

MINISTRY OF (UN) EMPLOYMENT

Our current labour law regime is minority rule and friendly fire that hurts most of our workers and hinders the biggest migration off farms in history

Contrary to perception and rhetoric, the biggest victims of our 25,000+ labour laws are not big companies. In fact, 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 labour law rationalization but they are hardly a binding constraint.

Reality is that our huge agricultural workforce (70%), farmer suicides and the view of farm-land acquisition as livelihood confiscation reflect our spectacular failure to create low-skilled non-farm jobs. The real victims of labour laws are unorganized labour; farm workers, unemployed, less skilled, less educated, first-time job seekers, small town residents, retired people, and women. Over time the Ministry of Labour & Employment (MOL) has unconsciously been driven away from this labour majority by a vocal minority (organized labour) that has positioned job preservation as more important than job creation and consequently 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 in the next four years. Only one in 61 primary school attendee's graduate from college and, on average, our education system produces unemployable people. Over 40% of our workforce is the working poor (make enough money to live but not enough to pull out of poverty). 50% of the workforce is marginally self-employed; 70% of workers generate only 18% of GDP.

Why is job creation a policy orphan? If the million negotiations of democracy don't let India change for a better option, do we have to wait for when unemployment will give no option? How have a small (30 million) but vocal minority of privileged insiders (largely not poor, middle aged men in organized labour) positioned their needs ahead of the disadvantaged majority? Why is the moral outrage of politicians higher 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". These "insiders" want to distribute the pie in their favor rather than increase the pie for everybody. But an important responsibility of a democratic state (the executive, legislature and judiciary) is

to prevent this kind of hijacking and ignore narrow self-interest positioned as national interest

Nobel laureate Sir Arthur Lewis wrote in 1954 that development occurs when labor and capital moves from lower value adding sectors into more 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 labor market insiders) is important for growth in productivity, output and employment. India is on the cusp of this migration. Current moves to raise agricultural productivity are honorable but living standards will not rise without most of our farmers moving into low skill manufacturing and service jobs.

While it may be arguable whether labour reform will accelerate organized job creation, low skilled formal jobs are disproportionately hurt by five unintended but very real consequences of our labour regime; exploding unorganized employment, capital substitution of labour, lower organized manufacturing jobs, blue collar exploitation and corruption. Let's look at each in more detail:

Exploding unorganized employment: In a world of cost-to-company (CTC) salary structures, all benefits are monetized. Consequently, various labour schemes like PF, EPS, EDLI, ESI, LWB, etc that confiscate about 42% of salary at source do not raise total compensation but reduce take home salary. For e.g. the recent hike in ESI coverage from Rs. 6500 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. The move echoes Samuel Johnsons quip about second marriages; the triumph of hope over experience. Lower rates have improved compliance and coverage in Income Tax; why not try it in labour laws? At lower absolute salary levels, today it is rational to work in the unorganized sector (as 92% of our workforce does) to avoid the high quasi-taxes of sloppily run labour schemes that offer poor value for money.

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 the amplification of people substitution by legislation seems blasphemous in a country like India. The 50% higher employment elasticity of unorganized sector growth is testimony to the employment retardation of labour laws on the organized sector.

Lower organized manufacturing jobs: A recent study by Ahmad Ahsan et al suggests that organized manufacturing employment in India is 30% lower than it would have been with labour regime changes. Our manufacturing is an anemic 13% of employment while manufacturing moved 114 million people off farms in China in the last decade. India will never truly compete with China's organized manufacturing productivity as long as legislation makes outsourcing to the informal sector preferable to hiring (permanent or temporary) in the formal sector.

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

Corruption: A candid labour official confessed that he was trying to enforce the unenforceable. The idealism behind labour legislation (the good is the enemy of the great) creates huge temptations of selective enforcement for poorly paid bureaucrats. Multiple interpretation possibilities combine with the infamous inspector raj to harass companies with or without the resources to create big regulatory departments (we have sixty employees and forty consultants to take care of our four hundred licenses and one hundred twenty monthly filings).

The MOL needs an updated and refined vision. It also needs the resources and mandate to proactively foster institutional preparedness on both the demand and supply side for India's "structural transformation". Handling the short term costs of job migration that, as ILO says, are "supposed to happen" needs mechanisms for labor market intermediation, skill development, retraining, targeted social security spending, and low-skill job creation that needs shifting from over-regulating employment to nurturing employability. It will involve tiering regulation to protect those that need it. It must foster competition for its benefit schemes to improve service and reduce cost and anchor these to employees rather than employers. I could give specifics but the agenda for reform is hardly unknown; optics and sequencing is where innovation lies.

A true Ministry of Employment may be an idea whose time has come. This should solely judge policy by its ability to create jobs and would emerge from a merger of the Ministry



Putting India to Work

of HRD and the Ministry of Labour to cover labour demand and supply issues together. Alternatively, it may be time to move labor from the concurrent list of the constitution to being a state subject and give them a free hand in crafting their job habitat.

Labour reform is a necessary but not sufficient condition for migrating people from agriculture. But it is also clear that labour laws conspire to lower the creation of low skill jobs that don't need English or a bachelor's degree. Life on an unviable farm is brutal; reforming labour laws that hinder migration seems like a small price to widen the circle of opportunity and deepen the meaning of freedom.