Shankar Acharya: OECD on India`s labour market

A PIECE OF MY MIND

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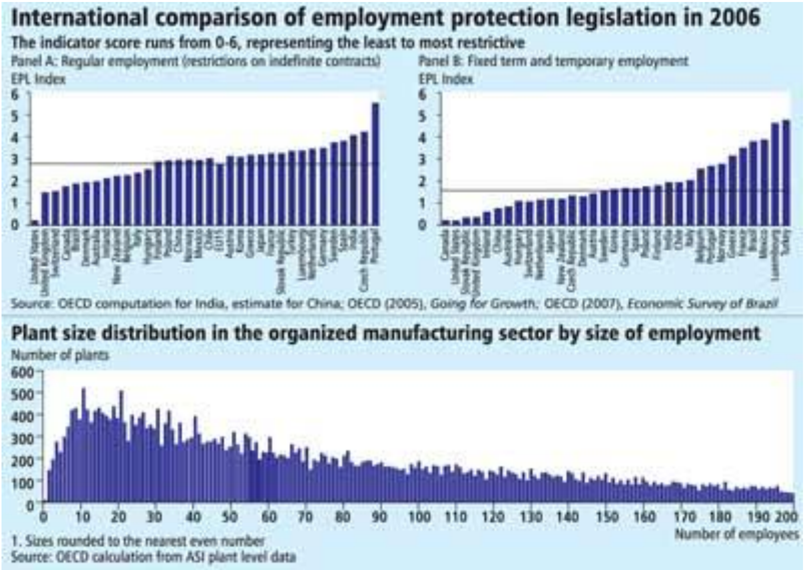
A few weeks ago the OECD published its first *Economic Survey* on India. After a day-long seminar at the Imperial hotel, followed by some desultory reporting in a few pink papers, the document seems to have been buried in dusty bookshelves without much fanfare or debate. This reception is on a par with the current treatment of periodic reports on the Indian economy by other international agencies, such as the World Bank, the IMF, the Asian Development Bank and so forth, not to mention the avalanche of publications from invest banks and fund houses. Fifteen years ago, when the Indian economy was weaker and more vulnerable, such documents provoked lengthy and passionate discussion in the press and frequent parliament questions. Now, with 8-9 percent economic growth a routine occurrence and a bulging portfolio of forex reserves, such reports provoke little interest and even less passion. What can the industrial countries tell us when we are buying up their steel plants and luxury car brands? That seems to be the implicit hubris.



Well, if we can extricate ourselves from this complacent, “know all” mentality for a moment, I would recommend chapter 4 of the present volume for a thorough read. The rest of the report is a fairly competent but largely unexceptional review of the usual terrain: growth, infrastructure, fiscal balances, financial system, human capital and so on. They can be skipped. But chapter 4 on India’s labour market merits careful perusal. It not only provides an up-to-date and analytical treatment of the well-known issues but, more refreshingly, it offers new perspectives and fresh, survey-based analysis.

In the first category, it reminds us that although total employment growth in the five years to 2004/5 has averaged a healthy 2.9 percent per annum and industrial employment has increased by over 6 percent annually, organized industrial sector employment has been declining at about 1 percent per year, bringing the share of organized industrial sector employment down from around 18 percent (of total industrial employment) in 1998 to only 10 percent in 2004. That is, over this period there has been increasing “casualization” of the industrial labour force. The OECD’s diagnosis of the reasons for this trend is in line with conventional wisdom: “The bulk of the growth in employment has been created in very small enterprises. There is much evidence that the main reason for the lack of job creation in the ‘organized’ or formal part of the private sector is the restrictive legislation governing regular employment in larger firms.”

There is much more along these lines, which is noteworthy but unremarkable. The novelty begins with the ranking of India's employment protection legislation (EPL) using the standard OECD methodology for assessing labour laws. The report finds that for *regular contracts*, "India's labour laws are stricter than those of all but two OECD countries, Portugal and the Czech Republic" (Panel A of figure 1). Interestingly, China scores an EPL index of close to the OECD average. Furthermore, if the notorious Chapter VB of the Industrial Disputes Act (which requires prior government permission for laying off employees in factories with more than 100 workers) "were not in force, the EPL for regular contracts would fall to the OECD average". For *collective dismissals*, India's EPL score is even worse, the strictest for all countries in the comparison and close to the maximum sore of 6 on the EPL index.

Turning to fixed term and temporary employment, the OECD methodology finds India's EPL regime "more relaxed…placing it just above the mean of OECD countries" (Panel B of figure 1). This moderation of EPL strictness is mainly because of allowing employees to work on temporary work agency contracts to carry on a range of "non-core" activities. However, it is noteworthy that even in this area India's EPL score is at least double China's. Unsurprisingly, the report finds that net employment of *contractual* staff rose by 9 percent a year between 1998 and 2004 in industrial units (covered by Annual Surveys of Industry), while employment declined by 2 percent per year for *regular* workers. Moreover, again as expected, net job growth was a healthy 16 percent per year in small (less than 100 workers) ASI units and a *negative* 5.5 percent in large (more than 100 workers) ASI enterprises.

The consequences of strict EPL for regular workers in large industrial enterprises have been rising capital intensity (in a labour surplus economy!) and falling share of wages in value added. Furthermore, as figure 2 shows and the report notes, the onerous burden of labour laws and other regulations encourage businesses to "start small and stay small. As a consequence, the size distribution of businesses in India is highly skewed towards small units with visible peaks in the distribution of plant sizes at 10 and 20 workers" (corresponding to the definitional cut-off for organized versus informal sector, with and without power). "Such small production reduces the efficiency of the economy and limits the productivity and incomes of businesses and workers".

Moving on, the OECD report breaks fresh ground by constructing a new, survey-based index of *state-level* reforms of labour laws and procedures in eight specific areas: the Industrial Disputes Act, the Factories Act, the Shops and Commercial Establishments Act, the Contract Labour Act, the role of inspectors, the maintenance of registers, the filing of returns and union representation. The index aims to "reflect the extent to which procedural changes have reduced transaction costs, through limiting the scope of regulations, providing greater clarity in their application, or simplifying compliance procedures". Based on the index and some cross-state statistical analyses, the report offers some interesting results.

First, there is enormous variation across India's states in the extent of EPL reforms in recent years. Thus, Gujarat, UP and Andhra have been done significant reforms, whereas Chhattisgarh, Goa and Bihar have done very little. Second, there is reasonable correlation between the reform index and job turnover rates in industry, "suggesting that states that have made more reforms to their labour rules and regulations indeed obtain more flexibility (in terms of job dynamics) in their labour markets and vice-versa". Third, across the states in the period 2000 to 2004, the data suggest that an increase in job turnover rates has limited the fall in the labour share of value added. Fourth, higher rates of organized sector job creation appear to damp the rise in the size of the informal sector employment.

Well, I hope I have whetted your appetite for reading the full chapter of this OECD report.

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