

Effect of contract based labourers on india's automobiles



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Research Question:

How are contract based labourers affecting the productivity of Indian automobile industry?

Introduction**Research Origin and Focus Area of Research**

The employment structure in the Indian scenario has been undergoing certain changes due to globalization. The firms in order to be competitive in a global market should have the flexibility relating to labour, capital and various bureaucratic procedures. Only then can it adapt itself to the rapidly changing environment and thereby stay ahead. Although, it has been said that the stringent labour laws not only put the domestic producers at a disadvantageous position but it is also one of the primary factor causing less inflow of foreign direct investment and eventually impact adversely on investment, output and employment. As a result, number of countries has amended their labour laws so as to make them more investment and employment friendly.

This has thereby led to different non-permanent employment structures, such as casual labour, contract labour, subcontractors, consultants and others, among which contract labour is the most prominent kind in the Indian industrial sector and in this paper I primarily focus on the Indian automobile sector only at present. In this research, the point to be noted is the contractual employment which is in accordance to the Contract Labour Regulation and Abolition Act, 1970. According to the law, a contract labourer is defined as one who is hired in connection with the work of an establishment by a principal employer through a contractor. Although a <https://assignbuster.com/effect-of-contract-based-labourers-on-indias-automobiles/>

contractor tries to produce the given results with the help of a contract labour for the organisation, a principal employer is the person responsible for the control of an establishment.

Over the years the pace of contracting has increased dramatically both across borders as well as within. The research will be dealing with the effect of these outsourcing activities. According to the WTO-ILO report (2009), contracting has largely taken place in the emerging economies. Now what could be the consequences of contracting on the labour productivity of a particular firm within the country is what this research paper will be discussing about.

Although a lot has been discussed about the rights in terms of wages and other emoluments for the contractual labour, not much has been said about the productivity of the contractual labour. Much has been said recently about the slowdown in the Indian automobile industry, in fact this sector of the Indian manufacturing industries has recorded its lowest point in terms of growth past year. In this research paper, I have taken up the issue of subcontracting of labourers as the one of the primary reason for this lag in productivity.

The organised auto sector in India broadly consists of three tiers and the Original Equipment Manufacturers (OEMs) sit at the top of the chain. Most of these OEMs are members of the Society of Indian Automobile Manufacturers (SIAM), while most of the tier 1 auto component manufacturers are members of the Automobile Component Manufacturers' Association (ACMA). Tier-2 and Tier-3 auto-component manufacturers are relatively smaller players. To

assess the importance of the sub sectors in terms of generation of employment, it is essential to analyse the intensity of labour employment in these sectors. There is a concern in the industry that wages are growing for the permanent labours without proportionate increase in the productivity front. As a result, higher subcontracting takes place in order to curb wage costs both in the periphery as well as in the core sector. Contract labourers, paid comparatively much lower than the permanent employees and enjoying hardly any other benefits, make up 70-80% of the industry workforce, according to estimates by trade union leaders. The underlying tension between their aspirations and outdated labour laws cause dispute and de-incentivise work effort and lowering productivity.

Literature Review

In order to proceed with the analysis of subcontracting and productivity, there are literature which illustrate the importance of investment in R&D. Romer (1990) has stated on the “ endogenous technological change” and hence proved how R&D plays an instrumental role in accelerating long run growth of a country. Thereafter, many works have been published citing the role of variable factors on R&D and long term growth, which varies from economy to economy. Scholars like Goo (2011) mentioned the effects of transportation costs in R&D technology sector on the endogenous growth. He showed that larger the transportation costs of R&D technology, larger will be the price of R&D technology and hence leading to slower economic growth. Lee (2005) empirically showed a direct and much stronger effect of information networks on international R&D.

Research in relation to this field by eminent economists has also discussed the strategically important interactions of firms and their implication of R&D of firms and the performances. Grossman and Helpman (2002, 2003), Egger and Egger (2003), Shy and Stenbacka (2003) and Antras and Helpman (2004) established the positives of outsourcing over any other organizational structures, for example the vertical integration and foreign direct investment. If outsourcing and R&D are complementary to each other, outsourcing leads to an increase in R&D, which leads to a reduction of the negative impact of outsourcing on wages and employment in the outsourced countries. Based on a similar framework, Marjit and Mukherjee (2008) argued that outsourcing has a positive relationship with the R&D investment and hence an increase in outsourcing causes an increase in the R&D investment in small markets and highly competitive product market, whereas it decreases the R&D investment in large markets

Based on the efficiency wage models, which talk about the positive effect of higher wages (Shapiro and Stiglitz, 1984; Banerjee and Gupta, 1998), have shown a direct effect on labour productivity of higher wages, as result of greater incentive. Hence, a decline in wage mean declining productivity and the entrepreneurs might be reluctant to reduce the wage, even in the situations of unemployment. That is the key argument explaining unemployment and wage rigidity at the same time. Dibyendu Maiti and Sugata Marjit (2011) had focused on the subcontracting part of a typical firm to the informal sector for a developing economy.

Although, these literature give us the basis of contractual labour hiring practices, but they do not mention much about the productivity perspective. <https://assignbuster.com/effect-of-contract-based-labourers-on-indias-automobiles/>

Dibyendu Maiti and Sugata Marjit (2011) gave an overview of the productivity and subcontracting issue for a developing economy, this research study will only deal with the Indian automobile sector as its primary domain.

Research Design and Methodology

Starting with a simple framework of a firm, which has two alternatives to hire labourers, i. e. either using subcontracting way at a lower cost or it can go for permanent employment of labourers. The formal wage structure is determined exogenously at each level whereas the contractual labourers' wages are determined endogenously by the market and using the bargaining power of the contractor. Also assuming, is the fact that contractual labour wage rate do not adjust rapidly in the short run. In case of a rise, in the wage rates of the permanent labourers the firm would go for contractual hiring, thereby increasing the demand for temporary labourers in turn leading to an increase in wages. In the short run time period, if the contractual wage rises, the firm would opt for the existing permanent labourers, which again leads to an increase in the demand for permanent labourers. With this relation between the wages of both the contractual and permanent labourers, we can establish the fact that the contractual wage and permanent wage would be correlated. Although from a long run view, the contractual wage is adjusted by the market forces. The net effect of the above interactions between the contractual and permanent wage determines the level of wage and employment in a particular sector.

In order to analyse the study, information from secondary sources of Indian database is collected. With these dataset, and to establish a significant <https://assignbuster.com/effect-of-contract-based-labourers-on-indias-automobiles/>

relationship between the wages and productivity regression analysis has to be done. The study takes the annual emoluments for hired workers in Non-Directory Manufacturing Establishments (NDME) documented by National Sample Survey Organisation, Government of India and annual emoluments of the various factory workers documented by Annual Survey of Industries, Government of India, Society of Indian Automobile Manufacturers (SIAM) and Automobile Component Manufacturers' Association (ACMA). Running pooled OLS regression with state and time as dummy variables and panel GLS regressions to estimate the relationship between contractual wage and formal productivity, and formal wage and formal productivity controlling other variables. With the results for the regression analysis it can be showed that the correlation between formal wage and formal productivity is not statistically significant, while for the formal productivity and informal wage it is highly significant and with the GLS panel regression, it can be proved that formal productivity is highly affected by informal wage.

The formal or the permanent workers' sector does not necessarily affect the contractual workers' sector in the long term. If the permanent wage increases, the firm will transfer its production activities from its in house permanent sector to external contractual sector which leads to two effects on the contractual wage rate. Firstly, a substitution effect would raise the demand for contract labours. The discharged labours from the formal sector due to shortage of production would also supply more labour. Therefore, the net effect remains ambiguous. If the contract labour sector have a net positive demand for labours, it would increase the employment and it would raise the informal wage when the economy is at its full employment level.

Again, if net demand is negative, it might also reduce the contractual wage. This situation alters the efficiency gain of permanent labours and also brings down the condition for the contract sector. Thus a developing economy or an economy with a higher number of poor populations will have less productive permanent sector. This indicates that when a society has a greater number of poor informal workers, those who are fortunate enough to land up with relatively high-wage jobs may not be as productive as they would be in a society where access to the low wage informal segment restricted.