy developments in both China and Brazil provide useful insights to policymakers in India in terms of crafting future labor policy. China has made great strides in recent decades. When China began its economic liberalization circa 1980, its per capita income was lower than India’s. By 2013, China’s per capita GDP was more than four times that of India’s (Table 1). Brazil’s per capita GDP is more than seven times that of India’s. Both China and Brazil also have higher attainments on some indices of social and human development. The 2012 Human Development Index for India was 0.554, well below both Brazil’s HDI of 0.73 and China’s of 0.699 (Table

1). The challenge for India is not only to once again kick-start economic growth but to make significant social gains at the same time.

When we consider India's needs in this light it puts the labor flexibility debate in a somewhat different light. As suggested earlier, there is no doubt that some reform of the complex web of labor laws would bring greater clarity for both employers and workers. On the other hand, simply making it easier for employers to hire and fire would be an over-simplification of a policy challenge. Moreover, there is no guarantee that any social gains would result from a single and simple change in the law. Even the potential economic benefits could be negated by a regressive "race to the bottom" when Indian firms would be tempted to compete on the basis of cost cutting rather than through innovation and value addition.

Lessons from China have to be drawn with the caveat that the government in Beijing can afford to be a lot more authoritarian than its counterpart in New Delhi. But these differences may not be as significant for economic policymaking as it may appear at first glance. First, a majority government in New Delhi wields more power in carrying its agenda through the parliament. Second, Beijing's authority may be supreme in political life but in many aspects of workplace governance including labor flexibility, the central government's role can be more limited as it navigates policy implementation by enlisting the help of state and local authorities.

China's experience with the great transition shows us that labor regulation needs to be designed in accordance with development goals and needs of the nation. In the early phase of its economic liberalization, labor policy tilted in favor of employers by diluting employment security rights of millions of workers. The "iron rice bowl" guarantee of lifelong employment was removed to facilitate a shift of employment from the state sector to the private sector. However, when the shift accelerated and other labor problems began to crop up such as informality and increasing level of labor disputes, both individual and collective, the policymakers moved gradually to re-regulate the labor market. The re-regulation has at its core the pluralist objectives of protecting the rights of both employees and employers. One lesson to take away from China's experience is that regulation needs to be adjusted to development needs over time. When greater labor mobility is desired across sectors then labor policy needs to facilitate transfers. However, China's experience has also shown that policies facilitating mobility can not address deficits in aggregate demand for labor. To make the economy grow other types of reforms may be warranted and they should not be confused with an undue emphasis on de-regulating labor policy.

When greater labor mobility is desired across sectors then labor policy needs to facilitate transfers.

We also learn from the China experience that both over-regulation and

under-regulation have costs associated with them. The same policy can appear to be a case of over-regulation in one time period and inadequate regulation in another time period. This notion of “appropriate” regulation may be criticized by some who would argue that worker rights should be based on principles rather than on the state of the economy. Certainly, raising the bar on rights is often considered as righting the historical wrongs. In this formulation, any deregulation is regressive, amounting to nothing more than “turning the clock backwards”. This may be true of certain core labor standards which are well-articulated by the ILO in its *Decent Work* agenda (ILO 2001). But labor regulation is much more than core labor standards. Moreover, the early theorists and practitioners in the then emerging field of labor market regulation and employment relationships, such as the Webbs in the U.K., John R. Commons in the U.S. and Mackenzie King in Canada, held that labor regulation should be closely related to industry and workplace conditions for both efficiency and stability considerations (Kaufman 2004). This view has a parallel in monetary economics, which can be helpful as an analogy. Money supply in any economy is regulated by the central bank to reflect growth in the production of goods and services. If money supply keeps in step with economic growth, growth can be expected to be sustainable and prices can be expected to be stable. If money supply grows faster than the rate of economic growth it would lead to rising prices (i.e., inflation). On the other hand, if money supply grows more slowly than the economy, the limited supply of money would compromise economic

growth and ultimately, the surplus would fund more and better jobs. So, just as monetary supply tries to keep step with economic growth, so should regulation evolve as labor market needs and goals change over time. It should be pointed out that the analogy is not perfect specially when we consider adjustment cycles. In case of money supply, adjustment frequency can be very short, sometimes as short as monthly or even at normal times, quarterly. Labor regulation does not need to be adjusted so frequently. It may be several years before sufficient changes take place to warrant changes in regulation or on occasion it may occur over a shorter duration.

Brazil’s experience in reducing informality and income inequality is even more pertinent to India’s case. Although democracy arrived in Brazil more recently, it is proving to be as resilient as India’s. With a Presidential system it provides more stability and continuity in policymaking than does India’s parliamentary system of governance. Brazil has embarked on an ambitious program of providing universal healthcare and education. As a middle income country, it faces greater pressures from globalization to cut costs and improve flexibility. The policy response has been to pursue social programs as aggressively as pro-market reforms aimed at improving macro-economic efficiency. Brazil is among the very few countries where economic growth has occurred at the same time as social progress as measured by decreasing informality, decreasing income inequality and decreasing unemployment.

Conclusions

As of mid-2014, India was facing great opportunities as well as significant challenges for reforms which if done right, could propel the country and its citizens towards greater prosperity (Tellis, 2014). Our analysis of Brazil and China suggests two overarching paradigms that could inform policy reforms in India. First, the labor flexibility debate needs to be recast in light of development priorities of the nation. India needs re-allocation of labor from the informal sector to the formal sector on a large-scale. Ubiquitous informality holds back economic growth as well as gains for labor in terms of legal protections, income, working conditions and skill development. India needs flexibility incenting informal workers and employers to move to formal status. India also needs a re-allocation of labor from rural to urban areas. Rural residence prevents people from having access to better education, health and employment prospects. Lack of opportunities for improving skills and accessing employment perpetuates poverty. Similarly, the educated but unemployed youth need policies that would facilitate easier transition from school to work.

These are all examples of re-allocation of labor in which India needs the kind of flexibility that would allow these transitions to occur smoothly. It is labor flexibility at a macro-level without which micro-level flexibility by itself would not lead to the achievement of key goals of development.

Second, India needs to build consensus around a grander vision of reducing

poverty through education and urbanization and by investing in people's skills and in physical infrastructure. The human development and infrastructure gap between India and other major emerging economies such as Brazil and China are considerable but bridgeable. India lacks not the physical, human capital or financial resources but the political will and administrative capacity to deliver results. Only a shared grand vision can loosen the status quo sufficiently for change to seep into the ossified layers of government and other institutions of governance.

Workers should have access to compensation based on length of service and the opportunity to re-train for other employment.

The above does not, in any way, negate the need for reforms for greater labor flexibility at the workplace level. At the very least, some administrative simplification of the web of labor laws will certainly help. But, if re-allocation of labor across firms and industries is to be made easier by allowing employers to terminate employment more freely then this policy must be matched with simultaneous policy responses in at least two areas. First, workers should have access to compensation based on length of service and the opportunity to re-train for other employment. Such worker assistance programs have been used in other countries with considerable success. Second, worker protection by law and through enforcement must be strengthened in the informal sector. Some aspects

of informality have to do with lack of literacy and local capacity to accommodate formality. But, a large share of informality lies in weak enforcement of existing regulations and fraudulent practices. These “leaks” can be plugged if government has the political will to do so.

Discussions of labor flexibility at the workplace level should not occur without a consideration of adequate labor protections, not only at the workplace level but also in the labor market at large. If such reforms are not coupled, we may see economic growth but without any significant social progress (Sodhi, 2011). If India is to join its peers on the world stage as a large but also a dynamic and strong economy, it can not afford to take a narrow view of labor flexibility. The flexibility debate is a great opportunity to leapfrog out of the small pond to begin building a world-class labor force that is as flexible as it is skilled and secure.

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