



Towards greater labour market flexibility: Issues and Options

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ABSTRACT

This report proposes how we could think about a workable approach to labour market reform, different from the polarised debates we have seen so far. It recommends that such an approach could be started by making small tweaks to social security administration, increasing federal freedom and competition, and engaging meaningfully with trade unions. One of the primary messages is to move the reform narrative to the informal sector.

Analysts and policymakers have long been pushing the cause of flexible labour markets in India. On the other hand, such proposals have been met with staunch resistance from those whose interests are vested in an inflexible labour market, including employees, trade unions, and the labour ministry. After almost six decades of impasse on this issue, it is time to find a workable approach that could be acceptable to both parties – as marginal progress is better than a stalemate. This report shows how this is within the realm of the possible.

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EXECUTIVE SUMMARY

Since the 1991 economic reforms, growth in India has quadrupled but the rate of good quality jobs has stagnated. India's labour legislation has become increasingly inflexible and restrictive over time. The costs imposed by such regulation forces businesses to remain in the informal or unorganised sector, where regulation is little or absent but social security is also non-existent. As a result, 93 percent of the Indian workforce is employed in low-quality, low-paid jobs, with hardly any social security cover. On the other hand, there is evidence of productivity being higher in the formal sector.

So is formalisation the immediate solution? In the long run, yes, but it is not desirable until statutory costs decline and service quality of social security mechanisms is improved. In the face of mounting fiscal and political challenges, which are also opportunities to exploit, it is now increasingly important to undertake reforms that boost the rate of good jobs and growth – even if it's in the informal sector for now. However, reforms related to labour market and labour legislation have historically stalled, as they are politically sensitive, and only applicable to the 7 percent formally employed. There is an immediate need to move the reform narrative to the informal sector in addition to the formal sector.

Labour reforms suggested by analysts and businessmen are usually drastic in nature, failing to consider stakeholders with vested interests in an inflexible labour market. This paper attempts to bring forth a workable approach – or a middle ground – by taking into account the perceived short-term interests of those in favour of status quo and those who tend to favour immediate reform. It endeavours to carefully consider the political economy aspects of the situation, and identify the low-hanging fruits, which could bring about significant benefits for most stakeholders – employers, employees, trade unions and the government – while also preparing the transition of social and economic structures of the labour market to modernisation.

The paper discusses three areas of the labour market that could undertake potential reforms, with the view to re-shift focus on the informal sector and highlight a workable approach: Can competition boost social security coverage and livelihoods? What are the political economy considerations for federal legislation to encourage friendlier regulation for workers and businesses? Can trade unions accept reasonable reforms? The paper aims to further this decades-long impasse with the assumption that marginal progress is better than a stalemate. The hope is to push the dynamics in the labour market – informal and formal sectors – to force regulatory practices to adapt to evolving structures.

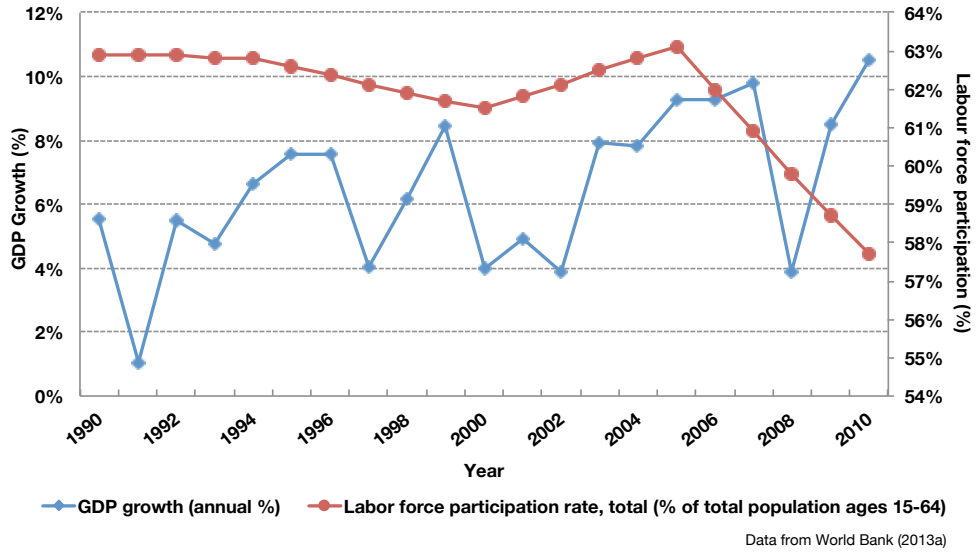
1. INTRODUCTION

In India, the relationship between economic growth and job creation has often been inconsistent. To the extent that even when jobs are added to the economy, they have been mainly in the informal sector. A growing informal sector often affects potential for business productivity and workforce security, highlighting the shifting relationship with economic growth. The interaction amongst these arguments can be clearly illustrated in the Indian context.

Informal sector in India can be best defined in three ways: “First, there is a definition in terms of exemptions from paying indirect taxes. Second, there is a definition in terms of small-scale industry (SSI), which again is defined in terms of threshold levels of investment in plant and machinery. Third, there is a definition in terms of labour laws. That is, an enterprise is unorganised if it uses power and employs fewer than 10 people or does not use power and employs fewer than 20 people. The last definition is the one that is used most often.” (Debroy, 2012). Informal sector workers can be identified by occupations like small farmers, fishermen, beedi packers, and/or bonded labourers, migrant workers, contract and casual labourers. Scavengers, loaders and unloaders also belong to this category (Planning Commission, 2001). For the sake of convenience, this paper uses the terms ‘informal’ and ‘unorganised’ interchangeably.

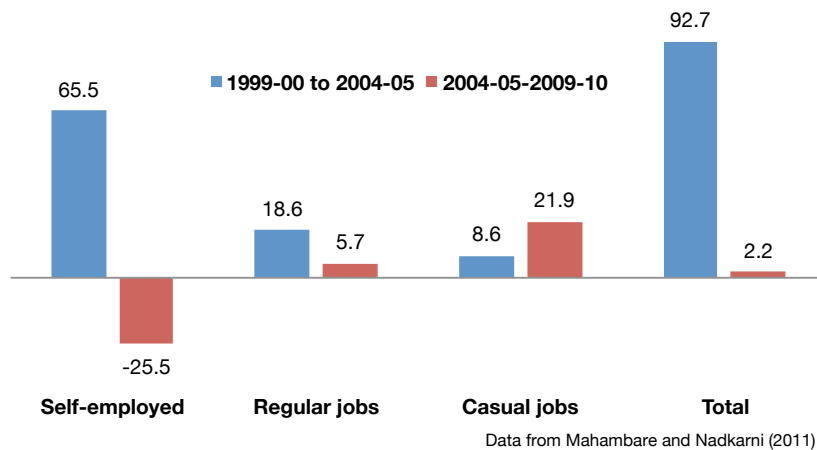
1.1 Inconsistent relationship between employment and growth: Since the 1991 economic reforms, employment rates did not pick up as much as growth rates. Sharma (2006) shows how overall employment, which experienced a steady growth of around 2 percent from 1961-90 (when average growth was about 3.5 percent) declined sharply to 1.5 percent during 1990-91 and further to around 1 percent during 1993-00, when growth rose to an average of 6 percent. The situation improved in 2000-2005 when India’s GDP growth rate averaged at 7 percent: employment went up by 1.6 percent (World Bank, 2013a). But as a U-turn, in 2005-2010 when growth averaged higher at 8 percent, employment dropped by 5.4 percent (World Bank, 2013a). Figure 1 captures these trends. Mahambare and Nadkarni (2011) analyse data from the National Sample Survey Office to conclude: “overall employment in India increased by 2.2 million between 2005 and 2010 as against 92.7 million between 2000 and 2005.”

Figure 1. Growth rate vs. Employment in India (1990-2010)



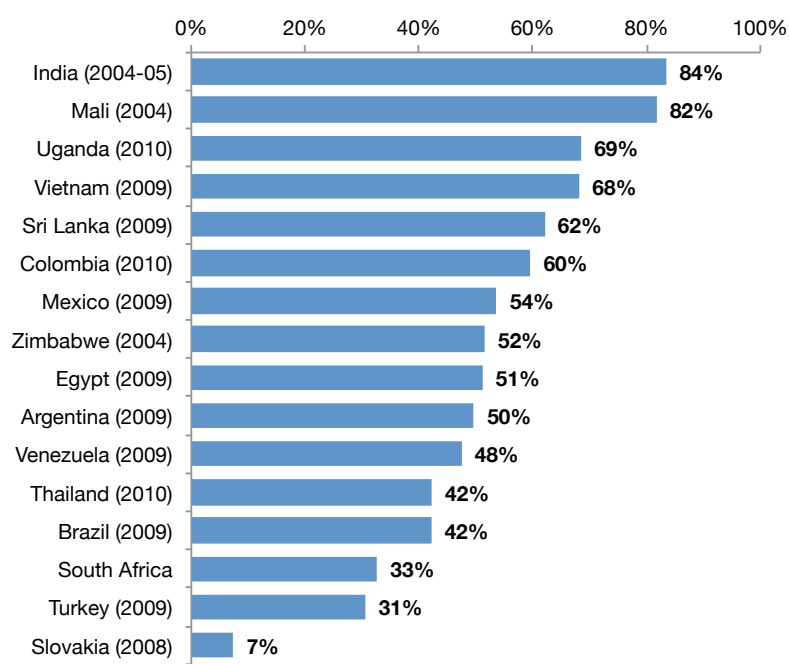
1.2 Slow rate of good jobs creation: It is also clear that while employment rate increased slowly, the rate of good job creation is going the opposite direction: while the formal sector grew slowly at 1.2 percent annually in 1983-94, this rate fell to 0.53 percent in 1994-2000 (Sharma, 2006). The massive fall in aggregate employment from 2000-05 to 2005-10 is mainly because of changes to composition employment. For instance, the number of casual (informal) jobs rose substantially in the latter period – 8.6 to 21.9 million. But regular jobs dropped from 18.6 to 5.7 million in 2005-10. However, the self-employed took the biggest hit with a drop of 25 percent in 2005-10 compared to 2000-05 (Mahambare and Nadkarni, 2011). Even the small increase in aggregate employment of 2.2 million during the low job growth period of 2005-2010 was due to a massive increase in informal jobs, as shown Figure 2 below (Mahambare and Nadkarni, 2011).

Figure 2. Changes in Employment in India (in millions)



1.3 Growing informal sector: A combination of slow and poor quality job creation has resulted in a bloated informal sector with poor productivity and security. The immediate reasons for a growing informal economy are increased taxes and social security contribution burdens, intensity of regulations, and low quality of public sector services (Schneider, 2002). Steadily increasing, today about 93 percent of the Indian workforce is employed in the informal sector out of a working population of over 400 million (Ministry of Labour & Employment, 2009).

Figure 3. Persons in Informal Employment (latest year available)



(Persons in informal employment as a % of non-agricultural employment)

Data from the International Labour Organisation (2013)

The World Bank (2013b) World Development Report focusing on labour issues directly links larger firms – in the formal sector – to a range of positive factors. They surveyed businesses in 102 countries, to find that larger firms (100+ workers) are likely to be more productive, innovate more, and compete in export markets, especially in the presence of foreign competitors. They are also likely to pay higher wages and control for worker characteristics like age or education through a wage premium. But it must be noted that the nature of India’s labour laws disincentivise businesses from expanding and moving to the formal sector, or even foreign investors to enter Indian markets. For instance, value added per worker India’s informal manufacturing sector is on average about one tenth that in the formal manufacturing sector (Sharma, 2009).

India’s massive informal sector also has negative consequences on the informally-employed workforce. Only about 7 percent of the workforce is covered by social security (Planning Commission, 2001). The rest of the 93 percent have no direct access to unemployment insurance, skills or training programmes, which also makes them less employable. Wages are lower as the minimum wage legislation would be too expensive for small informal businesses to implement, making poverty a widespread issue. In fact, as shown on Table 1, the share of informal jobs in the formal sector companies is on the upward trend (Papola and Sahu, 2012).

To put this in perspective, evidence has found that the average size of the informal economy as a percentage of gross national income in 2000 was 41 percent in developing countries, 38 percent in transition countries and 18 percent in OECD countries (Schneider, 2002). In general, richer countries tend to have small informal economies, and vice versa. An economy with a \$10,000 higher per capita GDP is associated with having 8 percent less output attributed to the informal economy (USAID, 2005).

Table 1. Distribution of informal workers in India

Year	Informal workers in Informal sector	Informal workers in Formal sector	Total percent of informal workers in the economy
1999-00	86.2%	5.86%	92.06%
2004-05	86.3%	6.37%	92.67%
2009-10	84.2%	8.09%	92.29%

Data from Papola and Sahu (2012), p. 41

Our current labour regulation framework is:

- **Archaic:** The current legislation that governs employment regulation is the Industrial Disputes Act (IDA) 1947, the clauses for which were conceived under the British Raj
- **Restrictive:** In 1976, changes to IDA were made so that firms employing 300+ people need to seek government permission to effect lay-offs, retrenchments and closures. This was further restricted to firms 100+ workers in 1982, making hiring or firing new workers extremely difficult even if they are inefficient (Sharma, 2006)
- **Convolutd:** Further arising from the IDA of 1947, there are about 47 Unions laws and 157 State regulations that overlap (Kant, 2012)

A growing formal sector thus seems to have more benefits – for businesses and workers – as opposed to the current trend of a growing informal sector. However it is difficult to expect businesses to formalise considering India’s poor institutional and regulatory setup.

Though many studies have looked into this issue, it may be worth revisiting the age-old debate of labour market reform to explore the scope of modernisation and flexibility with reference to the current political economy.

Historically, reforms suggested by analysts and businessmen have been drastic in nature, mainly pertained to the formal sector, and failed to consider stakeholders with vested interests in an inflexible labour market. While those interests are not entirely unreasonable, it might be interesting to collate a few reforms that have a workable 'go-between' approach for most stakeholders – employers, employees, trade unions and the government. This paper attempts to bring forth a workable approach – or a middle ground – by taking into account the perceived short-term interests of those in favour of status quo and those who tend to favour immediate reform. A middle approach could further this decades-long impasse assuming that marginal progress is better than a stalemate.

2. THE NEED FOR A WORKABLE APPROACH

The push for labour market reform is not new. A host of international and Indian economists, journalists, and analysts have written and discussed this subject for years. Discussing the benefits of a flexible labour market, Fallon and Lucas (1991) argue in their paper that employment in organised (formal) manufacturing would have been 17.5 percent higher in the absence of job security regulations. This agenda was brought forth in the Washington Consensus and reinforced subsequently, to promote labour market flexibility as part of "market fundamentalism."

Sharma (2006) also argues for the benefits of flexibility, but notes that the Indian labour (informal) market is already very flexible. Nonetheless labour laws could be made more simple and friendly as they currently promote litigation rather than the resolution of problems related to industrial relations. Sharma (2009) studies district-level panel data on informal manufacturing enterprises in India and finds that a major policy reform in 1991 removed license controls on specific informal manufacturing industries in India. This led to a contraction in the size of the informal sector and an increase in value added per worker, suggesting that entry deregulation could lead to productivity enhancing labour reallocation from the informal to the formal sector if labour laws are flexible.

On the other hand, several macro studies have contested the claims above. Roy (1998) found that job security regulations for the period 1960-61 and 1993-94 have not been responsible for slowdown in employment growth.

Real wage growth was also not responsible for poor jobs growth (Nagaraj, 1994; Papola, 1994). Goldar (2000) shows that employment in organised manufacturing sector grew at 4.03 percent per annum during the first half of 1990s despite the same statutory labour regulations.

Debroy (2005) captures the current extent of convoluted labour legislation and nature of restrictions. He also discusses the 2700-pages long recommendations in 2002 by the Second National Commission on Labour, which pushes for innumerable changes in labour market regulation. The restrictions imposed by Chapter V-B of the Industrial Disputes Act (1947) are mentioned in almost all studies as highly restrictive to businesses in the formal sector, and a major disincentive for informal businesses to formalise.

A more recent study by Debroy (2012) further reviews the unchanged state of labour regulation in India but throws in a different perspective by acknowledging that big changes may be politically difficult to bring about given political constraints. He also notes that rigidity in labour laws is just one of the many problems that discourage formalisation. Labour market reform has not been an uncontroversial task. Given that, a less-sensitive angle would be to examine the extent to which different Indian states have made amendments where possible to labour legislation and observe the results of those changes.

Besley and Burgess (2004) show that states that amended the IDA in a pro-worker direction experienced lower output, employment, investment and productivity in formal manufacturing; informal manufacturing output also increased. However, there have been some criticisms levelled against their failure to account for subjectivity in grading the states (Debroy 2012) and failing to account for labour laws other than the IDA (Bhattacharjea, 2006). The latest labour bureau report (July 2012) also guardedly acknowledges that states with more pro-labour legislation have not seen a fall in unemployment rates; whereas states like Gujarat, Haryana and Himachal Pradesh being more flexible have seen positive results. It should also be noted there is a lack of robust labour market data and, therefore, rigorous empirical research.

Opinion pieces and writings in the popular press have also accompanied these scholarly works. However, not much has been done mainly because reforms that are drastic in nature are not always feasible to implement.

In light of this, it may be worthwhile identifying labour market reforms which are realistically doable: exploring components of the labour market that could be usefully reformed, with lesser resistance, finding more ways to boost job creation, taking cues from different state reforms, developing the informal sector, and eventually explore the future prospect of formalising the informal economy to increase productivity. Finding a go-between, workable, approach is probably the second-best step in the right direction considering India's urgent need to boost livelihoods in the face of economic and political challenges, like:

2.1 Rising fiscal deficit: Although post 1991 saw employment rates declining, there was still good news in terms of rising growth rates. In 2011-12 growth rates fell as low as a decade ago (4.9 percent), even lower than the 2008 financial crisis. The Kelkar report (2012) on fiscal consolidation also warns of adverse consequences in light of the widening fiscal deficit (6.1 percent of GDP in 2012-13).

2.2 Exploiting the demographic dividend: The stakes to reform sooner rather than later will be particularly high in the coming decade to exploit the opportunities from the demographic dividend. As India's birth rate falls and life expectancy stabilises, the portion of the population that is of working age will grow. This will yield the "demographic dividend" – a period in which the burden of supporting the dependent young and old will be relatively light, leaving more income to plough back into investment.

2.3 Exploiting the New Manufacturing Policy: UPA introduced the this policy to harness the demographic dividend, aimed at increasing the share of manufacturing in GDP from a 16 percent (the figure is above 45 percent in China) to 25 percent and to add 100 million jobs by 2022. This is a classic case of putting the cart before the horse – those jobs won't be created if tough labour restrictions remain in place. Analysis by Crisil, an Indian consulting group, concludes that, without major reforms the share of manufacturing in GDP will only reach 17 percent (Crisil Insight, 2012).

2.4 Constant pressure to redistribute: While the failure to complete the reforms explains in part why growth has slowed it also represents an opportunity: Finishing the job now would eliminate barriers to business development, helping to pull the economy out of its slumping trajectory. The question is whether the changes are possible in the face of rising inflation, massive corruption scandals, and populist blowback led by opportunistic politicians.

Poor outcomes from the National Rural Employment Guarantee Act is a case in point (Wright and Gupta, 2011). The presence of about two dozen parties in the coalition with varied interests also adds to the difficulty.

2.5 Tendency to preserve the status quo: In 2008, economist Paul Vandenberg wrote a paper for the International Labour Organisation on the possible adoption of 'flexicurity' in India. Flexicurity is a combination of flexibility in labour laws to enable industry to manoeuvre itself out of a depleting fund situation by hiring and firing employees by means of individual contracts (and lesser regulation). This is combined with adequate social safety nets for the millions of workers who are dependent on such jobs. This idea, which has been Scandinavia's success story for long, was quickly dismissed by the Labour Bureau as unworkable in the Indian context. This is because it would only apply to 6 percent of the total workforce of India, and not to the other 93 percent in the informal sector – highlighting the lack of compelling narrative for such discussions in India. The discussion should rather be about how to bring the 93 percent under the system and apply a concept like flexicurity.

2.6 Striking trade unions: Virtually, all major Indian political parties have a trade union wing. "This means political parties (more so in a coalition) are reluctant to legislate on labour flexibility, since this would antagonise their own trade union wings" (Debroy, 2012). For instance, in February 2012 and 2013, millions of trade union members organised a national strike (All India Bandh) to demand permanent jobs and elimination of contract labour.

3. POLICY CONSIDERATIONS

For decades, the Union government has not been able to make a case to make labour markets more flexible due to several bottlenecks: trade union resistance, problematic legal drafting of amendments, tendency of the Union government to pass the buck on to States, passing reforms through small enclaves, or problems with inspections (Debroy, 2011). The policy recommendations below are an attempt to address these issues by taking a more workable approach – through a middle ground – to sensitively initiate the development of the labour market to pave the transition to flexibility and security in future. The reforms narrative must increasingly shift to the informal sector to boost social security reforms, sustainable livelihoods creation, State competition, and engaging with trade unions effectively.

3.1. Increasing contestability in the labour market:

How can competition and choice boost social security and livelihood opportunities?

While the formal sector is characterised by a rigid labour market, the 93 percent of the Indian workforce in the informal sector work under extremely flexible conditions. However, social security coverage is minuscule or non-existent. In India, social security in the formal sector is organised around the following key laws:

Table 2: Ministry of Labour & Employment (2013)

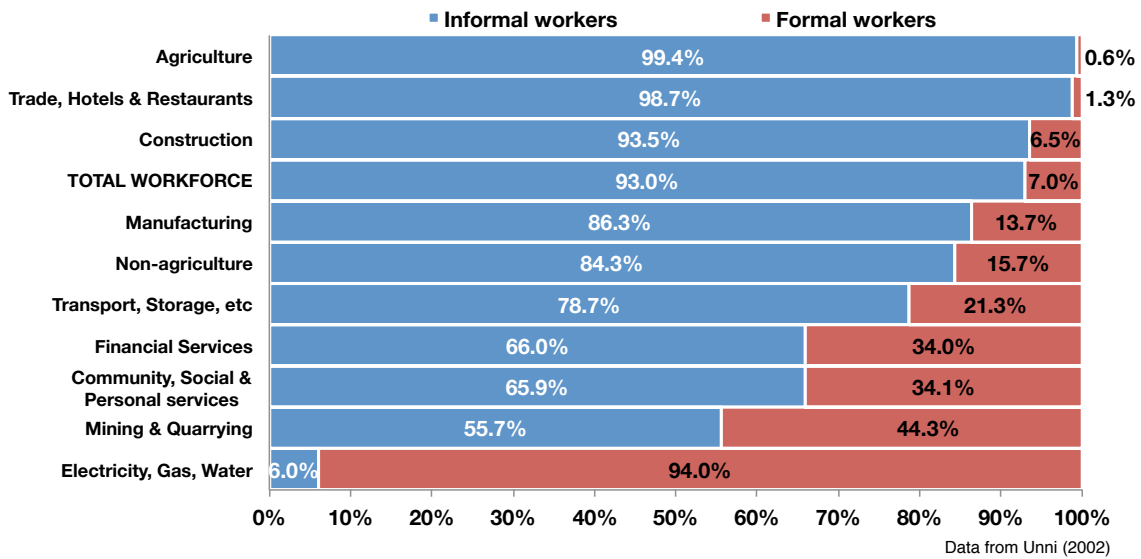
1. **The Employees' State Insurance Act, 1948** which covers factories and establishments with 10 or more employees and provides for comprehensive medical care to the employees and their families as well as cash benefits during sickness and maternity, and monthly payments in case of death or disablement.
2. **The Employees' Provident Funds & Miscellaneous Provisions Act, 1952** which applies to specific scheduled factories and establishments employing 20 or more employees and ensures terminal benefits to provident fund, superannuation pension, and family pension in case of death during service. Separate laws exist for similar benefits for the workers in the coal mines and tea plantations.
3. **The Employees' Compensation Act, 1923** which requires payment of compensation to the workman or his family in cases of employment related injuries resulting in death or disability.
4. **The Maternity Benefit Act, 1961** which provides for 12 weeks wages during maternity as well as paid leave in certain other related contingencies.
5. **The Payment of Gratuity Act, 1972** which provides 15 days wages for each year of service to employees who have worked for five years or more in establishments having a minimum of 10 workers

A cursory look at the most unionised state of India, West Bengal, suggests that three of their largest trade unions (CITU, INTUC, AITUC) focus their work around security for workers in the informal economy (Sen, 2009). Figure 4 shows the composition of labour force, by industry, employed in the informal sector. Scaling up security for informal sector workers could reduce the fierce resistance of some of these trade unions in addition to developing their work life in the informal sector.

3.1.1 Identifying difficulties to scale up social security in the informal sector: Although informal workers, especially contract employees, are supposed to be covered by social security schemes under the Employees’ Provident Fund Organisation (EPFO), implementation is often a problem because of several reasons:

A statutory body under the Ministry of Labour and Employment, the EPFO provides and regulates social security schemes such as the Employees’ Provident Fund (EPF), Employees’ Social Insurance (ESI) and Employees’ Pension Scheme (EPS). However, there is not much incentive for small, unregulated (informal) enterprises to adopt EPFO schemes mainly due to cost and administrative burdens.

Figure 4. Percentage of workers in informal employment to the total workforce in each segment, 1999-00



Businesses are increasingly moving to the Cost-to-Company approach of monetising all benefits to include in salaries, as opposed to providing benefits over and above the gross salary. Employers are required to pay expenses of 1.16 percent of salary or 4.46 percent of contributions (Sabharwal, 2012a). Benefits and contributions also leave low-wage employees with only over 50 percent of their monthly salary, as shown in Table 3. “This high salary deduction feels particularly brutal at lower wages and the biggest pushback for higher net salaries comes from employees who often have informal employment choices... EPFO costs 10-20 times more expensive than any public or private government securities mutual fund in the world,” explains Sabharwal (2012b). He recommends starting with the 12 percent employee contribution and gratuity to fix that.

Moreover, the perceived value for money is fairly less for low-wage workers as the EPF has often been criticised for poor customer service. The ESI, on the other hand, is also blighted with poor hospital facilities and lack of staff (Sabharwal, 2012b). A look at the ESI budget for 2011-12 and estimates for 2012-13 show that contributions have been steadily increasing, but expenses have been increasing too (ESIC, 2012).

There has been a net surplus at the end of all years, which shows a growing capacity to accommodate more people in the formal sector in future. However, poor service is unacceptable especially when their accounts continue to show a net surplus (Rs. 8557.87 crores in FY 2012-13).

Table 3. Salary deductions for Employees with Gross Monthly Wages of Rs. 5,500

	Employer (% cost)	Employees (% cost)	Monthly Total (%)	Monthly Total (Rs.)
Gross Salary				5,500
Deductions				
Provident Fund	3.67	12	15.67	862
PF Expenses	1.61		1.61	89
EPS	8.33		8.33	458
ESI	4.75	1.75	6.5	358
Professional Tax		3.18	3.18	175
Labour Welfare	0.36	0.36	0.72	40
Statutory Bonus	8.33		8.33	458
Gratuity	4.81		4.81	265
Total Deductions			49.18	2,705
Net Salary				2,795

Adapted from Sabharwal (2012b), *The Economic Times*, Dec 28, 2012

Collusion between businesses and labour inspectors is another adverse consequence of poorly managed social security schemes. A primary survey conducted in Karnataka highlighted several issues: creating bank accounts for provident funds proved difficult, unregistered firms often don't give their ex employees' contributions back, or don't deposit the contributions to the PF office (Rajeev, 2009). Here collusion becomes an optimal strategy: small, unregistered firms do not enjoy economies of scale and often have to cut back on contract wages and benefits. More often than not, they maintain more than one log – one for the labour inspector and other for the company. In such cases, the inspector often colludes with the company in exchange for a bribe. Therefore, for flexibility to work, implementation of existing laws is important in order to set a precedent for future laws.

3.1.2 Encouraging contestability and monitoring in social security provision: To reduce rent-seeking, improve value for money in contributions, and increase social security coverage for informal workers, competition in the pension sector is key. With the extension of the National Pension System (NPS) to all Indian citizens, including the unorganised sector – and the Pension Fund Regulatory and Development Authority (PFRDA) as regulator of the pension sector – employers should be encouraged to allow employees to opt into the scheme of their choice.

The NPS, unlike the EPF, runs on a defined contribution mechanism whereby a pensioner gets back the amount proportional to his contribution, rather than a fixed return. The NPS also enjoys a higher rate of return than the 8.25 percent under EPF. NPS scheme is web-enabled and removes the human interface that could invite rent-seeking, thereby inviting choice and contestability, and incentivising EPFO to reform alongside (Asher, 2011).

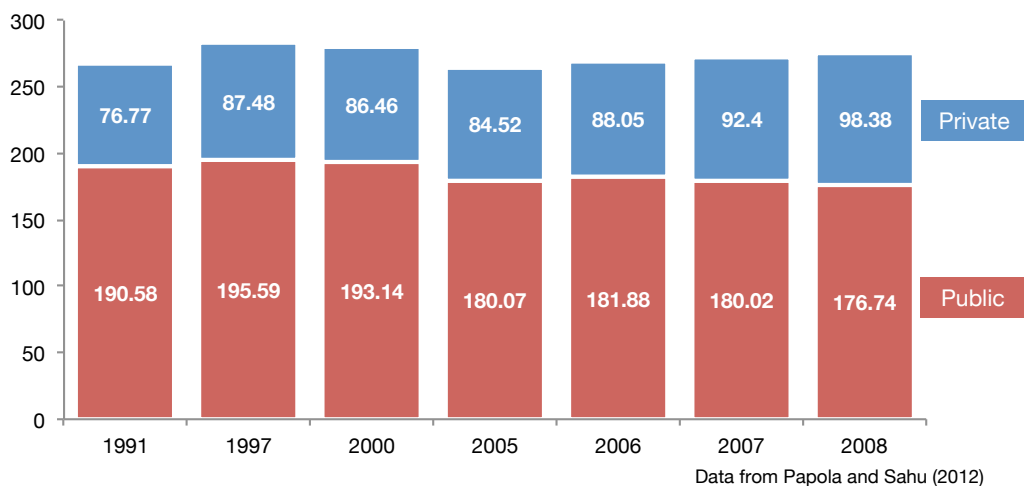
In addition, the government should look into investing and encouraging formal sector organisations modelled after private companies, like TeamLease Services, Ma Foi Randstad, Manpower and so forth, in the informal sector. For instance, besides extending a traditional human resources service, such organisations are also dedicated to improving their people supply chain by identifying and matching contract labourers – temporary staff – a sensitive subject amongst the trade unions. Contract labour is often exploited in India's formal sector – formal businesses employ short-term informal labourers absent social security provisions. The presence of such organisations would ensure that contract labourers get a fare wage for their services in addition to social security, as temporary jobs are still better than no jobs.

There is an increasing need for these organisations to set up shop in the informal sector. The government should incentivise small privately run organisations on a similar model to ensure safe contractual labour coupled with social security in the informal economy. This could help narrow the wage and benefits gap with the formal sector and also encourage informal workers to move to the formal sector, where productivity is higher (as cited before). Moreover, Aadhaar-linked benefits system could play a role in not only safe delivery of social security payments but also encourage financial inclusion.

3.1.3 Feasibility of formalisation and boosting livelihood opportunities: The Ministry of Finance’s 2013 Economic Survey acknowledges that, “while industry is creating jobs, too many such jobs are low-productivity non-contractual jobs in the unorganised sector, offering low incomes, little protection, and no benefits.” Formalisation is a desirable step, but without adequate skills and training amongst transitioning workers it would mean coming under expensive social security packages, especially where employers don’t offer the NPS option. Formalisation would also mean the application of innumerable labour statutes, which could increase costs substantially. The financial inability of small informal employers to provide social security and comply with labour regulations would result in either unemployment or mechanisation, or both. Moreover, majority formal sector jobs are in the public sector rather than the dynamic private sector, as Figure 5 shows.

However, these data may not be perfectly reliable due to wide job differentials and lack of tracking of active and inactive members in the EPFO (Pai and Moorthy, 2013). There is an imminent need for better data; professionalism in the EPFO and Labour Ministry should be a priority on this front.

Figure 5. Distribution of Jobs in Formal Sector (in Lakhs)



Small firms should be brought into the formal sector when statutory costs decline and service quality of social security mechanisms improve. It is important to remember that enterprises often consider the formality-informality trade off seriously: formalisation would entail entry costs and operating costs (Loayza, 1997).

Entry costs of doing business in India involve 12 procedures, 27 days, 49 percent of income per capita and paid-in minimum capital of 140 percent - as opposed to 5 procedures, 12 days, 4.5 percent and 13.3 percent respectively in the OECD (World Bank, 2013c). Operating costs – complex taxes, labour regulations, property rights, contract enforcement – are also high.

These factors explain why a whopping majority of enterprises in India choose to remain informal. But there are also costs related to informality: penalties and corruption, limited access to public services, missed opportunities on expansion, limited access to finance and cooperation with formal enterprises (Ishengoma and Kappel, 2006).

So is formalisation a solution in India at this stage? Contrary to most studies, Ishengoma and Kappel (2006) argue that considering the formality-informality trade off and the current business and regulatory environment in developing countries, “the opportunity costs of informality seem to be much lower than the cost of operating formally...total formality may mean closing up the business unless the business environment within which firms operate is improved.”

While States should be urged to act on boosting incentives to formalise, they should also allow individual states to boost livelihood opportunities in the informal sector with some provision of social security as argued above. This brings out the small difference between jobs and livelihoods. There may not be a necessary link between employment and poverty reduction “unless the employment provides assurance of sustainable livelihoods.” (CSPR, 2008). Informal jobs, often in the form of sustainable livelihoods, are frequently understood as substitutes to formal sector jobs in some countries. They should rather be looked upon as supplements mainly because the formal sector does not have the capacity to ensure adequate means of livelihoods (CSPR, 2008).

Gujarat Chief Minister Narendra Modi recently highlighted how we have power plants but no coal – and therefore no livelihoods – because of policy paralysis. Although the Law Minister intends to fix this, it is not directly possible as it is on the State List rather than the Union List (Bhatt, 2013). Different States have some degree of independence to undertake reforms to create and preserve livelihoods. States like Gujarat have been proactive in creating more choice and opportunities for farmers by amending restrictions on the Agricultural Produce Marketing Committee Act to allow them to sell their produce to wholesalers, exporters, industries and large trading companies.

That amendment also encourages contract farming, unlike other states like Maharashtra where farming activity is restricted, and output could be sold only via government-organised *mandis*. Gujarat has also been upbeat in making small amendments to labour regulation that has resulted in reducing rural and urban unemployment. It has even managed to keep its informal sector smaller than the national average (Hirway and Shah, 2011).

A bigger problem that restricts livelihood opportunities is also the lack of skills that are relevant to the market place. Welfare programmes like the MGNREGA have resulted in massive expenditure of taxpayer money and widening the fiscal deficit, but only creating a class of mostly young people without skills to contribute to India's economic progress or their own development (Ramakrishnan and Asher, 2012).

On the other hand, TeamLease (2009) recognises how “educated unemployment and shortage of competently skilled labour co-exist,” and therefore the importance of training labour in different skills and professions to avoid a mismatch as industry grows. Additionally, there is also a perceived preference for white-collar jobs in India, ignoring the importance of vocational skills that may be more suited to some workers' circumstances.

The State of Gujarat has entered into an agreement with TeamLease to set up the first ever vocational education university that aims to address the skills gap via its 22 community colleges that offer short associate degree programmes in conjunction with employers and increased access to technology.

Such initiatives could also benefit from scaling up knowledge economy aspects of skills development and talent building: “in which generation and application of knowledge, in all its varied aspects, are used as an integral part of generating income and wealth in the economy, and in household consumption and production activities” (Asher, 2013). Another way to boost such practices is to expand the number of internship opportunities offered to young students or graduates. This would enable organisations to reduce the time and cost of matching in the long run and tackle both educated unemployment and skills shortage (Asher, 2013).

It may therefore be safe to conclude that if labour laws and regulatory practices are not made compatible with economic and social structures prevailing currently – and with evolving structures – welfare cannot be advanced.

3.2. Political economy of economic freedom:

Can federal freedom encourage friendlier regulation for workers and businesses?

Another point of leverage for boosting productive livelihood opportunities is by making markets more flexible. While there are many ways of doing this, our aim will be to identify the low hanging fruit that could be exploited to make a marginally significant difference. While keeping within the decree of Union labour regulation, there are some spaces for individual States to make amendments and contextualise labour market laws in ways best suited to them in terms of increasing livelihoods, boosting productivity, flexibility, and maintaining stakeholder security. Positive outcomes from such an exercise would enhance the attraction of informal employers and workers to transition to the formal sector.

3.2.1 Moving legislation from Concurrent to State List: India's labour legislation is a subject in the Concurrent List, which means that both the Union and the State could enact laws pertaining to the relevant category.

There are:

1. Labour laws enacted and enforced by the Union government
2. Labour laws enacted by Union but enforced by both Union and State governments
3. Labour laws enacted by the Union but enforced by the State government
4. Labour laws enacted and enforced by the various State governments which apply to respective States (Ministry of Labour and Employment, 2011)

This simply means that as far as the State governments are concerned, they can make amendments to some Union statutes, and also add new State statutes to a certain extent. The Kerala Labour Laws Act of 2002, that is the simplification of returns and registers of small establishments, is one example (Debroy, 2011).

The 2004-05 Economic Survey by the Ministry of Finance also notes that, "Labour being a subject in the concurrent list, State-level labour regulations are also an important determinant of industrial performance. Evidence suggests that States, which have enacted more pro-worker regulations, have lost out on industrial production in general." State empowerment over labour legislation would mainly serve a twofold purpose.

On the one hand, states could safely experiment with incentives that suit their respective political economy in terms of boosting livelihood opportunities. On the other hand, they could incite competition with other states to perform better if the results are positive.

The following items appear under the Seventh Schedule (Article 246) of the Constitution, under the Concurrent List:

22. Trade unions; industrial and labour disputes.
23. Social security and social insurance; employment and unemployment.
24. Welfare of labour including conditions of work, provident funds, employers' liability, workmen's compensation, invalidity and old age pensions and maternity benefits.

States could easily exercise small reforms they have endeavoured to make by amending the Seventh Schedule to move labour to the State List. This will ensure that labour laws and regulatory practices are made compatible with economic and social structures prevailing in the States. It would also give them capacity to react to evolving structures to advance the welfare of workers.

There is already some evidence on this: the 2012 Labour Bureau survey documents that inter-state differences throw light on some having increased labour force participation and reduced unemployment rates. "Some of the States having pro-labour-rights policies have not performed well in terms of unemployment rate. The report is however not intended to arrive at any finding on the trade-off or complementarity between/of the pro-labour rights and pro-labour reform policies. It may perhaps be advisable for the State Governments to take cognisance of inter-state differences in framing labour-market policies."

3.2.2 Increased competition: The TeamLease (2009) labour ecosystem index, aggregating labour demand, supply and regulation, further shows why State governments should not miss out on the opportunity to differentiate themselves in the space available for labour ecosystem amendments to boost livelihood opportunities. This index shows Andhra Pradesh and Karnataka beating Delhi and Gujarat for the top spots on overall labour ecosystem, but several others who are improving on the different variables of their sub-indices that include strikes and lockouts prevention, labour participation rate, and inspector raj.

It is thus important to note that State initiatives in making amendments highlight the political will to boost flexibility for employers and job opportunities for employees. More importantly, successful initiatives to leverage opportunities via Union legislation show how individual States are better at dealing with their political economy issues. The continuous change in rankings on TeamLease's labour ecosystem index and sub-indices easily indicate how competition drives different States to do better than their peers. In addition, considering the challenges that the Union faces in initiating and implementing market-friendly legislation, it would make sense to make a case to move labour from the Concurrent List to the State List.

3.2.3 Evidence of improving employment and enterprise: Besley and Burgess (2004) show that states that "amended the IDA in a pro-worker direction experienced lower output, employment, investment and productivity in formal manufacturing." Informal manufacturing output also increased. States like Andhra Pradesh, Karnataka, Kerala, Rajasthan and Tamil Nadu, were considered to have more flexible regulation than Gujarat, Haryana, Maharashtra or Punjab. However, as mentioned before, Besley and Burgess (2004) failed to account for subjectivity in grading the states (Debroy, 2012) and for labour laws other than the IDA (Bhattacharjea, 2006).

A more recent study by Hasan and Jandoc (2010) improves on those criticisms (by incorporating Besley and Burgess 2004, Bhattacharjea 2006 and Gupta, Hasan and Kumar, 2009) but also concludes that Indian states with more flexible labour regulations tend to have larger-sized firms. The study also finds that average wages in labour productivity are much lower in small firms than large firms.

Debroy (2011) also documents the various States – Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, and Maharashtra – who wish to make labour laws more flexible to allow choice and opportunities for employees.

This includes flexibility in work hours, night shifts for women, or freedom to fix minimum wages. But these initiatives would require changes in Union legislation and have thus been shot down. Simultaneously, States have also attempted the same for employers. Initiatives have been taken to reduce the number of inspectors in Uttar Pradesh, Andhra Pradesh, Punjab, Gujarat, Karnataka, Orissa, and Rajasthan.

While the Union government was debating to introduce Voluntary Self-Certification (VSC) in the 11th Five Year Plan, Gujarat had already gone ahead with it (Hirway and Shah, 2011). VSC allows firms to register their compliance of labour regulation and avoid the inspector raj and unnecessary litigation in exchange. These certificates could be issued by “third party inspections with regulatory compliance certified by external recognised agencies.” (Debroy, 2011). Punjab, Rajasthan and Maharashtra are also trying to capitalise on VSC but there is often a tendency to pass such reforms in small enclaves, like special economic zones, to prevent rocking the boat too much.

Gujarat has also amended the IDA to allow retrenching workers but only at a higher compensation of 45 days’ pay. Workers can also be hired on “fixed term” – different from contract workers – to satisfy work needed to be done for short periods. Another popular reform that has increased flexibility for production units is to limit the number of registers to two (Hirway and Shah, 2011). But that same proposal to limit the number of registers to two, returns to one, and permit use of electronic formats, has been sitting in the Rajya Sabha since 2005 but no action has been taken so far (Debroy, 2011).

However, State freedom could also be used adversely. There are instances where reduction of State intervention could boost job opportunities: especially restrictions like the Shops and Establishments Acts that prevent employing women outside of ‘regular’ work hours adversely affecting establishments like call centres (Debroy, 2012). Sometimes, State freedom could also lead to ‘oversimplification’ (Debroy, 2012).

For example, the Factories Act for which States have the leeway to make rules, has seen “obtuse and unwarranted” intervention, with obsolete ideas – some states decree that factories must be whitewashed and plastic paint won’t do; earthen pots filled with water are required over water coolers; red-painted buckets with sand are required over fire-extinguishers.

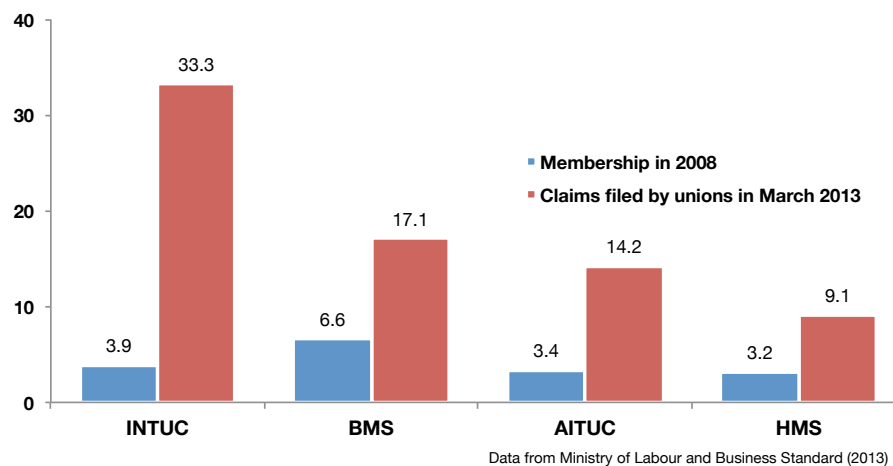
In some States, factories are not allowed to use modern computerised records necessitating the use of manual muster rolls (Debroy, 2012). This could be for the fear of substituting technology for jobs. However, eliminating such rigid rules and instead training people to use technology could result in boosting good quality jobs productivity rates, which is the need of the hour.

3.3 Political economy of resistance and dialogue:

How can trade unions accept reasonable reforms?

Several Union reform initiatives, especially reforms to simplify business practices like maintaining a limited number of registers, have met with strong resistance from the trade unions. Figure 5 shows the growth of union membership over time. One explanation is that unions see reforms as dilution of their rights. Another explanation is that such perceived dilution – emanating through the Planning Commission or the Prime Minister’s Council on Trade and Industry, as opposed to the Ministry of Labour and Employment – invites further resistance on their part (Debroy, 2011). In 2011, 2,943,221 man-days were lost due to strikes and lockouts, however this figure fell down to 198,578 in the first quarter of 2013 (Labour Bureau, 2013).

**Figure 6. Trade union membership survey: 2012-13
(major unions only; in millions)**



It is also interesting to note three things contrary to conventional wisdom:

One, instead of strikes, lockouts have become more common (Roy 1984 in Bhattacharjea 2006) to the extent that workers end up agreeing to downsize the workforce without government interference (Anant et al, 2006 in Bhattacharjea, 2006). While this is not an optimal solution, it is an indication that a healthy power balance needs to be brought about between workers and unions.

Two, employer unions also exist. However, due to lack of transparency in filing returns, it is not possible to determine the size of employer unions (Debroy, 2011). Additionally, there has been a rise in trade unionism in the informal sector.

National unions like the INTUC, AITUC, HMS, BMS and CITU are mainly manufacturing sector unions but there is a marked transition – “an increased switch to services and the rural sector” – in the union category (Debroy, 2011). For instance, SEWA, a Gujarat-based informal workers’ trade union enjoys high State-level membership.

Three, State-level unions form a much bigger chunk of the pie at 89 percent, the rest comprising of national unions (Debroy, 2011). Thus it makes sense to shift the political economy of dialogue from formal unions at the national level to informal unions in the State (Debroy, 2011). In general, it affirms the argument that labour and its related issues should be moved to the State List to ensure structural efficiency in regulation.

3.3.1 Balancing trade unions and flexibility: Most studies and papers often argue mainly about the detriment of restrictions – on hiring and retrenching in firms with over a hundred workers – to the health of the economy. While this may be true, it has also been politically difficult to scrap that portion of Chapter V-B of IDA because trade unions have historically defeated such moves. Instead, it would make sense to look at where labour market could be made flexible but at a lower cost to the trade unions to increase their likelihood of consent now and in the future.

One good approach to adopt was proposed by Debroy (2012), where efforts to segregate IDA’s layoff, retrenchment and closure provisions could provide some labour market flexibility. The three concepts reflect increasing degrees of severity, and unbundling them could make them more acceptable to the trade unions. Layoffs and retrenchment are more palatable to the trade unions and political parties than closures thereby making it easier to sell reforms. It is speculated that if compensation for layoffs and retrenchment were increased from 30 days’ pay per year worked to 45 days, political resistance may diminish. In West Bengal, this compensation is higher for layoffs – 50 percent of basic wages plus other benefits for the first 90 days and 75 percent thereafter until disposal (Sen, 2009).

Moreover, it is interesting to note that from 2007 data industrial disputes occurred more because of violence and indiscipline as opposed to layoffs and retrenchments (Debroy, 2011). In the latter case workers can approach labour courts where dispute settlements take an average of three to five years, some even span beyond 10 years. Debroy (2011) thus argues that it is possible to sell the idea that offering reasonable severance packages through IDA are far superior (and palatable) than haggling over layoffs and retrenchments. Severance pay policies in India are already “modest” by international comparisons (Asher and Mukhopadhyaya, 2005).

That brings forth the scope to trade off higher severance pay for three important opportunities – greater operational flexibility for businesses, greater professionalism in policy design and implementation by Labour Ministries, and lower transaction costs for new companies (Asher and Mukhopadhyaya, 2005).

3.3.2 Encouraging better quality, like-minded unionism: Unions comprising of similar industry units are more credible and easier to engage with. On the other hand, unions with members from differentiated industries and varied interests gives way to unchecked multiplicity whereby demands made by members result from herd mentality, and lack credibility. Changes to the Trade Unions Act 1926, such as Amendment Act 2001, could reduce unnecessary unionism that hampers productivity: “No union shall be registered unless at least 10 per cent (subject to a minimum of seven) or one hundred workmen, whichever is less, engaged or employed in an industrial establishment or industry, with which it is connected, are the members.” Earlier, any seven members regardless of connection to industry could apply to register a union. That was believed to be the main cause of union multiplicity (Sen, 2009).

The 2001 Amendment Act did see some immediate outcomes. For instance, the number of new registrations in West Bengal significantly and consistently dropped compared to previous years. Data from Sen (2009) shows that there were 10,274 registrations cancelled in 2001 – filtering out those registrations which probably did not meet the criteria of the Amendment in terms of industrial homogeneity. While there has not been much research on the direct implications of such outcomes, the main aim of such reforms are to ensure “orderly growth, reduce multiplicity and promote internal democracy in the industrial organisation and the economy.” (Business Portal of India, 2013).

3.3.3 Making bargaining unnecessary: Marginal investment in employee welfare and satisfaction could help foster better relations between employers and employees reducing the need for bargaining. Sen (2009) highlights employer strategies of union avoidance by providing incentives that could make unionising unnecessary in the first place. In fact, many large companies especially in the construction business in India tend to avoid unions altogether.

Three successful approaches include community development, work benefits, and timely breaks – to keep employees happy and satisfied thereby eliminating their need to join unions or spend time bargaining.

Some companies have undertaken community development measures by partnering with local governing bodies, like the panchayats (Sen, 2009). Activities include renovating railways stations, bathing ghats, or setting up social welfare activities like eye camps. Some companies also use the benefits approach – for instance, a multinational soft drinks and agricultural food processing company has adopted the route of employee satisfaction. They went beyond statutory requirements by providing transport, common uniforms for managerial and support staff, common dining hall, and extra cash for buying furniture or other household items. But these were combined with longer working hours (Sen, 2009).

The nature of composition of work times, breaks and benefits could also bring about positive results. An interesting example is that of a lubricant company that changed its working hours with similar employee gratifications: “Instead of a half-day on Saturday, it introduced a five-day week, with hours from 8.30 a.m. to 5.30 p.m. (apparently, nine hours). But this was softened by including a one-hour lunch break, providing breakfast, then lunch and finally tea in the evening. This ensures that all employees put in a full eight-hour workday.” (Sen, 2009). Unions in large firms with increased benefits are seeing a decline especially in the case of young and white-collar employees, who do not indicate a strong urge to unionise.

4. CONCLUDING REMARKS

Labour market reform is an important yet politically sensitive matter in most countries. Flexibility and security for employers and employees boosts livelihoods and the rate of good quality formal sector jobs. However, there are several stakeholders – employees and trade unions – who have a vested interest in keeping the labour market inflexible. Many of them think that a globalising world means a weakening of their rights – for the last two years trade unions have been going on national strikes to demand permanent jobs and declare an end to contract labour.

This paper identifies several potentially compatible reforms that could enable the political class to make a strong case for labour market reforms to all the stakeholders. Reforms are discussed in three areas of the labour market that could help on this front – social security and livelihoods, federal freedom to amend legislation, and engaging with trade unions' resistance:

One, extending social security coverage to the informal sector could be made possible by offering the less expensive National Pension System to employees. The NPS would serve as a competitor to poor quality services of the EPF and ESI thereby forcing them to reform, bring prices down and improve service delivery. This would also enable to bring down costs from the formality-informality trade-off for businesses. Creating sustainable livelihoods in the informal sector is a stepping-stone to economic progress and future expansion of the formal sector, where productivity is often higher.

Two, there is increased evidence that competition between different Indian states could spur reforms with positive outcomes. However, the presence of labour legislation in the Concurrent List serves as a bottleneck for States to exercise complete freedom in amending laws with respect to their prevailing political economy. Moving such legislation to the State List would not only add context specificity through State control, but also make labour laws less convoluted.

Three, engaging with trade unions is perhaps the most sensitive area of reform. It requires understanding the latest trends in unionism, encouraging organisation for credible demands, and designing benefits for employees that making bargaining and unionising unnecessary in the first place.

This is not a laundry list of reforms but a combination of suggestions to push the dynamics in the labour market to force regulatory practices to adapt to evolving structures – as without adaptability welfare cannot be advanced.

In the face of sluggish growth rates, a rising fiscal deficit, and a forthcoming demographic dividend, India's political elite must remember that boosting good quality jobs is a matter of top priority. On the other hand, simply discussing reform of the labour market in terms of 'labour law reforms' has not brought any results over the years – almost 60 years of reform concentration in the formal sector has not brought many results. Even if it is the intention of the government to reform in this area, selling those reforms in a way that compensates the 'reform losers' is an extremely difficult task. It is time we start a nuanced discussion on how to develop the labour market: to think about small reforms, which are compatible with the current political economy, and include the informal sector in the reforms dialogue.

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