WORLD ECONOMY UPDATE

March 14, 2014 | Vol. 4 No. 11

Changes in the Labor Market Since India's Economic Reforms

ISSN 2233-9140

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Introduction

Indian government's application for the IMF bailout program due to the exhaustion of its foreign reserves at the end of 1991 triggered its unexpected and external economic reform. It is an important example for the Korean economy because of its similarities to Korea's financial crisis of 1997. These two countries have experienced drastic economic reform through IMF's strong bailout program.

This report examines the changes in the Indian labor market since the 1991 economic reform. Analyzed here is the direction toward which the labor market moved, as the economic reform has proceeded, with focus on the post-reform changes in the labor market.

Phases of Economic Reform

To analyze the effects of economic reform in the Indian labor market, four phases are defined as follows: (i) the period of economic reform by external factors after the 1991 reform (from 1992 to 1997); (ii) the period of economic reform that reflected domestic demand of firms and industries (from 1998 to 2002), (iii) the period of the booming economy (from 2003 to 2008); and (iv) the period after the global financial crisis (after 2009).

In the industrial relation analysis, the period is simply divided into two with the 1991 economic reform as the divider because there has not been much change in labor market institutions, including industrial relations, compared to other sectors.

Trends of Labor Market Indicators After 1991

Trend for the labor force participation rate show only minimal changes since the economic reform, although it begins to decline in the mid-2000s. The downward trend of the youth rate was steadily seen and it became clear since the mid-2000s. The ratio of women in the labor force did not change much but started to decline after 2005.

Even though the employment rate has experienced no major change after the economic reform, it tends to decline due to the global recession in 2010. It is attributed to the declining employment rate of the younger population, in particular.

The unemployment rate of India has constantly decreased since the 1991 economic reform except in 2005 and reached its lowest point in 2010 since 1998. However, In the case of the unemployment rate, only the labor force is considered. Hence when the non-labor force, such as discouraged job-seekers who gave up looking for jobs, increases, it is not reflected in the unemployment rate despite evident signs of a weakening labor market. This issue has been appearing in the recent unemployment trend of India. Particularly in 2010, when the global economic crisis brought a recession to India, the unemployment rate actually declined. Unemployment rate of the younger population has a higher portion on the total unemployment rate, especially among the urban youth, and unemployment rate of women was found to be higher than that of men.

Regarding the employment structure since the 1991 economic reform, employment rate in rural areas showed a downward trend, while employment rates in the manufacturing and services sectors showed an upward trend. This most likely attributes to the enhancement of the Indian economy rather than economic reform. On the other hand, a significant drop in public sector's employment has been influenced by economic reform.

As employment elasticity, which measures the employment growth in response to economic growth, is analyzed, India achieved a low level of job creation in contrast to its rapid economic growth during the 2000. Although employment elasticity increased with the economic growth after 2000, only elasticities in agriculture and mining appeared over 1 while elasticities in manufacturing and services still stayed at 0.12 and 0.24, respectively. As opposed to the high economic growth, this is mainly caused by the inability to create jobs in manufacturing and services, which are the sectors that generated a significant portion of economic growth. Heavy reliance on services rather than labor-concentrated manufacturing as well as inflexible labor-related laws and institutions also contributed low employment elasticity. Moreover, the wage inflation that exceeds the economy's growth is another challenge that the Indian economy faces at the moment.

Labor Market Institutions and Industrial Relations in India

In general, it is viewed that India's labor market institutions have rarely saw any change since the economic reform of 1991. Since proemployee labor laws only apply to the regular employees in the organized (formal) sector, whose share accounts for less than 10 percent of all employees, firms hire more and more irregular employees, such as contractual and temporary workers. Furthermore, the rapid decline of employment in the public sector since 1991, which used to represent three-fourths of the organized sector, could also be another factor that contributed to jobless growth. During the same period, the private sector employment showed increasing trends in most sectors but it was not enough to compensate for employment decline in the public sector.

The power of employees and labor unions tends to fluctuate as employment rate changes. At times when employment rate increases, the number of labor unions, labor disputes, and dispute participants also increases, while at times when employment rate decreases, their number also decreases. Since the 1991 economic reform, the status of employees and labor unions has displayed a weakening trend. This is supported in the case when the Bharatiya Janata Party (BJP) government, with its pro-business character, ceased to create new employment opportunities in the public sector and began restructuring by voluntary retirement, which thus made the employment rate fall and the influence of labor unions and laborers decline. In the 2000s, as a consequence of the increase in employment rate led by the private sector, the number of unions and laborers rapidly increased, but the number of labor disputes decreased, leading to the stable shape of industrial relations.

The weakening of labor unions could be a result of special circumstances in India. Labor unions in this country were first organized primarily for political purposes. Major unions are affiliated with political parties and this made almost impossible for labor unions to form nationwide coalitions. This implies that first, the mutual solidarity among labor unions is weak and second, the weak labor unions are unable to support the increasing number of union members. Moreover, the Indian government has weakened the power of labor unions by implementing pro-business policies and institutions. For example, the labor union law that was revised in 2001 had made the registration of a new labor union more difficult.

The strong response from firms was another force to the weakening of labor unions. Recently, the number of strikes by laborers has started to decline but the number of lockouts has not decreased accordingly. Especially the rapid decline of strikes after the reform in the 1990s could be a response to the fear of labor unions for possible lockouts to be imposed by employers. Firms have also implemented a variety of institutions to weaken the power of labor unions, such as voluntary retirement, incentive systems, contractual employees, and outsourcing.

New policies and institutions were implemented in many sectors after the economic reform in 1991. However, there were still no significant changes in the labor market system. As for the revision of policies and relevant laws, labor is the sector in which the least progress has been made. The main reason was that while the status of laborers and labor unions continued to weaken, it remained difficult for politicians to establish policies that displease laborers, who are also voters.

The Indian government has been trying to implement pro-business policies and institutions since the 1991 economic reform by increasing the labor market flexibility, improving the transparency of labor unions, but none of these has been fulfilled so far and in fact, revision of relevant laws has not been made.

Korean firms that operate in India have experienced amicable labor relations. Most Korean firms are operated without labor unions. Nevertheless, there certainly exist potential factors that can provoke labor disputes. Disputes may soon arise from the demand for wage increases and large proportion of irregular employees. The high rate of labor turnover is also pointed as one of the biggest concerns in India.

Economic Reform and Workers' Living Standards in India

India's economic reform, which aggressively began during the early 1990s, has improved workers' living standards. This is well reflected in the previous literature, especially after the 2000s. According to earlier studies, the economic reform, which triggered the trade liberalization in India, achieved a record of poverty decrease and wage increase. With respect to unemployment, victims and beneficiaries with different types of professions or coming from different industries may coexist, but overall, economic reforms had little effect on the unemployment problem in India. In sum, trade liberalization may contribute to workers' living standards because it only has a limited impact on the unemployment with decrease in poverty and increase in wages.

Effects of Trade Liberalization on the Job Matching Process in India

This study examined the impact of India's trade liberalization on the job matching process (the relationship between job search and new hires) with the estimation of aggregate matching functions.

The matching function is a simple way to introduce frictions in the job matching process that cause transaction costs in the labor market and to explain why unemployment and job vacancies coexist. It has been a widely used tool in macroeconomics and labor economics (Pronongo and Pissarides, 2001). In the basic framework of the matching function, the openness of an economy, which is the sum of the export and import divided by the GDP, is incorporated to indicate trade liberalization as well as other policy changes of the Indian economy. The equation for estimation is shown in [Equation 1].

$$\ln M_t = C + \alpha \ln S_t + \beta \ln V_t + \lambda \ln Openness_t + \delta trend + \epsilon_t$$

[Equation 1]

Here, M is the number of matches (new hires), S is the number of job seekers, and V is the number of vacant jobs in a month.[1]

The implication of the results in this research does not differ from the results of past studies (e.g., Hasan *et al.*, 2012). It is inferred that the impact of the trade liberalization can vary according to region, industry, and type of profession because the relationship between the trade liberalization and new hires shows no statistical significance when the whole country is considered.

On the other hand, from the analysis by period, that is, with the four periods defined in this research, it is shown that new job creation tended to decline when trade liberalization was slowed because of the industries' demand (phase 2: the period of economic reform that reflected the domestic demand of various firms and industries from 1998 to 2002). This

[1] Time frequency (t) represents the month.

implies a possibility that the gradual opening to protect domestic firms will actually lead to a decrease in new job creation and thus, an increase in unemployment rate. This result suggests the importance of continuing globalization for the performance of the labor market in India.

Table 1: Effect of Trade Liberalization on Job Matching Process by Period

Period	Estimate	Standard error	p-value
entire period (1987.08–2012.03)	-0.172	0.122	0.16
after economic reform (1992.01–2012.03)	-0.19	0.128	0.14
before economic reform (1987.08–1991.12)	0.677	1.437	0.47
economic reform by external factors after the 1991 reform (1992.01–1997.12)	-0.209	0.28	0.46
economic reform that reflected domestic demand of various firms and industries (1998.01–2002.12)	-0.613	0.355*	0.09
economic boom (2003.01–2008.12)	-0.511	0.357	0.16
after global financial crisis (2009.01–2012.03)	-0.576	1.291	0.66

Notes:
1) Observation number = 308 (1987.08–2012.03)
2) The coefficient of the estimates in Table 1 is λ in [Equation 1].
3) Instrument for openness is lagged values (1st lag) of openness.
4) *Indicates 10% of the level of significance.

Policy Implications

For Korean Firms Operating in India

1. Labor Unions in India

The status of labor unions in India has been substantially weaker since the 1991 economic reform. Moreover, since the beginning of the 21st century, the Indian government has helped employers by implementing the systems that make the registration of new labor unions difficult. More importantly, most of the Korean firms in India operate without labor unions. Therefore, Indian labor unions will not become a barrier to the entry of Korean firms to the Indian market.

2. Labor Disputes in India

However, potential factors that can cause labor disputes in India still remain. First, labor disputes may arise during wage negotiations because continued inflation leads to high demands for wage increase whereas the level of labor productivity stays low. Second, Korean firms in India have a large proportion of irregular employees, which may provoke labor disputes regarding the hiring and firing of irregular employees. Third, the process of regular employee's retirement is almost impossible and this may be a burden to employers. Fourth, the turnover rate of regular employees in India is very high, and this can cause the lack of a skilled workforce. Fifth, in contrast with the trend of weakening labor unions' status in India, labor disputes, especially in foreign firms about particular issues, are associated with a high level of violence. Besides, Korean firms in India should be aware that there might be other factors in addition to the ones above; hence, full attention should be given to establish amicable industrial/labor relations.

3. Gap Between Wage and Labor Productivity

The gap between wage and labor productivity is also an important factor in the investment climate for Korean firms in India. They should pay more attention to this problem and formulate an adequate solution. To do so, Korean firms are required to either establish or facilitate educational programs within the firm and prepare long-term solutions by cooperating among themselves and other institutes, such as the Korean Chamber of Commerce in India.

4. Korea-India Cooperation for Trade Liberalization in India

Previous research, as well as this study, shows that trade liberalization is beneficial to the Indian economy. Because the impact of the liberalization on unemployment is limited in India, the expansion of trade works positively ameliorate the labor market environment. Therefore, the Indian government should constantly carry forward the promotion of trade liberalization. Regarding this, Korea and India are required to cooperate strongly in connection with the negotiation for the CEPA upgrade and to accelerate the mutual opening for trade expansion together. KIEP