

**1st Prize Winner of the Fraser Institute's 2009 Essay Contest**

**WHAT'S GOOD FOR BUSINESS IS GOOD FOR THE POOR:  
THE CASE OF INDIA'S LABOUR LAWS**

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On May 16, 2009, after almost two decades characterised by fractured verdicts and fractious coalition politics, when even fringe players could hold a ruling government's policies hostage, the participants of the world's single largest democratic exercise, bucking the predictions of political pundits everywhere, granted Manmohan Singh's ruling United Progressive Alliance (UPA) coalition a surprisingly decisive mandate for the next five years. *The Economist*, in the editorial pages of the following week's issue (May 21, 2009), asked the Indian Prime Minister to not, quite simply, waste it; and with good reason.

In the hands of the Dr. Singh, the architect of the liberalisation reforms that has yielded almost 19 years of hitherto unseen economic growth, is a unique opportunity. For the past five years, critics have pardoned the sluggishness of the government over reforms towards greater economic freedom, citing the need for pragmatism in an era of coalition *realpolitik*, the most notable roadblock being the fact that the Communist Party of India was the UPA's most important ally. Today, though, there is no such excuse.

Despite consistently being one among the two fastest growing economies in the world, almost 42% percent of the Indian population lives below the global poverty line of \$1.25 per day (Mozumder and Tuck, 2008). That, in India, is a staggering number; 456 million people. In China and many of the East Asian Tigers, the economic growth that has raised millions from poverty has been led by growth in the manufacturing sector; and this, has not happened in India (Besley and Burgess, 2002). Many economists point to this failure as being primarily responsible for so many millions being unable to reap the fruits of the last two decades of economic growth (see, for example, Bhagawati 1998, and Stern 2001).

One of the main conclusions of the Economic Freedom of the World report (Gwartney, Lawson, & Norton, 2008), and one that hundreds of other studies have consistently validated, is that greater economic freedom means greater prosperity and lesser poverty. And in India, one area where economic freedom is severely restricted concerns its labour laws. Indians are notoriously difficult to fire, legally at least. Such restriction of economic freedom, the essay seeks to argue, lies at the heart of the reason why so many millions in India are so desperately poor.

### **The Law is an Ass**

Although the Dickensian character who first used the above phrase was talking of the laws concerning marriage, it quite easily applies to India's labour laws as well. Labour, and all matters concerning it, falls, in India, in the Concurrent List. What this means, is that both the federal and the state governments can pass legislation regarding the same. And the essential piece of legislation concerning labour is the Industrial Disputes Act (IDA) of 1947. Although numerous state level

amendments may act as riders to parts of this legislation, in essence, it still contains provisions that make it impossible for any law bidding firm employing more than a 100 employees, to lay off any one of them without government permission (Section 25M). Or for that matter, as per Section 9A, even reassign a particular employee without first giving 21 days notice. What laws such as this, and others like the Contract Labour Act of 1970 and the Factories Act of 1948, do, is that they have “reduced the productivity of both labour and capital and hence the viability of the enterprise” (Tendulkar, 2003).

Private sector employers, though, have not taken all this lying down. As expected of any business interested in its own survival, ways have been found of adapting to these cumbersome restrictions, or even, bypassing them completely. These include measures such as adopting capital intensive technology to minimise employing permanent workers, outsourcing activities to unregulated and unregistered units, moving unit to areas with lax enforcement and even splitting the establishment into multiple smaller units to escape coming under the purview of legislation.

This propensity of employers to seek labour outside the bounds of regular, contractual employment in particular, has resulted in the exacerbation of what Suresh Tendulkar of the Delhi School of Economics calls, an “organised-unorganised duality” of the Indian labour force (2003). The ‘organised’ sector constitutes a tiny minority of India’s working class fully enjoying the privileges that India’s labour laws guarantee, while the vast majority, the ‘unorganised’, are unable to experience even those benefits that regular, contract based employment can provide them.

Evidence from other parts of the world also substantiates this point, that greater regulation results in an increase in the size of the unofficial economy and a less impressive performance in economic, political and social indicators, a fact borne out by an 85 country study conducted by Djankov et al (2002) looking at regulations governing the start of businesses. It’s not for nothing that in India, the decade of the 1980’s is referred to as the “decade of jobless growth”, when despite manufacturing output recording a 7.1% per annum growth, manufacturing employment stagnated (Bhalotra, 1998). And unsurprisingly enough, evidence shows that the 1976 and 1982 central amendments to the IDA that further strengthened job security regulations resulted in less demand for labour in firms covered by the regulation but not in small firms uncovered by the job security regulations (Fallon, 1987).

### **How the Lack of Economic Freedom Hurts the Poor**

The problem with economic truths such as spontaneous order, as Bastiat prize winning journalist Amit Varma (2008) puts it, is that many a time, they seem almost counterintuitive. This is, in a way, also the problem with labour laws. Laws that are framed with the intention of keeping jobs secure and setting centralized minimum wages end up having completely unintended effects, chief among them

being reducing employment altogether. If, for example, an owner of a cafe decided that she needed extra help for the summer in order to better service the seasonal increase in demand, she would ideally hire an employee for this very short period of say, 3 months, letting him off afterward. But, if, the entrepreneur in question decides that the extra help is not worth the trouble of say, dealing with the bureaucratic red tape involved in laying off an employee, then what the labour law in question has achieved is to reduce welfare all-round, that of the employer who might have benefitted from the extra help in the summer months, and of the employee who might have found the extra income useful.

The above example is, admittedly, a simplistic one. And yet, it highlights an important point, that allowing the invisible hand to work, often produces the most desirable results. Timothy Besley and Robin Burgess of the London School of Economics, in 2002, authored a remarkable study that highlighted essentially this same point. They looked at state level amendments to the Industrial Disputes Act, from 1958 to 1992, and classified these into three categories, pro-worker, proemployer and neutral. They then coded each of these with the values of one, minus one, and zero respectively. Upon regressing the labour regulation variable with indicators of economic development and poverty levels, they found that “regulating in a pro-worker direction was associated with lower levels of investment, employment, productivity and output in registered [*organised sector*] manufacturing”.

Their most striking conclusion concerns poverty levels, they found that “that regulating in a pro-worker direction was associated with increases in urban poverty” and that if Andhra Pradesh (a state considered pro-employer) had not implemented pro-employer reforms, urban poverty levels would have been 110 percent of its actual 1990 level. On the other hand, if West Bengal, a state considered pro worker, had implemented pro employer reforms, poverty levels would have been 10 percent lower in 1990.

The sad irony here is that it is those who claim to be acting in the interests of the poor that seem to do them the greatest disservice. The claim that economic freedom does not benefit the poor is, therefore, not only a false one, but a harmful one at that.

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