



Labor Regulations In India: Impact and Policy Reform Options

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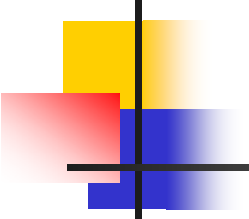
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A. Context - Labor Markets and Inclusive Growth

- The Indian economy has grown by more than 6% p.a. over the past two decades, and accelerated to 8% growth p.a. in the last 3 years.
- But there are growing concerns about whether India's growth is adequately inclusive:
 - muted poverty reduction
 - social exclusion
 - persistent regional divergence in growth
 - unsatisfactory labor market outcomes

Context and Motivation – Labor Market Outcomes

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- In the 1990s there was widespread concern with labor market outcomes
 - Job growth decelerated between 1993-00. While job growth has picked up since then over the past 20 years job growth has been flat at around 2% p.a.
 - There was growing “casualization” of labor and virtually no net job growth in the formal sector, especially in formal manufacturing.
 - Recent accelerating in job growth is accompanied by a deceleration in wages in almost all deciles (results from ongoing work).
 - More than 100 million working poor remain, whose earnings are inadequate to raise their families out of poverty.
 - India’s economic growth and employment pattern is atypical and raises questions about its poverty impact and sustainability

The Issue is Obviously Important: There is a close relationship between Real weekly earnings and real per capita Household Expenditures



Objectives of Study



Our Study analyzed the available evidence on labor market developments with the following objectives:

- (i) assessing developments in labor markets**
- (ii) identifying the key employment challenges facing India; and**
- (iii) making recommendations to improve labor market outcomes.**

The Report's Three Themes.

One: While labor markets outcomes in the 1990s were better than commonly perceived, and job growth has improved, overall labor market outcomes remain unsatisfactory

- On one side wages and labor productivity grew faster even in the informal sector, and workforce was deployed more efficiently
- But this has been offset by decelerating wage growth

Two: Looking ahead, however, India faces formidable employment challenges.

- Providing good jobs for the 8 to 9 million new workers expected to enter labor force annually over the next decade and increasing earnings of the currently more than 100 million workers who live in poverty and increasing earnings in general. Addressing Gender, Caste and Regional Disparities
- Labor Market Dualism, slow growth of formal sector jobs, and manufacturing jobs particularly.



Report's Three Themes (cont).

- *Three: Reforms are needed in laws and active labor market policies to deliver better outcomes*
 - Regulatory reforms are needed to accelerate job growth. Regulations are costly and hurt workers: we estimate 30% to 40% of formal manufacturing jobs have been lost on account of these laws. Such reforms need to be complemented by:
 - More effective active labor market policies to help workers, by providing protection and insurance in the informal sector, and enhancing skills



This presentation focuses on the impact of different Labor Laws in India

- A. Labor Regulations In India
- B. Enforcement
- C. Impact of Labor Regulations
- D. The Way Forward with Labor Regulation Reforms
- E. Need for More Effective Labor Market Policies



A. Complex labor Legislation and Regulations

- ***Altogether about 45 central laws and 170 State statutes directly deal with labor market issues. Labor is a concurrent subject.***
- **Industrial Relations**
 - Trade Unions Act, 1926
 - Industrial Disputes Act (IDA) 1947
- **Working Conditions**
 - The Factories Act, 1948
 - The Industrial Employment (standing orders), 1946
 - The Contract Labour Act, 1961
- **Wages**
 - The Payment of Wages Act, 1937
 - The Minimum Wages Act, 1948
- **Social Security and Insurance**
 - Workmen Compensation Act, 1923
 - Employee State Insurance Act, 1948
 - Employees Provident Funds Act, 1952
- **Plus a number of state laws such as the Shops and Establishment Act**

International comparisons

(Doing Business Data, De Jure indicators)

Labor Legislation in India and Comparator Countries

Country	Difficulty of Hiring (1)	Rigid Hours (2)	Restrictions to retrenchment (3)	Compensation for Dismissal (4)	Rigidity of Employment (5)
India	33	20	90	79	48
Comparators Average	27	45	48	87	40
High Income Countries Average	22	49	24	41	32
World Average	35	50.6	37.9	56	41
World Median	31	60	40	46	41

Source: Doing Business 2004 <http://rru.worldbank.org/DoingBusiness/>



Other issues with labor legislation

- Key concepts such as “workman” or “factory” subject to interpretation and with different meanings across Acts
- Diseconomies of scale. Laws establish size thresholds (Factories Act:20 L; IDA 20, but IDA, C5b 100) => It may create incentives for informalization.
- Empirical studies suggest important adverse effects on outcomes –More on this later.



Very few legislative reforms

- No recent reform initiatives regarding IDA
- Some amendments to the Trade Unions Act (2001)
- More initiatives at the state level regarding contract labor (Andhra Pradesh (Contract labor legislation, UP lifting the threshold)



B. Law enforcement – Almost wholly at the state level.

- **As the saying goes the "Licence Raj" has been replaced by the "Inspector Raj".**
 - Inspections per registered factory are a major source of transactions costs.
 - Although inspections have declined. IC (2002) data suggest large irregularities. 20 % respondents reports that inspectors reduce the number of visits in response to unofficial payments.
 - Labor inspectors were more often involved in this irregularities than other inspectors. The average reduction in visits (if unofficial payments reported) was 53 percent.



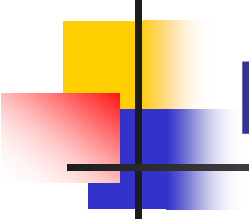
Law enforcement (Cont)

■ Inspections-

- Unofficial payments more often reported among large firms, exporters, and firms that dominate more than 20 percent of the market for their product (profitable firms)

- Unofficial payments more often reported among firms that perceive labor regulations as an obstacle for growth—
 - Payment of unofficial payments is the problem with regulations...
or
 - Inspectors target firms for which regulations are more binding and are willing to pay more in bribes

- Current the inspection regime is probably undermining workers' welfare.



Current laws creates incentives for prolonging disputes.

- The IDA sets three stages in dispute settlement
 - **(1)-Consultation**– Work Committees
 - **(2)-Conciliation**—Conciliation officers and Boards
 - **(3)-Adjudication**—Labor Courts and Labor Tribunals

Little incentives and effective at (1) & (2).

- Parties are not required to attend conciliation
- Most labor disputes deal with retrenchment issues. IDA & Labor Courts favorable to workers, workers go to stage (3) directly → Overcrowding of labor courts and Tribunals.
 - Average duration of proceedings In Labor Courts take 10 years
 - When appeals are included, dispute settlement takes 20 years (Khan, 2005)

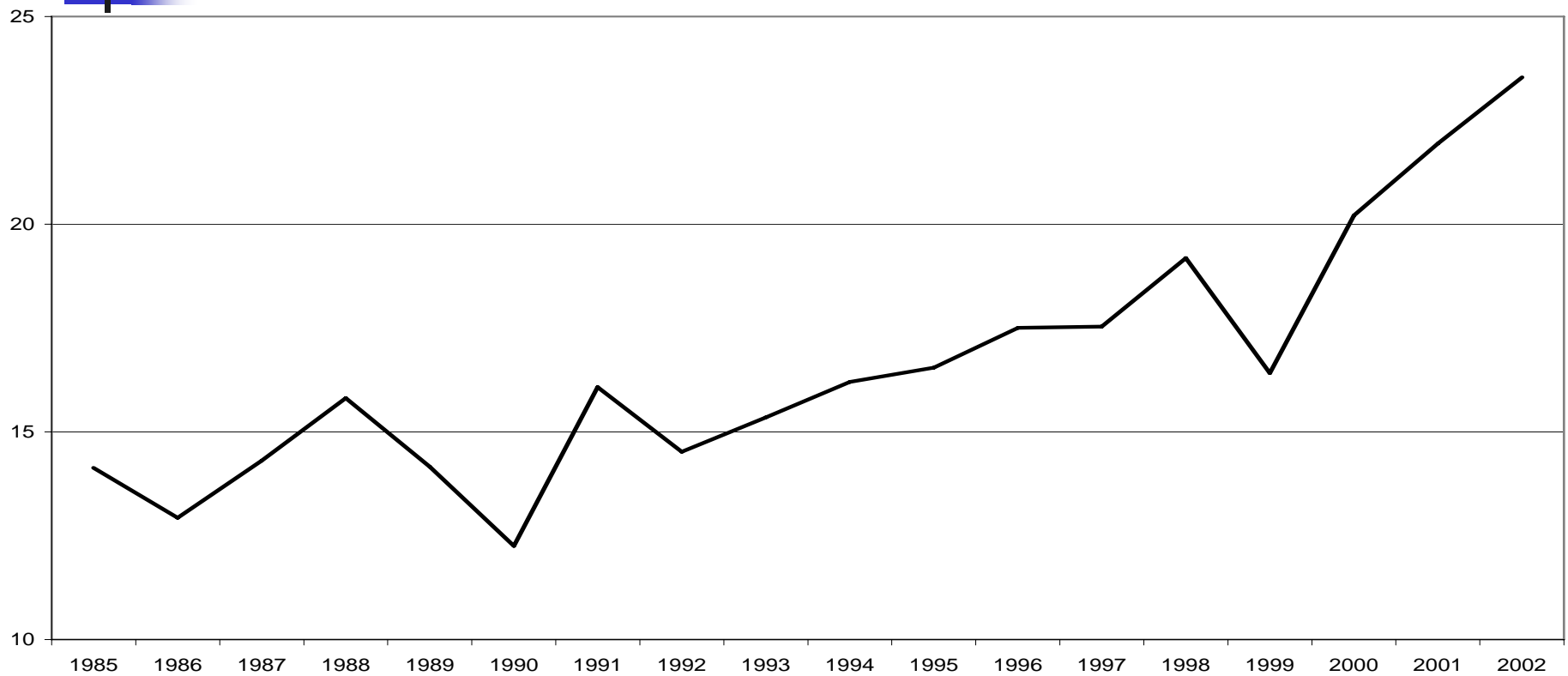


Some 533,000 Cases Pending- 28000, for more than 10 years

Major States	No. of Cases Pending	No. of cases pending for More than 10 years
Assam	189	138
Bihar	5,200	566
Delhi	28,837	2,342
Gujarat	133,916	8,616
Kerala	3,450	63
Karnataka	17,457	2,924
Maharashtra	142,345	11,508
Madhya Pradesh	89,341	0
Punjab	14,784	110
Rajasthan	20,066	775
Tamil Nadu	21,713	150
Uttar Pradesh	22,539	10,303
West Bengal	2,225	283
Total (All States & UT)	533,038	28,864

Increasing use of contract labor

Contract Labor (as % of manufacturing employment)
Average per year across states



* Average of the major 28 states. Source; Annual Survey of Industries



In sum..

- Overly complex **legislation**, more restrictive in the area of retrenchment relative to comparator countries, world average or developed countries. Very few legislative changes since 1990.
- **Poor & ineffective labor enforcement, coupled** with increasing use of contract labor (de facto deregulation).
- **Bias towards adjudication** → overloaded labor courts. Yet, **some shift in the stand of judiciary** (de facto deregulation)

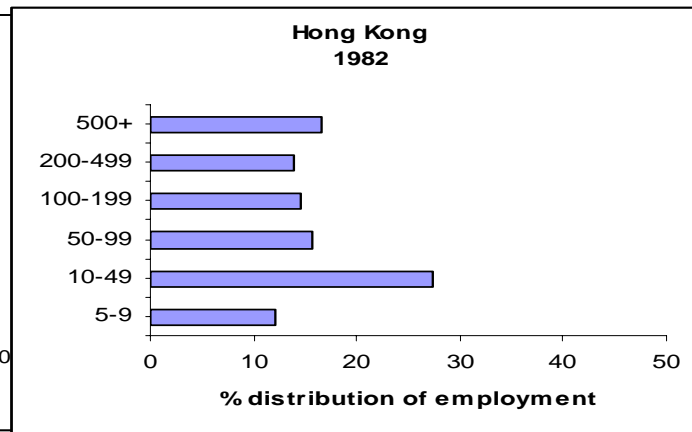
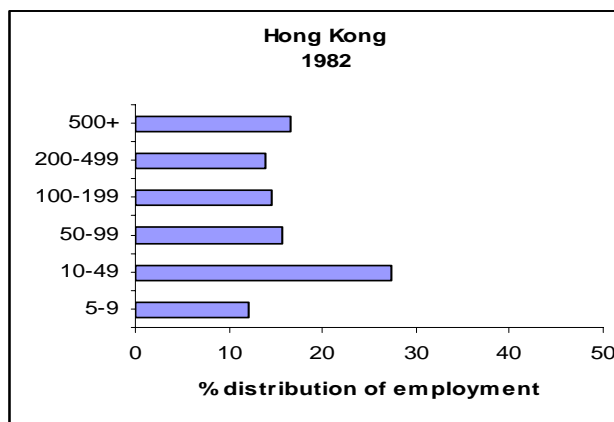
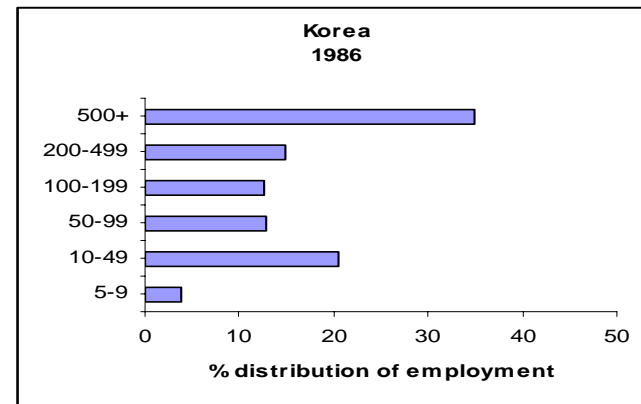
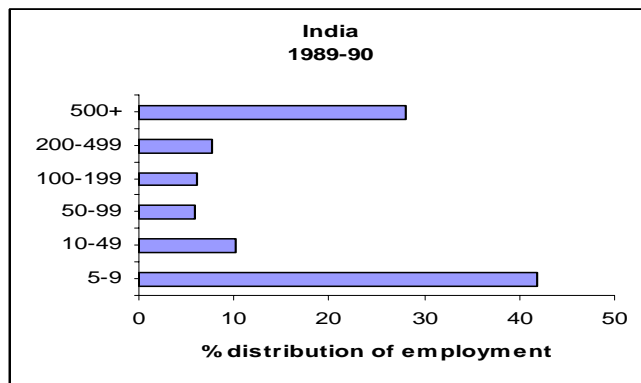


C. What is the impact: High Transactions Costs may be constraining formal sector employment.

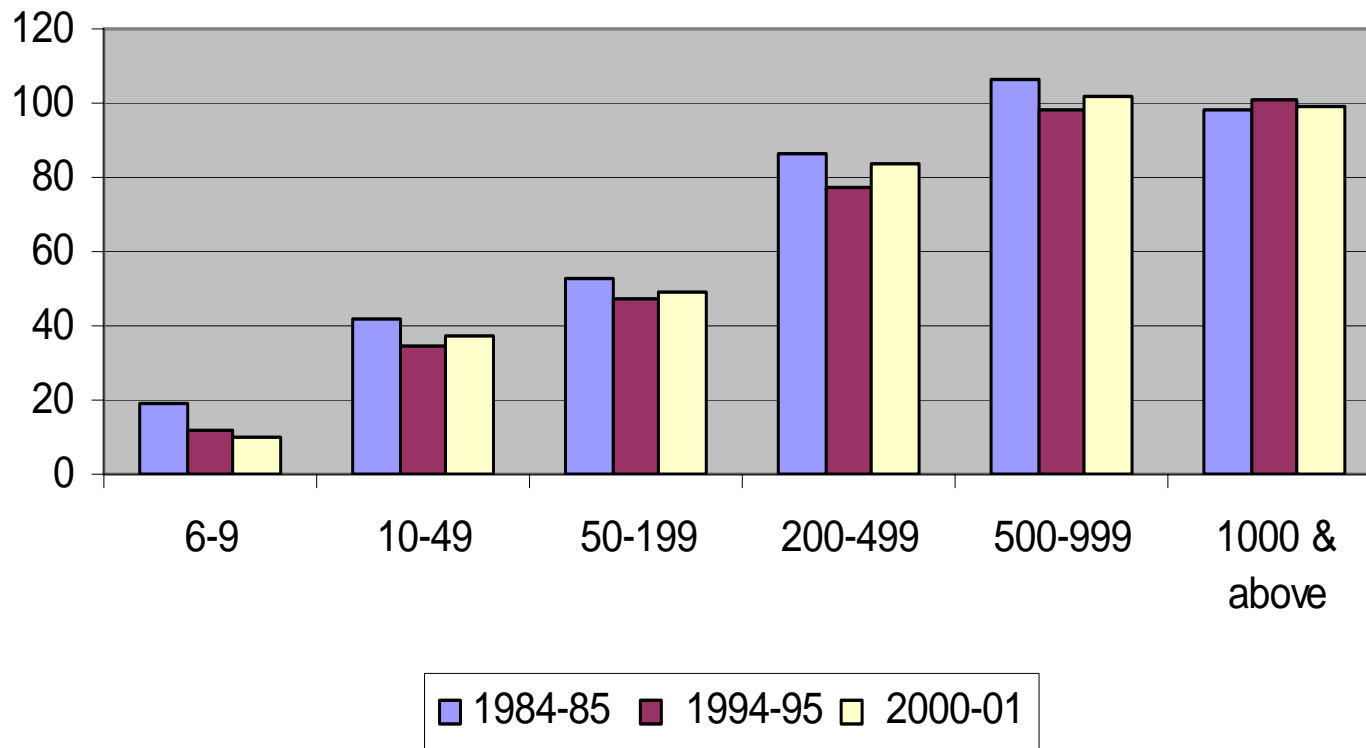
	1983	1993-94	1999-00	2002*
Self Employed (percent)	52	50	48	50
Regular Workers (percent)	16	16	16	16
Casual Workers (percent)	32	34	35	33
Total (in millions)	234.8	304.6	336.8	350.6

*Source: Sundaram and Tendulkar, 2005b; * Staff calculations*

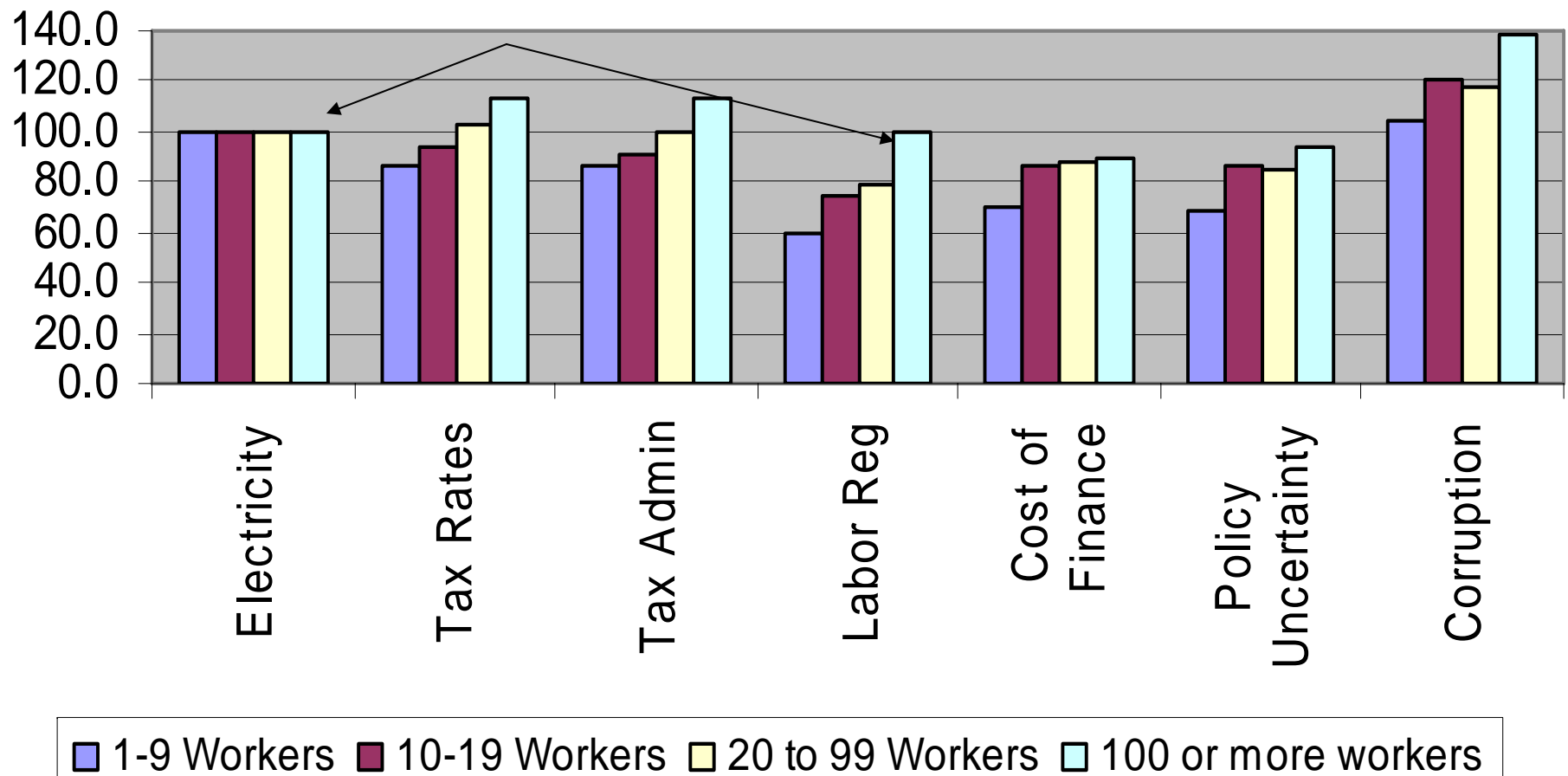
Leading to The Missing Middle Manufacturing Firm Size in India – Late 1980s



Which is Continuing: Labor Productivity By Different Size of Firms



Medium Sized Firms Consider Labor Regulations to be a Significant Constraint





Assessing the effects of regulations.

- Objective
- Methodology of this study
- Data used
- Results



Objective of this section:

- We attempt to provide a quantitative assessment of the effects of labor regulations on economic outcomes in India:
 - GDP per capita/ manufacturing/registered vs. unregistered sector
 - Employment/wages/labor share
 - Investment/ # of Establishments.



Effects of labor regulations: Former studies

- **Fallon & Lucas, (1991, 1994)** –studied 1976 amendment to IDA. Find that manufacturing employment declines in many industries—those with large firms & lower unionization.
- Yet, **Dutta Roy (2004)** examines the 1982 amendment to IDA on the cost of adjustment of firms and finds no effect.
- **Besley and Burgess (2004)** study effect of state amendments. They find regulations have adverse effects on Employment and output, but bunch all regulations into a composite index– which laws are behind these effects?
- **Lall and Mengistae (2005)** find that labor market regulations explain differences in labor productivity gaps and location choices between cities—which laws?

→ **We follow Besley and Burgess (2004) with important modifications:**

- (1) We decompose their measure of labor regulations in various measures
- (2) We also assess the effect of increasing use of contract labor (de Facto deregulation)



Methodology to estimate economic effects of labor legislation

- Following Besley & Burgess (2004) we use state differences in labor legislation.
- We then compare the evolution of reforming states with non-reforming states —controlling for differences in policies and economic structure.

“What would have happened if labor reforms would not have taken place? ” or alternatively, “what was the effect of specific reforms in the reforming states?”



Measuring Reforms

- Large number of state amendments to IDA, 1947
- We term:
 - A = Job security for workers (cost of adjusting labor for employers)
 - D = Increase opportunities and incentives to engage in labor disputes (cost of labor disputes for employers)
- All amendments to IDA refer to A or D
 - In each state-year, we code (+1) any legal amendments that increase A, or D, and (-1) any amendments that reduce A, or D.
 - In state-years where there is more than one change, we code (+1) if sum amendments increases A or D, and (-1) if it reduces them.
 - Focus on period 1958-1997
- We use as our explanatory variable the cumulative sum of amendments.



Examples of coding

- **Rajasthan –1984.** The procedures for layoff and retrenchment specified in Chapter Vb are applicable to establishments that employ more than 100 (A=1).
- **Tamil Nadu—1982** State government can issue a special order to preserve industrial peace if necessary, while employers and workers should observe the conditions of the order. (D=-1)
- **Karnataka—1988.** Amendment increases the power of conciliation officer to enforce attendance of hearings regarding industrial disputes (D=-1)
- **The appendix of the paper lists all codes.**



Different regulation can have differential effects

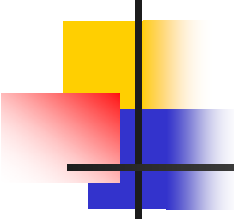
From the point of view of employers, labor regulations may cause:

- **“Price” effect:** Increase in the cost of labor → May lead to substitution of labor for capital.
- **“Expropriation” effect:** Regulations may make it easier for workers to appropriate part of the surplus of investments once they are sunk → reduces incentives to invest.
- **“Cost of adjustment” effect:** Regulations may increase the cost of adjusting labor → reduces mobility but also can increase L.
- Different labor regulations have different effects because they involve different combination of such effects.



Data

- State level data on GDP, manufacturing, agro, construction, non-agricult GDP from Besley & Burgess (2004). Period 1959-1997
- Manufacturing data at the state-industry level, from Annual Survey of Industries (ASI) period 1959-1997 (Y, L, K, W, Number of Establishments)
- Data on industrial disputes—Labour Bureau.



We estimate the following specification:

$$Y_{it} = \tau_i + \tau_t + \beta X_{it} + \phi R_{it-1} + \varepsilon_{it}$$

X_{it} controls at the state, year level:

- Budget deficit as a percentage of GDP
- Log development expenditures per capita
- Log (pop)

$R_{it-1} = \text{SumDit-1}, \text{SumAit-1}$

Some specifications run at the state, industry, year level
Industry dummies are added to those specifications

We account for error autocorrelation allowing for clustering of the errors
Within states or states and industries.

Larger effects of sumD

Results (1): Estimated Effects of regulations on GSDP

De Jure Reforms and Gross Domestic Product at the State Level: 1958-1997

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Log GDP per capita	Log Agricultural GDP per capita	Log Non Agricultural GDP per capita	Log GDP in Construction per capita	Log Manufacturing GDP per capita	Log Registered Manufacturing GDP per capita	Log Non Registered Manufacturing GDP per capita
sumA[t-1]	0.011 (0.27)	0.003 (0.09)	-0.013 (0.31)	-0.018 (0.25)	-0.079 (1.15)	-0.158 (1.87)+	0.055 (0.60)
sumD[t-1]	-0.045 (1.92)+	0.001 (0.05)	-0.073 (2.91)*	-0.078 (1.15)	-0.1 (2.19)*	-0.192 (3.33)**	0.031 (0.80)
Number of Obs.	591	591	591	591	591	591	591
Adjusted R-squared	0.99	0.98	0.99	0.95	0.98	0.97	0.95
Ftest A=D (P.value)	0.35	0.96	0.3	0.59	0.84	0.75	0.85

In addition to the regressors shown in this table, all specifications include year and state fixed effects; *sumA* denotes the cumulative sum of all IDA amendments relative to Adjustment of Labor; *sumD* denotes the cumulative sum of all IDA amendments relative to resolution of Labor Disputes; Absolute t-statistics calculated using robust standard errors clustered at the state level reported in parentheses. + significant at 10%; * significant at 5%; ** significant at 1%



Results (Cont)

- Results robust to controlling for state policies (deficit/GDP, log of dev. Expenditures, log of pop)
- Results robust and stronger once we estimate results at the state-industry level within manufacturing.

Estimated Effects of regulations on GSDP (state-industry level results) Registered manufacturing sector

	Log Net Manufacturing Value Added per Capita	Log Net Manufacturing Value Added per Capita	Log Net Manufacturing Value Added per Capita	Log Net Manufacturing Value Added per Capita
sum A [t-1]	-0.104 (1.66)+			-0.079 (1.30)
sum D [t-1]	-0.257 (4.83)**		-0.145 (1.78)+	-0.157 (1.92)+
sum c5b[t-1]		-0.182 (1.81)+	-0.078 (0.77)	
sum c5b[t-1]*sum D [t-1]			-0.241 (2.93)**	
sum A [t-1]*sum D [t-1]				-0.061 (2.28)*
Observations	8214	8214	8214	8214
Adjusted R-squared	0.89	0.89	0.89	0.89

All specifications include, state and period dummies, and control for log(pop),deficit/GDP and log(dev. Expenditures/pop).
** denotes significant at 1 %, * significant at 5% and + significant at 10 percent. Robust standard errors clustered at the industry-state level.

Effects on employment (State-industry level analysis) Registered manufacturing sector

Effects of *de Jure* Labor Regulations on Employment. State-Industry Variati

	(1)	(2)	(3)	(4)
	Log of persons employed per capita	Log of persons employed per capita	Log of persons employed per capita	Log of workers employed per capita
sumA[t-1]	-0.11 (2.08)*			-0.098 (2.08)*
sumD[t-1]	-0.158 (3.69)**		-0.08 (1.30)	-0.122 (3.58)**
sumc5b[t-1]		-0.183 (2.18)*	-0.123 (1.41)	
sumc5b[t-1]*sumD[t-1]			-0.169 (2.66)**	
Log of Fiscal Deficit to GDP	0.017 (1.93)+	0.008 (0.87)	0.017 (1.87)+	0.02 (2.51)*
Log of Develop. Exp. per capita	0.33 (2.17)*	0.46 (3.04)**	0.292 (1.91)+	0.158 (1.45)
Log of Population	-0.252 (0.36)	-1.115 (1.62)	-0.883 (1.18)	-0.026 (0.04)
Observations	8334	8334	8334	7050
Adjusted R-squared	0.89	0.89	0.89	0.92
Ftest A=D	0.55			0.74

Effects on Wages and Productivity (State-industry level analysis) Registered manufacturing sector

	(1)	(2)	(3)
	Log of earnings per worker	Log of labor productivity	Log of Labor Share
sumA[t-1]	0.033 (1.78)+	0.032 (0.92)	0.001 (0.03)
sumD[t-1]	-0.06 (4.25)**	-0.077 (3.05)**	0.016 (0.70)
Log of Fiscal Deficit to GDP	0.007 (1.98)*	0.016 (1.50)	-0.008 (0.80)
Log of Develop. Exp. per capita	-0.016 (0.34)	-0.045 (0.49)	0.025 (0.31)
Log of Population	0.659 (2.33)*	0.993 (1.91)+	-0.341 (0.73)
Observations	7047	6940	6937
Adjusted R-squared	0.95	0.82	0.42
Ftest A=D	0	0.04	0.74

**Differential
Effect on
earnings**

Effects on Wages and Productivity (State-industry level analysis) Registered manufacturing sector

D reduces productivity

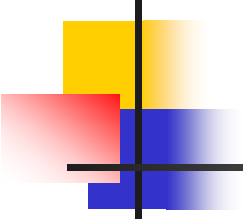
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Effects on Wages and Productivity (State-industry level analysis) Registered manufacturing sector

No effect
On Labor
Share

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Effects on Investment (State-industry level analysis) Registered manufacturing sector



Reduction in investment
Particularly D

Effects of *de Jure* Regulations on Other Outcomes. State-Industry Variation

	(3)	(4)	(5)	(7)	(8)	(9)
	Log of productive capital per capita	Log of fixed capital per capita	Log of Factories Registered per capita	Log of Workers per Factory	Log of productive capital per Factory	Log of Labor Share
sumA[t-1]	-0.152 (2.24)*	-0.053 (0.86)	-0.112 (1.93)+	0.002 (0.04)	-0.037 (0.60)	0.001 (0.03)
sumD[t-1]	-0.215 (3.57)**	-0.162 (2.98)**	-0.105 (1.83)+	-0.053 (1.11)	-0.112 (1.91)+	0.016 (0.70)
Observations	8311	7052	8336	8334	8311	6937
Adjusted R-squared	0.9	0.9	0.89	0.80	0.83	0.42
Ftest A=D	0.56	0.27	0.95	0.54	0.48	0.74

Includes Fiscal Deficit, Log (POP), log of Dev. Exp/pop, time and state dummies as controls

Effects on Investment (State-industry level analysis) Registered manufacturing sector

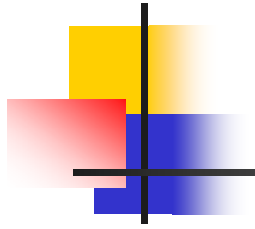
Reduced net
Entry of firms

Effects of *de Jure* Regulations on Other Outcomes. State-Industry Variation

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Effects on Investment (State-industry level analysis) Registered manufacturing sector



**D Reduces
Capital per
Firm**

Effects of *de Jure* Regulations on Other Outcomes. State-Industry Variation

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Effects on Investment (State-industry level analysis) Registered manufacturing sector

**Reduced
Capital intensity
Due to D**

Effects of *de Jure* Regulations on Other Outcomes. State-Industry Variation

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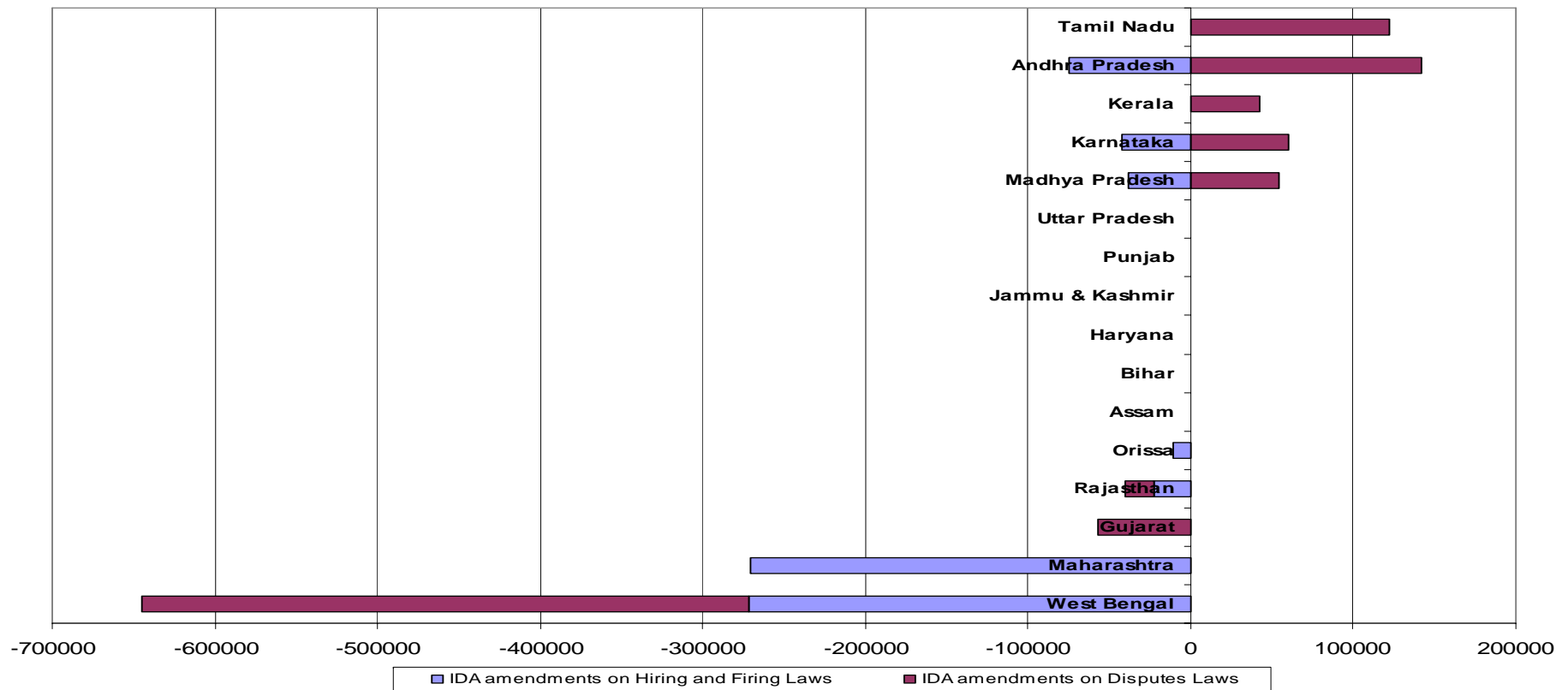
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	(3)	(4)	(5)	(7)	(8)	(9)
	Log of productive capital per capita	Log of fixed capital per capita	Log of Factories Registered per capita	Log of Workers per Factory	Log of productive capital per Factory	Log of Labor Share
sumA[t-1]	-0.152 (2.24)*	-0.053 (0.86)	-0.112 (1.93)+	0.002 (0.04)	-0.037 (0.60)	0.001 (0.03)
sumD[t-1]	-0.215 (3.57)**	-0.162 (2.98)**	-0.105 (1.83)+	-0.053 (1.11)	-0.112 (1.91)+	0.016 (0.70)
Observations	8311	7052	8336	8334	8311	6937
Adjusted R-squared	0.9	0.9	0.89	0.80	0.83	0.42
Ftest A=D	0.56	0.27	0.95	0.54	0.48	0.74

Includes Fiscal Deficit, Log (POP), log of Dev. Exp/pop, time and state dummies as controls

Effects of reforms by State (employment)

Effect of State Labor Reforms on Organized Manufacturing Employment by State



Source: Ahsan and Pagés (2006)



Other Results

- Effects of A are more important in Labor Intensive industries
- Effects of D are more important in Labor Intensive industries
- Contract labor does not attenuate the adverse effects of regulation.



In sum

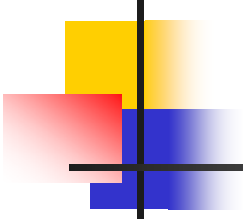
- While all the attention is on chapter 5b (retrenchment regulations), we uncover strong effects of dispute related laws.
- Regulations that increase A , increase salaries for employed workers (and job security) but also lead to lower L , lower Y , lower wage bill, lower investment, and higher share of workers in the informal economy [mostly in Labor intensive industries]
- Regulations that increase D , reduce salaries, investment, GDP and employment and do not increase labor share [mostly in Capital intensive industries]
- Combination of high A and high cost to resolve disputes, D , very problematic
- Increasing use of contract labor does not ameliorate the adverse effects of legislation, particularly on L .



But...

- The solution is not to completely de-regulate the labor market.
- The solution requires improving regulations (& enforcement) so workers' rights can be protected and good jobs can be created.
- There is a need to improve the dispute resolution mechanisms—More conciliation, more expedite courts
- Less employment protection and better mechanisms to protect workers against unemployment. (remove prohibition, create severance pay accounts –individual, per firm or state level)

The India report lists a number of proposals on how to reach a better balance between job creation and better worker protection.



Thank You.