Economic liberalization, business-government relations and labor policy in India

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Questions addressed by the paper

1. How have economic reforms affected business-state relations in India?

2. What impact has this had on policy-making more generally and labor policy more specifically?

3. What constrains corporate influence in labor policy?
Outline

• Brief overview of policy regime and economic reforms process
• Business-government relations in the licensing and liberalization eras
• Business preferences and influence on labor policy in the liberalization era
• Policy suggestions
India’s economic policy regime 1947-1991

- Strategy of import-substitution based on heavy industrialization
- Public investment would be the key driver of growth
- Private sector was to be peripheral and controlled, regulated and protected by state
- Industrial licensing system ("license-permit raj") and control on decisions from registration, capacity expansion, diversification, location, imports were regulated through licenses and permits
- Licensing and protectionist trade policies – protection from competition and monopoly profits
- Framework basically unchanged until 1980s except when restrictions were increased in late 1960s
India’s economic policy regime 1947-1991

• Indira Gandhi’s return in 1980 and ‘pro-business’ attitudinal change (tax concessions, liberalization of licensing requirements, MRTP exemptions)

• Rajiv Gandhi continues pro-business measures (abolishing licensing for certain industries, easing of licensing, ‘broad-banding, lower corporate taxes, legalized political contributions of firms)

• Reforms abandoned due to opposition from a coalition of forces (labor, left elements within Congress, business)

• Growth increased in 1980s but accompanied by fiscal expansionism

• Fiscal expansionism and political uncertainty led to a BOP crisis in 1991 – immediate catalyst for reforms
The 1991 reforms

• Abolished industrial licensing in almost all areas
• Opened up areas previously reserved for public sector to private sector
• Easing of FDI regulations
• Import-substitution measures abolished
• QRs abolished and tariffs reduced
• Import policy liberalization – no licensing except a short negative list
• Wide-ranging financial reforms
Market reforms in India

• Like neo-liberal reforms world over, this resulted in a very different role for the state and the market
  – Private investment displaced public investment as the key vehicle of growth
  – Decentralized decision-making
  – A more external orientation
  – Firms had to face a more competitive environment
Business and state relations in the licensing era (1947-1991)

- Protection from internal and external competition
- In addition, government provided infrastructure and long-term capital
- Business interaction with government at both the individual (firm) level and collective (association) level
- Individual lobbying more effective than collective efforts
Individual lobbying in licensing era

• Business’ main influence as firm
• Incentives for individual lobbying – permanent industrial ‘embassies’ in New Delhi dedicated to lobbying for licenses
• Used personal connections and resources (assets and jobs) to gain particularistic benefits in terms of licenses and permits
• Pre-emption of licenses as a tactic
• “Brief-case” politics – black-money from tax evasion and illegal operations exchanged with politicians for licenses and permits
Business collective organization in the licensing era

- Numerous trade, industry, employers associations and chambers of commerce
- 2 main peak associations until 1991– Federation of Indian Chambers of Commerce and Industry (FICCI) and Associated Chambers of Commerce and Industry of India (ASSOCHAM)
- A third peak association CII, established in 1991, has proved to be highly influential in the liberalization era
- Established prior to independence, autonomous from political parties, fairly well-funded and organized by developing world standards
Policy role of collective business organizations in the licensing era

• Participated in government committees, advisory groups, reports but role largely symbolic
• Business was mainly reactive and little influence on broader direction or content of policy in most areas
• Collective action curtailed by
  – Policy regime: State retained autonomy of agenda
  – Collective strength, coherence and unity restricted by individual and sectoral lobbying, regional, community loyalties and varied association strategies
The 1991 reforms and transformation in business-state relations

- Elimination of licensing and introduction of competition
- Market imperatives of competition reduced pay-offs to individual lobbying
- Business’ structural power as capital grew as state governments began to compete for private investment and location decisions were freed
- Transformation in collective influence of business
- From business as firm to business as association and capital
Scope of business collective activity since 1991

• Increase in scope of activities – 4 realms detailed in paper

1. Collective goods to members to increase competitiveness
   – Training and consultancy services in logistics, quality management, energy use, environmental assessments to name a few
   – Skills shortage and short-term association measures (certification for entrants, skills registry, university collaboration)
Scope of business collective activity since 1991

2. Proliferation of activities related to business’ information function and exchange of information with government
   – Policy briefs, surveys, reports, market research
   – Involvement in government reports and advisory committees
   – Seminars, trade fairs and brand-building exercises (ex. Davos 2006)
   – Greater two-way exchange of information with government
   – Government responds to business concerns more frequently (FMIs address business post-budget)
Scope of business collective activity since 1991

3. Service delivery through PPPs, increased private investment and CSR activities in infrastructure, education and health
   - PPP - common model in many areas since 1990s
   - Industry has been lobbying for PPP in infrastructure
   - Increased private sector investment in health and education
   - Skills-development and engagement with education
   - CSR – Primary education, health initiatives such as HIV/AIDS programs
Scope of business collective activity since 1991

4. Involvement in India’s international affairs
   – Part of official foreign delegations, trade fairs, summits and brand-building exercises and suggestions that role is an active one
   – Active Involvement in WTO negotiations
   – Some direct involvement in diplomacy – “track II” diplomacy with Pakistan and China
Patterns of access in the liberalization era

• Scope of business activity and increase channels of access
• Privileged access vis-à-vis other groups increased
• Business association meetings attended by senior government officials
• Regular meetings with government officials to discuss policy and other matters
• Informal personal access continues
Individual lobbying in the liberalization era

• Reforms greatly reduced the incentive to lobby for individual benefits

• Individual lobbying continues
  – Lack of transparency in early stages and case by case decision-making in some areas such as infrastructure
  – Tax concessions and subsidies
  – Continued corruption at central and state-levels

• Governments in turn willing to lobby for individual firms (Mittal-Arcelor and Tatas)
Patterns of access – political funding

• Very little known about patterns of business funding to parties

• Corruption related to large contracts in infrastructure

• Company contributions to firms
  – Continue to be made mainly through black-money route (Sridharan 2001)
  – Both parties and firms not willing to divulge identity

• Some individual firm efforts at transparency in election contributions
Federal dimension of business-state relations

- Reforms increased role of state governments - competition for private investment
- Taxes, concessions, pockets of high-quality infrastructure (SEZs) to attract capital
- States’ role politically reinforced by coalition governments
- Differences in performance and growth
- Variation in “pro-business” inclinations of states – responsiveness to business needs, capabilities in implementation and levels of corruption
Summary of business-government relations in reforms era

• Both business and government keen to emphasize that there is a growing partnership
• Transformation of business collective action – coherent and unified demands, increased scope of activities, more channels of access
• Individual access continues though individual lobbying diminished
• More pro-active, has a direct policy role and greater influence in some areas of policy

What impact did this have on labor policy?
Some key features of the Indian labor market

• Labor force estimated at 406 million in 1999-00
• Segmentation and dualism
  – Organized sector – less than 8 per cent of the labor force and 40% of output
  – Unorganized sector – agriculture still accounts for an overwhelming majority of employment (60%) and an urban informal sector
  – Unorganized sector wages and working conditions significantly worse
• Business concerned predominantly with organized sector
Some key features of the Indian labor market

• Growth of organized sector employment very slow compared with GDP growth
  – Rate of growth of organized sector employment declined between 1983-84 and 1993-94 to 1993-94 to 1999-00

• Growing ‘casualization’ of the workforce - increasing proportion of non-permanent employees
  – Contract labor as a percentage of total employment grew from 7% in 1984 to 21.6% in 1998
Background of trade unions in India

• Estimates of number of unions as large as 50,000 and 10,000 associated with 10 major trade union federations
• All major trade union federations affiliated to political parties
• Fragmentation and competition between trade union federations
• In some states, multiplicity of unions within same firm
• Political parties unwilling to undertake major reforms partly due to union links but reforms have also exposed contradictions between the political and union wings of parties
Background of labor legislation in India

- Labor is a concurrent subject in the Indian constitution
- Multiplicity of laws with overlapping jurisdictions
- Extensive legislation aimed at long-term employment but unintended consequences (dualism, slow permanent sector employment)
- Enforcement of laws very weak
- Major legislation includes Industrial Disputes Act, Contract Labor Act, Trade Union Act, Social security (ESI Act and EPF Act)
Business Preferences and Influence on Labor Policy

• Five aspects of labor policy studied in the paper
  1. Labor market flexibility
  2. Social security provisions
  3. Skills development
  4. Reservations or affirmative action in the private sector
  5. Unions, collective bargaining and industrial disputes
Labor Market Flexibility

• 3 aspects of business demands
  – Exit policy or ability to close without prior permission (section V-B of the IDA and closure, lay-offs)
  – Easing of contract labor restrictions including allowing cyclical or seasonal employment
  – Non-interference in issues such as work hours and firing decisions on grounds of indiscipline
Labor Market Flexibility

• Arguments made by business in favor of flexibility
  – Rigidity of laws has had a perverse effect on employment generation
  – Rigidity of laws has encouraged sub-contracting and use of contract labor
  – Undermines competitiveness and rival firms in other countries operate in business-friendly environments

• Increased social security provisions in return for flexibility
Business influence and flexibility

– Both the Congress and BJP have tried to amend laws to increase flexibility but abandoned plans due to resistance from unions as well as opposition parties

– Business has abandoned the call for ‘exit policy’ and rhetoric shifted to ‘right-sizing’ and stress on ‘productivity’ and changes in contract labor laws

– No change in laws barring individual cases such as Andhra in 2003

➢ No legislative change but de-facto reform
Flexibility and de-facto reforms

– De-facto labor market flexibility through 3 main routes
– Enforcement machinery deteriorated
– Increased use of sub-contracting and contract labor especially in support and logistics
– Voluntary Retirement Scheme (VRS)
  • ‘Golden handshake’ – lump-sum payment for voluntary retirement
  • Private sector reluctant to report figures on VRS
  • By some estimates the top 30 firms alone shed 90,000 jobs between 1997 and 2002
Business and organized sector social security

- Under current laws, there are provisions related to health (ESI), retirement benefits (EPF), workmen’s compensation and gratuity for organized sector workers.
- For workers below a certain monthly limit, firms and workers make contributions to the government-run schemes.
- EPF – contributions accumulate interest and paid on retirement; workers can also borrow for various purposes prior to retirement.
- ESI – Contributions made to ESI corporation and health care through ESI-run hospitals and centers.
Business preferences and organized sector social security

• Claims that it is willing to accept increased social security provisions for greater flexibility in hiring and firing

• Acceptance of inadequacy of current provisions
  – ESI and weak delivery mechanisms
  – Poor quality of services, leakage and corruption
  – Workers choose to pay out of pocket
  – Suggestions include expanding range of insurance providers, expanding choice of hospitals and vouchers enabling workers to use private hospitals
Business preferences and social security

• Preferences for unit-level social security provision for organized sector
  – Lack of trust in government delivery mechanisms
  – Related to labor market flexibility and control over hiring and firing

• No significant changes in mechanisms for organized sector

• Government initiatives towards unorganized sector social security, which has received business support
Skills Development

• Increasing concern with the skills shortage at all levels, particularly higher technology
• Problem not of quantity but quality of graduates
• Industry requirements of type and quality not matched by education system
• Few pockets of excellence in higher education but poor quality of median institutions
• IT sector – At best 30 per cent of graduates in relevant fields have suitable skills to enter industry
• IT and tapping into manufacturing’s traditional graduate pool
Skills development

• Short-term measures
  – Firm-level
    • In-house training
    • University collaboration
  – Association-level
    • Skills registry database
    • Finishing schools and certification programs
    • Revising college curriculums
    • Upgrading industrial training institutes
Skills development – lobbying for privatization of higher education

• De-facto privatization of the education system due to breakdown of state education system and exit of elites from public education system (Kapur and Mehta 2004)

• Certain state governments eased regulations regarding privatization of higher education in the 1990s – proliferation of private higher education institutions, particularly professional colleges

• A paradox exists where de-facto privatization on one hand and high degrees of state control on both private and public institutions
Skills development – lobbying for privatization of higher education

• Business for allowing increased privatization, foreign investment in education and creating a more ‘market responsive’ and competitive system

• Other suggestions include providing funding directly to students through voucher systems rather than providing funding directly to university

• Government higher education policy remains ambiguous – politicians increasingly use higher education as vehicles of patronage and parties averse to decreasing state control
Affirmative action in the private sector

• Idea of job reservations for SC/STs proposed by Congress in 2004 manifesto and included in the common minimum program of the UPA

• Government claim that it is committed to the policy but would prefer industry to act ‘voluntarily’

• Various government panels have been set up to study the feasibility of the idea and various politicians have called for legislation from time to time
Affirmative action in the private sector

- Initial industry reaction was widespread opposition on various ground including impinging on competitiveness, meritocracy and lack of success in the past
- Fear of legislation
- Two peak associations (CII, ASSOCHAM) have formulated an action plan on affirmative action, which includes a voluntary code of conduct and steps such as scholarships, vocational and entrepreneurial training, coaching classes for professional exams
- Official position of industry is that it is against legislation and quotas but would undertake voluntary measures to meet goals
- Politicians continue to use threat of legislation but so far no concrete moves beyond accepting ‘voluntary’ action
Collective bargaining and industrial disputes

• Collective power of unions has been on the wane since 1991 due to internal and external factors
  – Growth in services, contract labor: challenges for traditional union strategies
  – In certain cases disjuncture between unions and their affiliated parties
  – Fragmentation between politically-affiliated unions
  – Multiplicity of unions even within same firm
Collective bargaining and industrial disputes

• Changes in the nature of collective bargaining
  – Trend towards decentralized bargaining (at firm rather than industry or regional level)
  – Managements moved away from collective to individual bargaining and use productivity-related clauses
  – Downsizing in late 1990s – union emphasis on job protection and reticence in collective bargaining
  – Trend changing in last 3 or 4 years – high growth, skills shortage and wages have risen
  – Some signs of increased union activity but in an environment of relatively favorable wages
Industrial disputes

• Industrial disputes since 1991
  – Industrial relations system more decentralized and less state-dominated since 1991
  – Trend of less state involvement and more bipartite resolutions
  – Number of industrial disputes and strikes fallen in the 1990s
  – Person-days due to lockouts now outstrip those lost due to strikes
  – Role of judiciary and employer-favorable decisions
Conclusion

• Business is more influential in the policy realm since 1991 yet no legislative changes in regard to labor policy
• Business influence varies even within the ambit of labor policy – de-facto reform with regard to labor market flexibility yet fearful of affirmative action legislation
• What factors circumscribe business influence in the broader policy realm and particularly labor policy?
• On what policies is business likely to have more impact?
Constraint 1: Mass politics

- Varshney (1999) provides a simple and useful distinction on how to think about reforms and economic policy, more generally
- Policy arena consists of those that affect “mass” politics and those affecting “elite” politics
- Ex. of “mass” politics – inflation and “elite” – financial liberalization and trade policy
- Many second-generation reforms such as labor policy in India falls into the mass realm – politically converted to a mass issue by parties and unions
- Mass politics provides some insulation against business influence
Constraint 2: Opposition politics

- Marked discontinuity between party stances when in power and opposition at both the national and state level
- High levels of electoral competition and anti-incumbency
- This explains both continuity of reforms process and the lack of consensus on second-generation reforms
Constraint 2: Opposition politics

- Labor policy – both the Congress and BJP-led coalitions have tried to implement changes when in power
- Both have opposed the changes they proposed in opposition
- Numerous other examples – insurance reform, VAT
- In addition, unions still capable of obstructing at least temporarily
Conclusion

• In short, labor policy is in the mass realm and parties have markedly different stance when in opposition and power

• Likely that labor reform will continue to be difficult in the current political environment

• Paper does not suggest that Indian state is responsive to the needs of its masses but democratic politics provides an automatic obstacle to business’ ideal policy preferences
Policy suggestions

• Strengthening enforcement of labor laws imperative
  – Multiplicity of laws detrimental
  – Conflicting jurisdictions and very little actual protection to labor
  – Scope for rationalization
Policy suggestions

- Current labor legislation and lack of enforcement resulting in a sub-optimal situation for labor and business
- Changes in law can be made that would benefit both
  - For example permanent employment generation is low and of a very poor quality due to ‘causalization’
  - By addressing some flexibility in contract labor laws but enforcing these laws, plight of laborers as well as business needs can be addressed
  - Major steps have been taken towards unorganized sector social security
Policy suggestions

• Business and inclusive development
  – Reliance on voluntary action in areas such as affirmative action and social security likely to be detrimental
  – Immediate steps other than legislation can be taken towards affirmative action
  – Tie subsidies to affirmative action measures
EXTRA SLIDES
Labor legislation in India

• Laws applicable to this paper
  – Industrial Disputes Act
    • Principal legislation for industrial disputes
    • Applies to all industries regardless of size
    • State adjudication of disputes (tripartite system)
    • Section (V-B) related to lay-offs, closure and retrenchment most contentious in terms of labor market rigidity debate
    • Firms with more than 100 workers need state government permission before lay-offs, retrenchment and closure
    • In case of closure, workers entitled to 15 days wages for every year of service
    • Section V-B amendments – business lobbied for long time for ‘exit policy’
Labor legislation in India

- Contract Labor (Regulation and Prohibition) Act
  - Regulates employment of contract labor
  - Includes measures for prohibition of contract labor where governments consider jobs to be of a perennial nature
  - With little success in terms of IDA amendments, increasing business demands to amend Contract Labor Act to allow for seasonal increases and decreases
  - Some state governments have eased contract labor provisions – AP passed law allowing temporary contract labor in core areas and increasing scope of non-core areas

- Trade Union Act
  - Formation and regulation of unions
  - Ease of formation but no clear rules for recognition of unions
  - No legal compulsion for employers to collectively bargain

- Factories Act
  - Registration and working of factories
Labor legislation in India

• Laws related to social security provisions in the organized sector
  – Employees’ Provident Fund (EPF)
    • Covers all employees earning less than Rs. 6500 per month
    • Employers and employees requires to contribute 12 per cent of the basic wage, dearness allowance and retaining allowance every month to fund
    • Amount accumulates interest and employees entitled to receive it on retirement after 55
    • Employees can borrow from the fund
Labor legislation in India

• Employees’ State Insurance (ESI)
  – Employers and employees have to contribute a certain percentage of monthly income to ESIC to provide for healthcare and benefits in the case of sickness, accident or maternity
  – Covers all employees earning less than Rs. 10,000 but companies exempt if they are willing to provide greater benefits than required by Act
  – Healthcare provided through ESI hospitals or designated providers under state government jurisdiction