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## FLEXIBILITY IN LABOUR MARKET: IS THERE A NEED IN INDIA



Parul Jain

M.Phil. Research Scholar at Centre for International Trade and development,  
SIS, JNU.



### ABSTRACT

The paper focuses on the issues concerning labour market reforms in India. The prevalent issue is the inflexibility in the labour market which has created difficulties for producers to adapt and respond to changes in the market and the production process. In the context of India, major labour regulations and their coverage have been discussed. The empirical evidence in the given literature suggests that employment protection does not necessarily result in unemployment and slower growth of the manufacturing sector. The entire debate on labour market reforms appears to be premised on the denial of existing regulations either directly or

indirectly and hardly intends to respond to the changing production process.

**KEYWORDS :** *VFlexibility ,Labour Market , labour market reforms .*

### INTRODUCTION

Labour market is a social institution which not only supports work and production, but also impacts the representation, social integration and the personal goals of its participants. Labourmarket reforms or labour market flexibility generally include relaxation of regulations and laws by the institution that regulates the labour market so as to adapt and respond to changes in the market and the production process. To understand the need for labour market flexibility, it is important to analyze what it means when labour markets are not flexible. A labour market is inflexible "if the level of unemployment-insurance benefits is too high or their duration is too long, or if there are many restrictions on the freedom of employers to fire and to hire, or if the permissible hours of work are too tightly regulated, or if excessive generous compensation for overtime work is mandated, or if trade unions have too much power to protect incumbent workers against competition and to control the follow of work at the site of production, or perhaps if statutory health and safety regulations are too stringent" (Solow,1998). Thus, given this inflexibility in the labour market, there is a need for labour market reforms. The debate on Labour market reforms was a part of the strategy proposed by the OECD in its 1994 Jobs Study - which regarded higher job creation in the US vis-à-vis Europe due to greater flexibility in the former and both the World Bank and the IMF have often taken a

similar view.

The concept of 'flexibility' is multidimensional and does not imply wage flexibility alone (Roy, 2008). According to the ILO, there are different kinds of flexibility being practiced at the firm level which include -organizational flexibility, numerical flexibility, functional flexibility, job-structure flexibility, temporal flexibility and labour-force flexibility. These different forms of flexibility practiced at the firm level give freedom to an employer to adjust the number of workers to the changes in market demand. Table 1 gives a brief description of the different kinds of labour market flexibility practiced at the firm level.

Table 1: Types of Labour Market Flexibility Practiced at the Firm Level

Type of Flexibility	Intended Processes and effects
Numerical Flexibility	Adjustments in the number of workers tied to changes in market demand and technological innovations. Results in shedding of workers whose skills have become obsolete and hiring of workers through contractual or temporary arrangements so that this workforce can be laid off easily when situation demands.
Functional Flexibility	Reorganization of workforce by a firm at varying levels due to technological changes. Job rotation, multi-skilling, re-training and internal mobility are adopted to achieve functional flexibility. Reduces labour cost and helps the firm to carry out tasks with existing workers. Results in no incentive for firms to have an additional hiring of workers.
Wage flexibility	Adjusting of wages according to changing cost competitiveness and product demand in the market. Regulations such as minimum wages are seen as a hindrance to this form of flexibility. Here the labour would be given free hand in setting wages and the labour unions and organizations would have no power to direct wage setting. This form of flexibility would help in adjustment needed in market clearance in the labour market.
Working time (or temporal) flexibility	Adjustment and utilization of labour hours (working time) according to seasonal variations in the product demand. Helps the firm to adopt practices of overtime work, part time work, shiftwork and weekly or annual arrangement of work without making changes in the number of persons employed in the firm.

Source: Sen and Dasgupta (2009), pp. 17-18

Globalization has resulted in a sharp increase in the range and intensity of competition, and more adaptable production systems and labour markets are needed if firms are to survive in the new global economy. There are three broad reasons for the perceived need for flexibility in labour markets. The first one emphasizes on the need for labour force to change according to the market fluctuations which happens because of increase in specialized products that requires firms to quickly change the size, composition, and at times the location of the workforce. The second emphasizes on lowering the labour costs and increasing productivity because of rising competitiveness. The third emphasizes on the need for organizational changes required to meet global competition.

Business firms and employers, today, largely do not want to abandon existing labour market institutions, and instead, prefer to push for changes that make institutions work in their favour. The need for labour market reforms is not because of changing production process due to global integration of the economy but because of their desire to retain their position of being the exploiter of labour power by legitimizing the practice of flouting the existing laws. To explore this issue further, we need to look at the arguments in favour of and against labour market flexibility.

### DEBATE ON LABOUR MARKET FLEXIBILITY

According to Jha and Golder (2008), there exist two broad views on labour market flexibility - institutionalist and distortionist. The "distortionist" view favours labour market flexibility. They view labour market regulations as the major obstacles to growth and employment mainly for the following reasons:

First, they argue that market outcomes are efficient and Pareto optimal if there are no institutions that regulate the labour market. The free play of market ensures employment of resources at the market-clearing prices; leading to both - efficiency (as almost all resources are employed) and equity (all are rewarded according to their marginal contribution) (Sharma, 2006). Regulation of the market by the state leads to deviations from full employment of all resources. In case of labour market, with the presence of trade unions and protective labour legislations, wages will always be greater than the marginal product of labour which will increase the cost of hiring the worker thereby leading to misallocation of resources and curtail the free operation of market forces to ensure full employment of labour. Hence, attempts should be made to remove as many of these market-distorting agents in the market as possible so as to achieve full employment of all resources and optimal social welfare (Sharma, 2006).

Second, regulations may create major obstacles in the adjustment of labour markets to different types of economic changes in a dynamic setting (Jha, 2008). They argue that in the face of adverse shocks, employers have to reduce the workers' strength; but they are not able to do so owing to the existence of stringent job security provisions. On the other hand, when the going is good and the economic circumstances are favorable, the firms may want to hire new workers. But they would hire only when they would be able to dispense with workers as and when they need to. Thus, the social security benefits accruing to workers become potential hiring costs for the employers. This affects the ability and the willingness of firms to create jobs (Sundar, 2005).

Finally, labour regulations that redistribute economic 'rents' from capital to labour may reduce profitability of the investors thereby discouraging investment and, thus, dampen the prospects of economic growth. Hence, there should be no institutions which compel employers to share rent with the workers.

The other view is the "institutionalist" which has a perspective that labour regulations may fulfill important redistributive roles in a market economy, particularly from the point of view of vulnerable categories of workers and this may provide necessary insurance from adverse market outcomes (Jha, 2008). They argue that reduction in nominal wages will lead to a decline in the effective demand which was based on Keynes ideology. Keynes, argue that this orthodox position is based on three unrealistic assumptions: a) reduction in nominal wages leaves demand unaffected which is not the case because reduction in wages must have some impact on aggregate demand via reduction in purchasing power of the workers; b) society's marginal propensity to consume should be equal to 1 i.e., increment in income because of reduction in price should be fully reflected through increase in consumption, otherwise the entrepreneurs cannot reap the benefits through increasing sales at the given rate of profit c) employment would increase because of reduction in nominal wages only when demand for labour in response to changes in nominal wages is not inelastic. It has been generally viewed that the price of a product can be reduced only by pushing down nominal wages rather than reducing the nominal profit. Hence, if labour market is left free of institutional rigidities, the entire burden to reduce prices will fall on the worker instead of capital. This creates a need for labour market institutions to protect the welfare of the workers (Roy, 2008).

Furthermore, as long as a firm continues to compete on the basis of low wages and bad working

conditions, there is no motivation for innovation to improve productivity. Only when the path to competition on the basis of low wages and bad working conditions is barred by providing a floor of labour standards, the firms will focus on investment in technological and organizational innovation, which, in turn, will lead to better wages and working conditions (Sharma, 2006).

Apart from this, they argue that the trade unions do not affect the profitability of capital. By acquiring firm-specific skills, workers create economic rent which increases the marginal value product of labour. Thus, trade union's demand for increasing wages in order to share the economic rent does not affect the firm's profitability. Rather, this effort protects the skill specific internal labour market and prevents recourse to a degenerating production process involving 'raw' labour. So employers pay efficiency wages in order to retain skilled workers by way of which they can also reduce search costs for hiring productive labour. The efficiency wage argument suggests that profit maximizing firms pay efficiency wages, i.e., higher than market clearing wages but this is if and only if the gains in productivity from doing so outweigh the costs, so that profits are increased (Roy, 2008).

### LABOUR FLEXIBILITY IN INDIAN MARKET

The issue of flexibility in the Indian labour market has been particularly debated in recent years in the context of manufacturing sector employment – comprising both the factory and the non-factory segments (Sharma, 2006). To analyze the effect of the effect of flexibility policies on Indian labour market, it would be important to look at some of the main changes that have been brought forth in recent years which have direct implication on labour market flexibility and the main demands that are still being raised to usher in more labour market flexibility in India. The two main labour laws that are the major points of debate in this regard are the Industrial Disputes Act (1947) and the Contract Labour Act (1970).

### INDUSTRIAL DISPUTES ACT (1947)

The Industrial Disputes Act (IDA) 1947, provides for machinery and procedure for investigation and settlement of industrial disputes and applies to all industries irrespective of their size. The main amendments are as follows: 1972- any industrial establishment employing more than 50 persons will have to give 60 days' notice to the appropriate government before the closure of the industry, stating reasons for the closure, 1976- a special chapter (Chapter V-B) was introduced which made compulsory prior approval of the appropriate government necessary in the case of layoffs, retrenchment and closure in industrial establishments employing more than 300 workers, again in 1982 the limit of the employment size was lowered to 100 for mandatory permission before closure and the number of days of notice were increased to 90 days. In 1984, this amendment was again redrafted and layoffs, retrenchments and closures in establishments having more than 100 employees had to follow the same procedures for seeking permission from the government.

The main labour market reforms demanded by Indian firms are the repeal of Chapter VB from the Industrial Dispute Act, 1947, which argues that the company can be saved by lay off and retrenchments instead of closing it down. Currently Chapter VB of the Industrial Dispute Act says that industrial establishment, viz. factories, plantations and mines employing not less than 100 workers have to seek prior permission from the appropriate government department to effect lay-off, retrenchment or closure. This, it is argued, creates unnecessary deterrence in quickly responding to the fluctuations faced in the product market and makes the firm uncompetitive, thus hindering its capacity to generate employment.

Section 9 A of the Act has also been a cause of concern. It lays down conditions for service rules,

according to which employees should be given at least 21 days' notice before modifying wages and other allowances, hours of work, rest intervals and leave. It has been said that this can cause problems when employees have to be redeployed quickly to meet certain time bound targets and also could constrain industrial restructuring and technological upgrading (Roy, 2008).

### Contract Labour (Regulation and Prohibition) Act (1970)

The Contract Labour (Regulation and Abolition) Act 1970 seeks to protect the interests of workers employed on contract and provide the contract workers, minimum wages through licensing of contractors and by holding principal employers accountable for enforcement of the law. It empowers the state and central governments to prohibit the conduct of certain kinds of works through contract labour. It was argued that this will restrict factor market flexibility, impede efficiency and reduce employment. It is, therefore, necessary to amend the law to facilitate outsourcing of activities without any restriction and to make appointments on contract.

However, the workers believe that amending this Act will finally result in employers employing only contract workers and the 'sacking' of all regular workers. Hence, instead of generation of more jobs as promised by the employers, it will lead to more exploitation and poorer working conditions. But the employers have a different opinion. They say that more emphasis should be laid on core activities and peripheral activities should be contracted out as that will be more efficient and will lead to lesser costs and for that they should have greater freedom to employ contract workers. So employers are of the opinion that the Act should be scrapped (Sundar, 2005).

Apart from these other issues such as delinking of dearness allowance with consumer price index, relaxation of labour laws in export processing zones and permission to employ women in night shifts are a part of the reforms agenda. Though these laws are reviewed in order to reduce the cost of hiring the worker, the capitalists in India are pushing the labour market issue so as to make the workers disposable. In other words they are trying to legitimize the normal practice of flouting of existing laws (Roy, 2008).

### EMPIRICAL EVIDENCE FOR INDIA

In the Indian context, there has been an argument that inflexibility in the labour market has impaired the growth of firms, thus, obstructing the prospects of overall growth of the Indian economy. We need to look at the empirical evidence to substantiate the rigidity impact of labour laws. It appears from many studies that changes in labour law that employers want will make Indian labour market more flexible, making it easier for them to suit the hiring practices to the needs of the market demand. Sharma (2006) shows the weak link between change employment and labour laws. Instead, employment is influenced more by micro and macro-economic factors. The author concludes that labour laws and other related restrictive measures play a small role in employment in manufacturing firms in India. Interestingly, there is a phenomenal change in the new hiring practices (informalisation of the workforce in the organized sector), firms showing marked preference for this as it is likely to be the result of restrictive labour measures such as any retrenchment of employees in the firm, which has more than 100 workers require government permission. Because of this restrictive policy arrangement, companies subscribe to either more of temping or outsourcing of activities (Sharma 2006).

In spite of all the "protective" labour legislations, there was improvement in the growth of employment in organized manufacturing during the first half of 1990s. At the aggregate level, the growth rate of employment was 1.6 per cent per annum during the period 1972-73 to 1989-90, which increased to around 3 per cent per annum in the period 1990-91 to 1997-98 (Goldar, 2002).

Another major work (Besley and Burgess, 2002) examines the link between labour regulations and economic performance in Indian States. The study specifically looks at the role of labour regulations (by looking at the amendments to Industrial dispute Act, 1947) in explaining manufacturing performance in different Indian States, covering a long period of 35 years from 1958 to 1992. The amendments are classified as pro-worker, pro-employer and neutral. The study finds that states which had enacted pro-worker regulations experienced lowered output, employment, investment and productivity in formal manufacturing. Their analysis also found that regulation in pro worker direction was associated with increase in urban poverty. States with pro-workers amendments, on an average, had a high per capita manufacturing output in 1960 relative to control states and pro-employer states. However, by the 1990s, the study notes that, there was no statistically significant difference between pro-worker and pro-employer states. The study finds that labour regulations have had a significant effect on creation of informal sector. With regard to employment, which is the focus of this paper, the study notes that States with more pro-worker regulations have lower level of employment in registered manufacturing, indicating that there is less absorption of labour in the formal sector. The study argues for reforming labour laws which will help in generating an impressive economic growth from the manufacturing sector.

However, there have been some criticisms leveled against their failure to account for subjectivity in grading the states and failing to account for labour laws other than the IDA.

Bhattacharjea (2006) however, has a different opinion. In his article on the review of papers relating labour relation to industrial performance, he criticizes Besley and Burgess (2004) by saying that classifying a state as pro-worker or pro-employer on the basis of a single amendment while all other central or state laws remain unchanged can be quite misleading. But still, he advocates for reforming labour laws by rationalizing them, avoiding inconsistencies and making compliance less arduous. He also raises an important point saying that the organized manufacturing sector comprises only 6 per cent of the total labour force, the rest 94 per cent being in the unorganized sector, where chapter VB is applied to the smaller figure, whether reforming labour laws would make any difference to the national employment situation in spite of labour flexibility creating employment in this small portion of the sector.

In another study by Deshpande et al (2004), around 1,300 manufacturing firms across nine industry groups are examined to determine the levels and changes in employment between 1991 and 1998. The study reports that both the unionized and non-unionized firms increased capitalintensity over the relevant period; thus, the presence of unions does not support the core conclusion of the distortionists as regards the adoption of capital-intensive technology. The study also reports that the share of permanent manual workers declined from about 69 per cent in 1991 to 62 per cent in 1998, but the share of casual workers in the non-poor permanent category increased even faster, and the bigger firms resorted to greater use of non-permanent workers. This study clearly shows that the labour law does not create any rigidity in the labour market.

Thus, it appears from the above review that the employment protection does not necessarily result in unemployment. These studies, however, indicate that there is a valid concern over the types of jobs that are being created due to flexibility in laws. The whole debate on whether rigidity of the labour laws is hindering growth of the manufacturing sector and hence employment generation in this sector seems vague.

## CONCLUSION

The above analysis suggests that the labour market in India is not rigid enough to reduce

employment and feeds upon the profit of capitalists. Further, all the hue and cry to create flexibility in the Indian labour market further lacks adequate factual support as the Indian labour market is already rendered flexible due to the presence of vast informal sector (informalisation of formal sector) and lack of strict enforcement of the already existing labour protection laws. This is giving an advantage to employers to weaken the workers' bargaining capacity and enabling them to retain their power in the capitalist production. Even if we look at the labour market legislation in India, we will find that there is hardly any amendment in the labour laws since 1989. Despite that, the Indian labour market has become flexible in a concealed manner.

Also, competitiveness of a country in the global market is so often linked to the degree of labour market flexibility measured in terms of union density. But, by looking at the World Economic Forum's Survey of global competitive index of countries for the year 2007-08 and the ILO figures for the share of unionized labour in the total number of employees, we find that countries having first ten rankings according to the global competitiveness index vary largely in terms of percentage of unionized labour. On the one hand, countries such as the US and the UK with competitiveness ranks of one and nine respectively, are relatively less unionized having unionized employees in the tune of 13 per cent and 29 per cent. On the other hand, countries such as Denmark, Sweden and Finland with competitiveness rank three, four and six record highly unionized labour force, the percentages being 76, 82 and 76 respectively. Hence the argument that trade union activism throws stumbling blocks in the way towards achieving competitiveness is empirically flawed (Roy, 2008).

In the present context, the main intention of labour market reforms is not to meet the demands of the changing production system but to satisfy the appetite for higher profits and to retain the power of exploiting the labour class by not abandoning the existing labour market institutions, but instead preferring to push for changes that makes institutions work in their advantage.

Thus, we can say that labour market reforms are premised on a denial of existing regulations, either directly or indirectly and hardly intends to respond to changing the production process.

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