Business Standard

Subir Gokarn: A potential jobs breakthrough

What the government should do to realise the full benefits of Rajasthan's labour reform

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The announcement by the Rajasthan government that it would amend the state's labour laws to give employers in the manufacturing sector the flexibility to lay off workers without prior government approval is an extremely significant development. The plan is to raise the ceiling under which such approval is not needed from 100 workers to 300. This comes 14 years after the first attempt to do this at the central level was made and aborted. The Budget speech in February 2000, delivered by Yashwant Sinha, finance minister at the time, proposed raising the ceiling to 1,000 workers. This was strenuously resisted, particularly by trade unions, including the Bharatiya Janata Party-affiliated Bharatiya Mazdoor Sangh. Ultimately, even a compromise ceiling of 300 went nowhere, leaving as perhaps the most significant component of the unfinished reform agenda.

Over the past few years, some other states attempted to use their powers under the Concurrent List - on which labour laws happen to be - in order to implement this reform. But this required the assent of the president of India, which would only have been given if recommended by the central government. This, clearly, did not happen. One would presume that the new dispensation will facilitate the passage of the Act and, barring a legal challenge, at least some other states will follow suit. Twenty-three years after the process of liberalisation began, this most critical of domains is finally being included in the process.

Several analysts, including myself, have been crying themselves hoarse about the importance of this reform. Flexible labour contracts are typically associated with faster employment growth. One can cite cross-country evidence in favour of this proposition, but why go that far? In our own context, the much faster growth in employment in the services sector compared with manufacturing is directly attributable to the fact that the former does not have to deal with the same job security mandates as the latter. The ability to lay off workers when business conditions so warrant - however brutal and harsh this may seem - actually provides employers an incentive to hire more workers when times are good. If they can't be laid off, they won't be hired.

Of course, many other factors play a role in businesspersons' willingness to hire workers. Assuming that the most significant of these are taken care of (and that is a major assumption), the proposed amendment will accomplish two things. First, it will induce new investment in factories that can achieve cost competitiveness in the 100-300 worker range. Second, it will encourage them to choose technologies that are relatively labour-intensive. However, in my view, while the proposed reform is very significant, a number of other things have to be done on the labour regulations front to be able to realise substantial benefits from it. Here are three.

First, while the new ceiling applies to existing as well as new establishments, it is necessary to go one step further and introduce a grandfathering mechanism for establishments with more than 300 workers. This means that, while existing establishments will have to work within current regulations, new ones will be free to lay off workers. This will effectively tilt the competitive scales towards new investment, which is good for both employment and productivity, because new factories will use newer technologies. Since the existing firms can't lay off workers, there aren't really any direct losers in this game. For those who have an aversion to the concept of grandfathering, here are two arguments. One, China did exactly this in the early 1990s, when it sought to expand employment opportunities outside its special economic zones, with success. Two, we have used grandfathering in a number of situations. For example, government employees who joined after 2004 were put on a defined contributions (provident fund) scheme, while those who started earlier remain on defined benefits (lifetime pensions). Also, the reform of the Mumbaj tenancy legislation, which applied to buildings constructed after 1987, balanced rights between tenants and owners, leading to a residential real estate boom in the newer areas of the city. Notwithstanding its intrinsic unfairness, if a larger purpose is served, it should be done.

Second, we cannot really visualise workers being laid off unless a safety net is provided, even if for a limited period. Safety nets are typically funded in part by contributions from workers when they are working. The state may enhance the resource base to ensure a minimum threshold of benefits. Designing and funding an appropriate safety net should be an integral part of the reform process. Where the public funds will come from depends on each state's particular situation, in terms of both potential job growth and fiscal space. Perhaps the Centre will also have to contribute. One channel that could be explored is the setting up of a national urban workers unemployment insurance scheme, akin to the national rural employment guarantee programme. It will be a long haul to make it relatively leak-proof, but it is an unavoidable component of any labour market reform strategy.

Third, outside of the legislative and administrative processes involved, a capacity to predict the kinds of jobs that may be generated as a result of these reforms needs to be put in place. There is always an element of control in this. The government can specially encourage the growth of certain industries, making it easier to decide what sort of skills need to be created to ensure that the jobs that emerge can be filled. But the process can also be spontaneous, which means that the skill requirements have to be anticipated based on some judgements about likely trajectories. Errors will inevitably be made. People will train for jobs that might never materialise. The role of this forecasting activity is to minimise such errors, even if it cannot eliminate them. This, of course, puts the onus on the state to ensure that appropriate training and certification capacity is available, or quickly created.

The bottom line is that our slow pace of employment generation is one of the greatest threats to political stability in the country. A lot of time has been lost in attempting to meet this challenge, a period during which technological conditions and the nature of work itself have changed dramatically. But that doesn't mean we should stop trying. The Rajasthan government's proposals, if designed correctly, offer a potential breakthrough on the jobs front. The economy really cannot afford another setback.

The writer is director of research, Brookings India, and former deputy governor, Reserve Bank of India. These views are personal