INDIAN INSTITUTE OF MANAGEMENT KOZHIKODE

Working Paper

IIMK/WPS/179/OBHR/2015/015

March 2015

Deregulation of labour market: A comparative study of secondary sector in India and China

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DEREGULATION OF LABOUR MARKET: A COMPARATIVE STUDY OF SECONDARY SECTOR IN INDIA AND CHINA

Global competition, technological advancement, and outsourcing of production have demanded the organizations to be cost effective and flexible in order to face the change for their survival and growth. However, factors like slow growth rate, high unemployment and presence of union have constrained the government to deregulate the labour market in India. Can India learn from China on the deregulation of the labour market and practice flexibility? The purpose of this paper is to identify the success factors linked to deregulation of labour market and its impact on secondary sector in China. A model of these factors which led to the change in the legal system in China leading to flexible labour practices is explored based on the secondary data. The author tries to critically examine this model of labour market deregulation and its impact on the labour class in China. This paper also attempts to compare the existing legal system in India against the China model. The labour market regulations influencing the secondary sector in India and China is also debated against the practices in the developed countries. This research outcome will provide input for the policy makers and government authorities of both the countries to have a relook at their strategy for labour market regulation. The findings have also implications for the actors of industrial relations such as employers and trade union leaders in deciding their future course of action in labour management.

Key Words: Labour market regulation, Deregulation, Secondary Sector, India, China

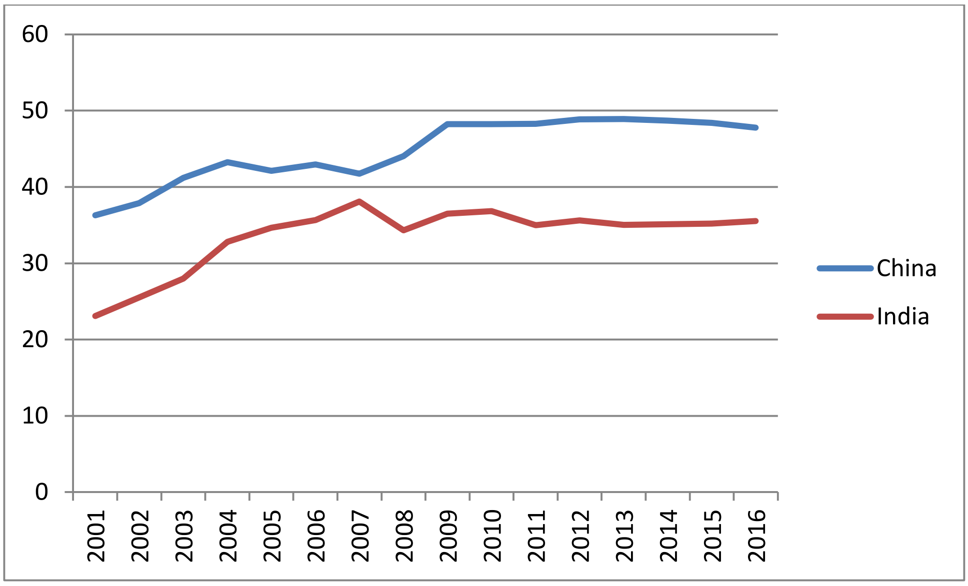
INTRODUCTION:

India and China created headlines for the World Bank and the other international organizations by advocating that trade liberalization leads to economic growth. While China opened up its market in 1980s, India followed the suit of its neighbor in 1990s by liberalizing the economic policy and allowing foreign direct investment (FDI) by setting up of Special Economic Zones (SEZs) and Export Processing Zones (EPZs). However this magic of liberalization, privatization and globalization (LPG) along with the trade policy reform has not only influenced industries but also the labour force of those countries more particularly in the developing economies which were not prepared enough to abreast the subsequent changes of this deregulation of market. China has adopted flexible trade policies and made the necessary changes to the labour laws which had helped in the growth of the market particularly in the industrial sector. This paper tries to explore the effectiveness of the deregulation of labour market as a part of the liberalization process and compares the position of China and India visa vie each others.

AN OVERVIEW OF INDIA AND CHINA

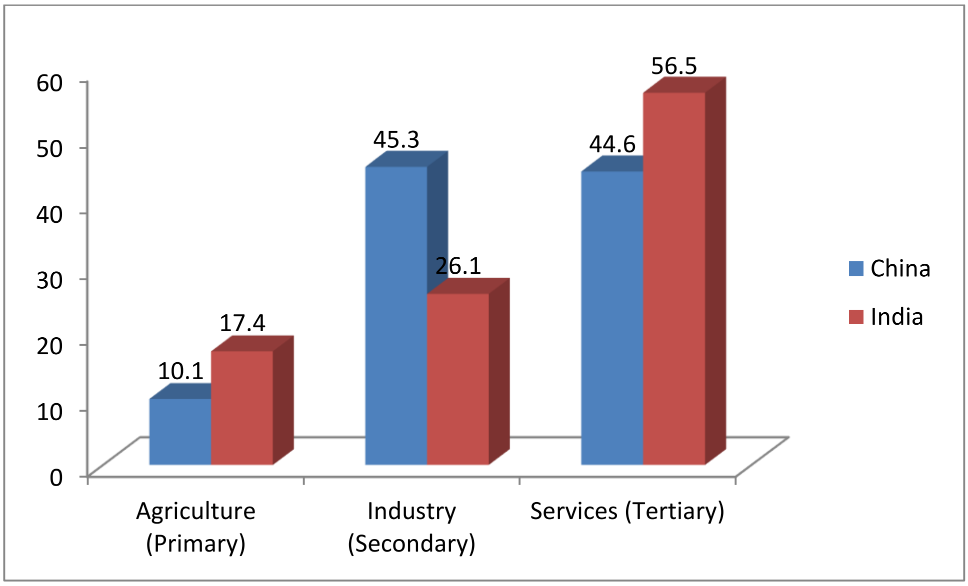
China and India are the country which has experienced the growth of their economy after liberalizing the market. Both the country has experienced increase in the contribution of invest as a percent of GDP (See Figure 1). While India saw a steady growth of FDI inflow in tertiary sector, the major inflow of FDI in China is in the secondary sector. China's GDP is equivalently contributed by the secondary (45.3%) and tertiary sectors (44.6%), while India has a sectoral imbalance as the corresponding contribution to GDP is 26.1% and 56.5% by the secondary and tertiary sector respectively (See Figure 2). The world development report reflects that India and China has a total share of 36.2 % of the global investment in the year 2012 (see table 1).

Figure 1: Total Investment as Percent of GDP



Data Source: Planning Commission, Government of India

Figure 2: GDP Composition by sector (in %): a sector wise comparative view of China and India



Date Source: The World Factbook

Table 1: Distribution of Global investment

	Share of Global Investment		
Country	2000	2007	2012
China	11.0	18.2	28.1
India	4.0	6.9	8.1

Date source: World development report 2013

Chinese government initiated the economic reforms way back in 1978 and carried them forward in 1990s. China followed an export oriented growth pattern as opposed to an Indian ‘import-substitution’ pattern (Sinha, 2008). China has seen various rounds of decentralization, centralization and recentralization motivated by economic and political factors. However, 1994 recentralization policies including the tax sharing reform led to a fundamental shift in relations between the central and local governments (China Daily, 5 November, 2013).

The Indian government is termed as conservative in its approach as the liberalization policy is not supported by flexible labour regulation which has facilitated the corporate an easy entry to the market but difficult operation and exit regulations. Though the economic policies and economic and industrial regulations have become liberal, industrial labour laws have not. Barriers to entry have been eased, but not the barriers to exit. While studying the FDI performances in China and India, Wei (2005) noted that about two thirds of the FDI flow to China went to manufacturing sector (secondary sector) mainly to high tech industries such as electronic circuits and mobile phones. In India, by contrast, FDI has been much less important in driving export growth except in information technology (tertiary sector). FDI has contributed to the rapid growth of China’s merchandise exports and helped driving China’s economic growth. As per the World Investment Report 2013 by United Nations Conference on Trade and Development (UNCTAD), India is ranked as the third most attractive destination for foreign investment behind China and the US, based on a survey of 500 global companies. FDI in India declined from 29% to $25.5 billion in 2012—it contracted 18% globally to $1.35 trillion—due to policy uncertainties and fragile economic conditions (live mint).

FDI flows to China also reached a record level of $124 billion, and flows to the services sector surpassed those to manufacturing for the first time. China continued to be in the top spot as investors' preferred destination for FDI, according to UNCTAD report (world investment report 2012). China and India saw inflow of FDI and continue to be the two large emerging economies. The rise of FDI is nearly by 8 per cent and 31 per cent for China and India respectively as per the World Investment report 2012.

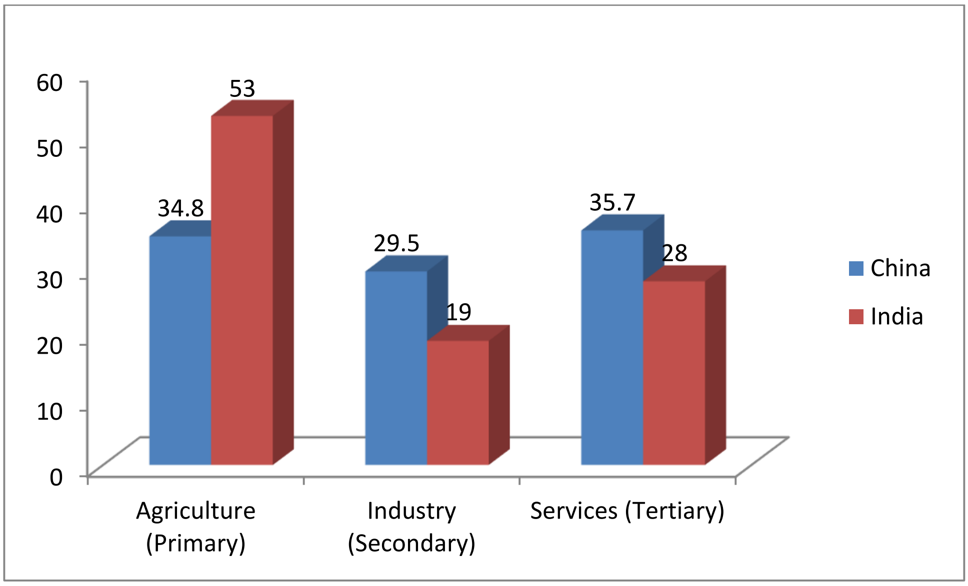
FDI in India continues to be local-market-seeking in the first place; its world-market orientation has increased in the aftermath of economic reforms.

SECONDARY SECTOR IN INDIA AND CHINA: AN OVERVIEW

The secondary sector of the economy is that which creates the finished and tangible product which include the production and construction (Wikipedia -a). This sector is often divided into light and heavy industry. In terms of economic diversification and structural change, China has moved from primary to manufacturing activities in the past 25 years. The manufacturing sector has doubled its share of workforce and tripled its share of output, which, given the size of the Chinese economy and population, has increasingly made China "the workshop of the world" (Chandrashekhar & Ghosh, 2007). At the sector level, it turns out that favorable growth effects of FDI in India are largely restricted to the manufacturing sector, where FDI stocks and output are mutually reinforcing in the long run. (Chakraborty &Ninnenkamp, 2008). Post liberalization economy of China saw the FDI coming into microelectronics, telecommunication and energy sector. Subsequently the growth was noticed in the production of industrial vehicles, motorcycles and automobiles. In India, the growth was noticed in the industry such as machinery, household electric appliances, steel, pharmaceuticals, and, more recently, software, services, telecommunication, motorcycles, automobiles and air communication have been the crucial dynamic sectors (Valli & Saccone, 2009).

Figure 3 describes the labour force of India and China employed in different sector. While 53% of the employment in India is into primary sector the China employs 34.8 %. The secondary sector in China which is considered to be the most employment generating sector employs 29.5 of the working population where as it is 19 percent in case of India. When read together figure two and three reflects that India has a complete sectoral mismatch of the economy as the primary sector which employs 53% of the working population contributes only 17.4 percent of the GDP where as the tertiary sector which employs 28 percent of the labour force contributes 56.5 percent of the GDP. China has a balance between secondary (45.3 percent) and tertiary sector (44.6 percent) in terms of contribution to GDP. High dependence on any sector of economy has an adverse impact during the economic downturn. Contrarily, China has a shrinking primary sector which may pose a threat for the economy with large population.

Figure 3: Labour force by occupation (in %): a sector wise comparative view of China and India



Date Source: The World Factbook

DEREGULATION OF LABOUR MARKET AND ITS IMPACT ON SECONDARY SECTOR

At least 53 countries and economies around the globe adopted 86 policy measures affecting foreign investment in 2012. The bulk of these measures (75 per cent) related to investment liberalization, facilitation and promotion, targeted to numerous industries, especially in the service sector. Privatization policies were an important component of this move. Other policy measures include the establishment of special economic zones (SEZs). Governments made more use of industrial policies, adjusted previous investment liberalization efforts, tightened screening and monitoring procedures, and closely scrutinized cross-border M&As. Restrictive investment policies were applied particularly to strategic industries, such as extractive industries. In general, governments became more selective about the degree of FDI involvement in different industries of their economies (world investment report 2013).

China continues to experience rising wages and production costs, the relative competitiveness of ASEAN countries in manufacturing is increasing (World Investment Report, 2012).

Chinese government made structural changes in the economy, provided strategic infrastructure in form of SEZs, took strategic policy initiatives to provide freedom and openness in trade and made flexible labour laws to attract efficient labour in the manufacturing sector (Sinha, 2009). China and India, have established specific guidelines and policies under which their approach to FDI is constantly reviewed and adapted if necessary. In China, new policies are reflected in specific lists that identify the industries where FDI is encouraged, restricted or prohibited. India regularly reviews its FDI policy measures and publishes changes in a “Consolidated FDI Policy” document, which contains general conditions of FDI as well as industry-specific conditions (e.g. industries in which FDI is prohibited or permitted) (World Investment Report, 2012).

The movement of workers out of the agricultural sector has been a potent source of increased productivity in China. Both average and marginal labour productivity appear high in non-agricultural activities and so the movement of labour has boosted the growth of productivity. According to the *Economic Survey of China*, the movement has boosted incomes by 0.5% each year on average in China in the period 1998 to 2003. Movement of labour between major sectors also appears to show a beneficial impact of labour mobility on aggregate labour productivity in India as well (Herd & Dougherty, 2007).

COMPARISON OF THE LEGAL SYSTEM

Trade liberalization can bring economic growth if it is supported by a well designed fiscal policy, tax reform, deregulation of market and liberalization of inward foreign direct investment.

Asia Monitor, while analyzing the risk to India's growth story highlighted archaic labour laws as a major challenge. There are more than 40 labour-related laws pertaining to compensation, retrenchment and industrial disputes, which makes the 'hiring and firing' of workers an extremely difficult and often costly process in India. There is a dire need of amendment to these labour laws which can support the growth process (Asia Monitor, 2011).

Provision of Hire and Fire

In Indian context the hiring and firing is largely influenced by Industrial Disputes (I.D.) Act, 1947. The act protects the workers covered under the provisions and the employers need to take the permission from the government before lay off and retrenchment of any employee. As chapter V-B of the act is applicable to the industries employing 100 or more number of employees, lay off and retrenchment is not permissible without government approval. The same provision is applicable restricting closure of the economically non-viable industries which is not in case of industries in China. This partly explains why most Indian firms are small: 87 percent of employment in India's organized manufacturing sector is in firms with fewer than ten employees, compared with only 5 percent in China. Small Indian firms cannot reap economies of scale or exploit the latest technology, and so suffer from lower productivity than if they scaled up, employed more people and were much bigger companies. This cripples Indian firm's ability to rapidly expand or adjust with changes in global economy, both during early opportunity phase and during economic change. China's legal system does not require any such approval from the government for hire and fire and the mass use of contract labour has facilitated the process. But the absence of liability on the principal employer and disparity of wages has led to a deplorable condition of work leading to workers suicide. As per Ministry of Labour (2014), the government of India has started a 'Make in India' campaign and proposed a plethora of amendments to its existing labour laws in order to add flexibility to its system and make it more employers friendly. Some of the salient features of these proposed amendments are

- Increasing the threshold limit for coverage under Factories Act under Sec. 2 (m) from existing limits of 10 workers (for units with power) and 20 workers (for units without power) to 20 workers (for units with power) and 40 workers (for units without power) respectively.
- Amendment of Section 66 of the Factories Act to allow employment of women for night work.
- Amendment of Sections 64 and 65 of the Factories Act to enhance the limit of overtime hours from the present limit of 50 hours per quarter to 100 hours per quarter.
- Empowering the State Government to increase the period of spreadover from 10.5 hours to 12 hours (Section 56) through notification in the Official Gazette.

Some of the state amendment proposed also to increase the minimum membership for registration of trade union to 30%, and relaxing the pre-conditions of permission from the appropriate government, notices, compensation for lay off, retrenchment, closure, it is proposed to increase from 100 to 300 workmen for applicability.

Contact Labour

The new amendment to the labour contract law of the People's Republic of China in 2012 tried to offer better protection to the workers employed through labour dispatching (who are called as 'contractor' in Indian context). The amendment regulates the number of contract labour by the 'host company' and states all the employers shall stick to the principle of 'equal pay for equal work'. Labor Administration Department of the State Council has the authority to decide the actual percentage of dispatched workers for the domestic companies. However, the act does not ally to the foreign companies as they are not allowed to hire Chinese employing directly (Arbetter et al. 2013).

The Indian counterpart, contract labour (regulation and prohibition) Act, 1970 vests the power with the government to abolish the employment of contract labour in certain process, but does not provide provision of equal pay for equal work. The equal remuneration Act, 1976 of India also does not have any such provision, but the aggrieved employee can claim the same if the work performed, conditions of work, educational qualification, mode of recruitment etc. are same in case of both regular and contract employees.

Social Security

While drawing lesions from the European nations, reforms in systems of social protection over the last two decades have shown a high degree of convergence. Similarities in the processes of transformation and systemic evolution are especially evident in pension and labor market policies, both in Western and Eastern Europe. In the area of *pension policy*, changes can be seen in the introduction of a model based on three pillars: 1) transition from defined compensation schemes to certain contribution schemes, 2) relative reduction in social services offered and 3) tendencies toward mixed financing (taxes and contributions) (Batic, 2011).

Working Hours

While a standard working hour in India is for 9 hours in a day the normal working day is China is of 8 hours. However, the Indian organization are required to provide at least 30 minutes rest at least before 5 hours of work, whereas no such rest hour is available in China. The maximum hours for overtime (OT) allowed in India is 300 hours in a year, whereas, the same is 432 hours per annum in China. The wage rate for OT in India is double the ordinary wage rate, but the corresponding figure for China stands at 150 percent. Thus the working condition in China can be termed as deplorable without any defined rest hours, lesser payment/OT with more hours of work (Wikipedia -b).

India's private sector has discovered ways to evade labor regulation: "(i) adopting capital intensive technology to minimize employing permanent workers; (ii) outsourcing activities to unregulated unregistered units; (iii) moving units to areas with lax enforcement; (iv) passing on excess labor costs in the form of mark-up pricing to consumers, where the product market structure permits; and (v) splitting the establishment into multiple smaller units to escape coming under the purview of the legislation" . Combined with increased outsourcing and the growth of contract labor, these strategies continue to weaken the coverage of labor laws in India and create more conflicts between employers, workers and the government. This labor unrest has been exacerbated by the recent global economic downturn. (Warnecke & Ruyter, 2012). Subcontracting, outsourcing, starting parallel production, shifting the production to smaller units has given the employer an edge over the unorganized labour force of India.

Union density in China is high but declining. While China has a 59 percent union membership in mid 80s the density declined to 42 percentages in late 90s (Harris, 2008). However, the unionization rate in India is low — 8.83% in 2001 and employers' widespread antagonism toward trade unions dissuades many workers from unionizing; this is exacerbated by the generally weak enforcement of labor law across India. Employers suppress industrial unrest by hiring more apprentices, supervisors, and "non-workmen" category employees. (Warnecke & Ruyter, 2012).

HOW FLEXIBLE ARE INDIA AND CHINA?

While staring a business in China on an average takes 41 days, while the same requires 89 days in India. It takes 241 day to enforce a contract in China whereas in India the same can realize in 425 day (Sinha, 2008). China's potentially huge domestic market is the major determinant of its inward FDI from OECD countries, while for India, both domestic market and cheap labor cost are important determinants of its inward FDI from OECD countries.

Comparing to India, China's better performance in attracting FDI from OECD countries was mainly due to its larger domestic market and higher international trade ties with OECD countries. India, on the other hand, had advantage in its cheaper labor cost, lower country risk, geographic closeness to OECD countries, and cultural similarity. These advantages helped India decrease the gap in FDI (Wei, 2005).

THE ROAD AHEAD

The European Commission has proposed the founding of a Globalization Adjustment Fund (GAF) in order to help those who have become unemployed as a result of the industrial restructuring process. The GAF should be implemented in consultation with social partners, in order to avoid confusion between existing adjustment measures. Employees faced with dismissal should be informed in advance so that they have sufficient time for additional training and professional education, or for finding another job (Batic, 2011). Indian labour laws are considered to be very highly regulated and rigid as compared to those of other countries in the world. The intensity of these laws have been criticized as the cause of low employment growth, large unorganized sectors, underground economy and low per capita income. However, a complete hire and fire system by giving upper hand to the employer will take away protection and social justice earned by the labour unions after decade long struggle. Restructuring has led to negative social effects that are hitting the social protection systems, which are being undermined by a growing unemployment rate and high public debts. All this would be possible if the neoliberal deregulatory state were to be transformed into a powerful, globally cooperative interventionist state (Batic, 2011). Though it is desired for India to look into adopt flexibility of the legal system which in turn will help in the development process of the economy a complete deregulation is not desirable as well. China is amending some of its labour law and trying to bring back the protection to the contract labourers and adopting a social insurance based protection system can be a learning lesion for India.

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Title: Deregulation of labour market: A comparative study of secondary sector in India and China	
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*Subject Area(s)***:**	*Research Grant/Project No.(s), if any:*
Supporting Agencies, if any:	*Date of Issue***:** *(to be filled by Research office; same as month of submission)* ***March 2015***

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