

Create a ministry of employment

Our current labour law regime hurts most workers and keeps organised employment lower than it should be. That has done no more than help a small elite of organised workers, says **Manish Sabharwal**.

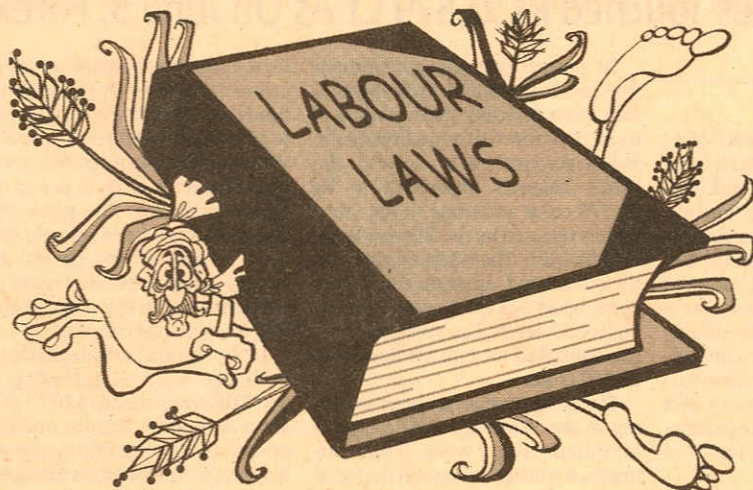
CONTRARY to perception, the biggest victims of our labour laws are not companies. Corporate India has made peace with labour laws and sees them as a thorn in the flesh (not a dagger in the heart). Companies would welcome easing of labour laws but they are hardly a binding constraint.

The real victims of labour laws are unorganised labour: farm workers, unemployed, less skilled, less educated, first-time job seekers, small town residents, retired people, and women. The hijacking of the labour regime by the minority of organised labour has positioned job preservation as more important than job creation and bred unemployment.

The vital symptoms of our labour markets are horrible. Unemployment may reach 29% by 2020. Our demographic dividend means 74 million people (25% of the world's new workers) need jobs till 2010. Only one in 61 primary school attendees graduate from college and, our education system, on average, produces unemployable people. Over 40% of workers are working poor (make enough money to live but not enough to leave poverty) and 50% of workers are marginally self-employed. Unemployment is more than organised employment and most unemployed (94%) are young (15-34 years old).

How has a small (30 million) but vocal minority of privileged insiders (largely not poor, middle-aged men in organised labour) positioned their needs ahead of the disadvantaged majority? What explains the higher moral outrage of politicians when somebody loses their job than when somebody is unemployed? Political scientist Mancur Olson called this dysfunctional outcome where special interests overwhelm greater good the "power of distributional coalitions".

Nobel laureate Sir Arthur Lewis wrote in 1954 that development occurs when labour and capital moves from lower value-adding sectors into dynamic, higher value-adding sectors. While Lewis focused on development, the important message was that facilitating inter-sectoral mobility (like changing the status quo for labour market



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insiders) is important for growth in productivity, output and employment. India needs this migration because living standards will only rise if most of our farmers (annual TFP growth of 0.4% since 1993) shift to low skill manufacturing and service jobs.

The debate about whether labour reform will accelerate organised job creation is crucial, complicated and unresolved. But it is clear that low-skilled formal jobs are disproportionately hurt by five unintended consequences of our labour regime — exploding unorganised employment, capital replacing labour, lower organised manufacturing jobs, blue collar exploitation and corruption. A closer look at each:

Exploding unorganised employment: In a world of cost-to-company (CTC) salary structures, all benefits are monetised. Consequently, various labour schemes like PF, EPS, EDLI, ESI, LWB, etc., that confiscate about 42% of salary at source don't raise total compensation but reduce take home salary. For example, the recent hike in ESI coverage from Rs 6,500 p.m. to Rs 10,000 p.m. will raise absolute contributions in the short run but surely reduce total coverage in the long run as evasion increases. At lower absolute salary levels, today it is rational to work in the unorgan-

ised sector (as 92% of our workforce does) to avoid the high quasi-taxes of sloppily run labour schemes that offer poor value for money. If lower rates have improved compliance and coverage for income-tax, why not try that in labour laws?

CAPITAL substitution of labour: The anecdotal evidence of corporate India's higher productivity over the last decade (Bajaj Auto, Tata Steel, etc) is reflected in the employment elasticity crash to 0.15. Technology, by definition, lowers the employment intensity of growth but amplification of people substitution by law is blasphemous in a country with our population. The 50% higher employment elasticity of unorganised sector growth is testimony to the employment retardation of labour laws on the organised sector.

Lower organised manufacturing jobs: A recent study by Ahmad Ahsan et al suggests that Indian organised manufacturing employment is 30% lower than it would have been with labour regime changes. Our manufacturing employment is an anaemic 13% of the workforce while manufacturing moved 114 million people off farms in China in the last decade. India will never truly compete with China's

manufacturing (China's industrial total factor productivity has grown annually at 6.2% versus 1.1% in India since 1993) till legislation makes outsourcing to the informal sector preferable to hiring (permanent or temporary) in the formal sector.

Blue collar exploitation: Blue collar workers suffer information asymmetries, low labour mobility, and poor skills. But our poorly designed labour laws create opportunities for blue collar exploitation by individuals with criminal, regulatory or political connections that provide regulatory arbitrage. For e.g., 99% of temp/contract labour workers (80 million people) are in the unorganised sector that gives a 40% wage discount to temp blue collar workers (relative to permanent workers). This discount, absent in organised white collar temping, may not go away (it may reflect skill differentials) but will sink to 10%-15% as Contract Labour Act reform makes regulatory arbitrage redundant.

Corruption: Complex labour laws combined with the infamous inspector raj to harass companies with or without the resources to create big regulatory departments (we have 50 employees and 60 consultants to take care of our 400 licences and 120 monthly filings).

The ministry of labour needs an updated vision and policy architecture. It also needs the resources and mandate to proactively foster institutional preparedness on both the demand and supply side for India's "structural transformation". This involves shifting from over-regulating employment to nurturing employability and tiering regulation to protect those that need it. It must foster competition for its benefit schemes to improve service and reduce cost. A true ministry of employment may be an idea whose time has come. This will solely judge policy by its ability to create jobs and would emerge from a merger of the ministry of HRD and the MoL to attack labour demand and supply issues together. Additionally, it may be time to move labour from the concurrent list to the state list of the Constitution thereby giving states a free hand in crafting their job habitat.

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