Paradigm Shift in Compensation to Workers in Indian Manufacturing-Role of LPG Policies

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The paper aims at analyzing the trend of compensation to the workers and employees in Indian manufacturing sector. The data for this study is collected from Annual Survey of Industries 2014-15 published in 2017 by Central Statistical Office. The function distribution of income theory approach has been used as the basis to design this paper. The comparative analysis of pre-reform and post-reform data has been done using dummy variable regression to check the structural break in series due to 1991 reforms. The major finding of this paper is that the profits have increased more than the other factors of production. On the contrary, the compensation paid to employees and workers has gone down drastically.

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Introduction

Compensation is the reward that workers get for their service or contribution to the organization or firm. No matter how big or small the business is paying appropriate remuneration to employees and workers is equally important. Compensation is basically the payment/benefits which provide income to workers and employees and it is also an important cost or expenditure to the employer (Martocchio, 2011). Workers cannot be expected to give their efforts without assured return for their labor. As viewed by Armstrong and Murlis (1994) that reward is a means through which various needs of the workers' are satisfied. And thus unsatisfied workers normally reduce workplace morale and it may further lead to lower productivity. The classical theory says that the return for labor is reward for the efforts of workers; thus every industry engages their labor for economic rewards and incentives (Igalens & Roussel, 1999; Ciarniene & Vienazindiene, 2010). Further, employees' compensation has been generally divided into two parts or categories i.e. the extrinsic and intrinsic rewards. Intrinsic rewards are related

to a psychological mindset which is experienced by workers at their workplace. On the other hand the extrinsic reward includes employees' pay along with benefits, which workers enjoy as an outcome of their efforts in the organization. Lai (2012) found that the most important tool to create value to an organization is extrinsic compensation. It has been established in several studies that job related factors such as pay, hours of work, promotion opportunities, job security influence job satisfaction (Capelli & Sherer, 1988; Clark & Oswald, 1996; Bygren, 2004; McCausland et al., 2005; Heywood & Wei, 2006; Brown et al,. 2008) .Thus compensation is a major concern for both employers and their employees. For an employee, pay is of paramount importance in meeting their basic and economic needs. The pay is so significant because when workers are satisfied with their pay, their attitude and behaviors could be influenced towards the desired objective (Onukwube, 2012). Along with workers there are certain other factors which are used for production process. These factors are generally known as the factors of production. These factors pose a direct effect on the quantum of compensation paid to workers and employees. The factors majorly discussed by economists' are land, capital and profits. The compensation to these factors of production depends on the objectives, goals, vision and mission of the firm.

In last few decades, the objectives, goals, vision and mission have witnessed a great change. They have been moving from profit maximization to revenue maximization and further towards balanced interest theory. The balanced interest theory was adopted by different business firms and all the factors of production were treated as equal partners. At the same time researchers and academicians started discussing the income distribution among factors. This change of business philosophy and policies can be attributed to government policies. As the government policies play a very crucial role in directing the growth of different sectors of the economy. It is generally found that the government's policies have the power to make or mar the growth and future of any industry or sector. Thus, analysis of any sector's data provides the reflection of the type of the policy a government has been adopting for a particular sector. From the decade initiated in 1980, the major economic policies of Government of India had been targeting for the growth of business class in general and economic growth in particular. Indian industrial sector reform majorly involved deregulation and de-licensing of different sectors of the economy. These reforms on the one hand benefited the business class but at the same time posed a negative impact on compensation to workers due to increase in contractual and daily wage jobs. On the other hand capital sector reforms have promoted the cause of easy availability of capital to the businesses. The major economic reforms have been tar-

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geting over banking sector reforms. This has resulted in promoting the easy and cheap availability of funds to the industrial sector. The financial sector reforms have promoted the simple, affordable and business-friendly tax regime in India. At the same time external sector reforms have increased the easy availability of foreign capital to the Indian business sector. This resulted into the increase in the collaborations of Indian corporate sector with the foreign corporate sector. These economic policies have given a boost to the cause of Indian manufacturing sector in particular and Indian business in general. All these changes have resulted in reasonable economic growth during the last two decades. Efficiency and productivity of the Indian manufacturing sector have also increased relatively. This in return has boosted the compensation to the entrepreneurs/businessman in the form of higher profits.

Thus this study aims at finding the empirical shreds of evidence for the same in the Indian manufacturing sector. Efforts have been made to relate the changes in compensation to workers and policy reforms. The economy of any country can mainly be segregated into three sectors such as primary sector, secondary or manufacturing sector and tertiary sector which is also known as the service sector. This paper is about the Indian manufacturing sector. The trend analysis has been done to see the changes in the compensation to workers to net value added in last 34 years. The manufacturing sector aims at converting the inputs into output using different factors. But many a time the process is not efficient. This inefficiency may be due to internal or external environmental factors. This fact sometimes requires a thorough revision of all the factor of production with regard to the overall process. The manufacturing sector has been selected as this sector employs large number of manual workers and it is the bedrock of Indian economy. In India, the manufacturing or factory data is collected in the form of Annual Survey of Industries. This ASI data has been used in this study. The study period is from 1981-2015, which makes it a 34-year analysis.

Theoretical Background

Determination of compensation to be paid to workers and other factors is not similar to product pricing. The main point of difference is that factors of production have both joined and derived demand. And they contribute to production in a combined way. The estimation of supply of the factors of production is also difficult as compared to product pricing. There are some theories of economics for determining the price to be paid for the services of a particular factor of production. Here it is important to note that it is not the price paid for the factor but only for its services. Compensation is paid for the services rendered by workers and employees in any firm. Production of any product becomes possible only by the pooled efforts of the different factor of production. Thus the revenue earned from the sale of a product or service needs to be allocated among the factors, of production. The theories of factor pricing suggest the criterion for income distribution among these factors of produc-

tion. There are two approaches for these theories i.e. the personal distribution and functional distribution. Individual factor's income generation is studied under personal distribution.

The functional theory has macro as well as micro theories. The macro theory of distribution of income deals with aggregates of a country. The micro theory deals with distribution of the relative shares of different factors of production. The Marginal Productivity theory is the oldest and the most important concept in the micro theory of factor pricing. According to this theory, the factors are demanded, for their ability to produce the goods and services. Thus a factor is demanded till it is productive to a business firm. Here it should be noted that the productivity of a factor is an important consideration for determining the relative share in the net value added.

Review of Literature

The literature review indicates that the impact of trade liberalization and other trade reforms has been one of the widely discussed and researched areas among the academicians, researchers and policymakers. Many of the existing studies suggest that the policy reforms in favor of businesses decrease wage rates and increase wage differentials in the economy. Further, this decrease in wages goes to increase the share of profits in total value added. In1980s many countries including India started realizing the importance of trade reforms to boost up the manufacturing sector of the economy. After pursuing an import-substitution strategy for several decades, India adopted a drastic liberalization for its external sector. The average tariff rate in Indian manufacturing drastically decreased from 117 percent in 1990-91 to 39 per cent in 1999-00. This reduction in tariffs was more than in Latin American countries like Colombia, Brazil, and Morocco. India has also reduced non-tariff barrier since 1991. The average import coverage ratio (the share of imports subject to Non-Tariff Barriers) declined to 17 per cent in 1999-2000 from 82 per cent 1990-91. (Mishra et al, 2013).Das (2003) undertook a research to study if the trade barriers have declined in India after the reforms of 1991 and found that trade barriers have been drastically decreased after the adoption of LPG reforms. Pal et al (2004) found that Indian economic liberalization has eased the lending norms and national banks have started giving a certain quota of total credit to SMEs and to agriculture. As a result of it, many banks avoided lending to small farmers and small industries considering them to be less creditworthy. These changes resulted in more and easy availability of credit to relatively big and growing manufacturing sector. Several studies conducted outside the country confirm that trade reforms and trade liberalization have impacts on the labor market. Also, there is a consensus that trade liberalization has resulted in increasing the aggregate incomes, which has fur-

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ther led to the growth of businesses. However, the internal distributional effects of trade reforms and the effect on labor markets are still debated. Cragg and Epelbaum (1996) conducted a study in Mexico and found that wage dispersion increased due to liberalization and privatization in most industries between 1987 and 1993. At the same time, some of the increases in inequality may be attributed to factors other than trade reform. Feenstra and Hanson (1997) found that part of the increase in wage inequality can be attributed to an increase in foreign direct investments that resulted from reductions in restrictions on investments during early 1980s. Feliciano (2001) using micro-level data of Mexico found the impact of trade reforms on employment and wages. She suggested that the trade reforms have increased wage inequality. She also finds that a decline in import license reduced the wages of the workers in the reformed industries but did not have an impact on relative employment. This study also found that the change in the labor market cannot be solely attributed to trade reforms and other policies also contribute to the labor market. Many studies have been conducted using the multi-country data. As Sebastia's (1993) study using the cross-country (OECD) aggregate data from 1982-2003 found that the stringent job dismissal regulations negatively affects the productivity growth of the industry. On the other hand, Nickell and Layard (1999) found a positive relationship between employment protection and productivity per capita using cross-country variations only. There is a paucity of research which have emphasized on the impact of trade reforms on the productivity of individual factors of production and majority have related the productivity to industrial productivity. In another research Belot et al (2007) using the 17 OECD countries data showed that there is an inverse U shape relationship between economic growth and employment protection. They have also asserted that the optimal level of employment protection depends on some other features of the labor market, such as the minimum wage rates, the bargaining power of workers. They also found that mandatory dismissal regulations have a negative impact on productivity growth of the industries where layoff restrictions are more likely to be binding on the related firms. According to Alesina et al. (2005), within a neoclassical framework, regulation can increase the cost the firm faces when expanding its productive capacity and limits its capacity to respond to changes in fundamentals. Therefore, a high employment protection legislations result in a negative impact on extension of investment by increasing firms' adjustment of the costs over time.

Employment protection may slow down economic growth and, together with it, welfare.

Employment protection may slow down economic growth and, together with it, welfare. This also is the central argument of Panagariya (2001). He has argued that rigidity in labor laws increases the costs for employers and also negatively impacts the firm's size by discouraging them from employing more than a

fairly small number of permanent workers. He also argues that the costs of such rigid labor laws go beyond those incurred by existing entrepreneurs as these laws discourage entry.

Aghion et al (2005) showed that output and employment in any industry increase relatively more in the pro-employer states than in others. Their focus here was on de-licensing. They also showed that deregulation can be more useful in the presence of better labor laws. In states with better labor institutions, deregulation has had a positive effect on productivity, but not in other states. Even after controlling for de-licensing, trade liberalization is shown to have a productivity-enhancing effect. The "pro-competitive effect" clearly dominates the "market-size effect". However, they pointed out that a stronger beneficial effect of trade reforms on productivity are felt in the presence of more flexible labor market institutions. There also seems to be an impact of these variables on factor accumulation and employment. Labor market flexibility, by itself, can improve productivity to a large extent and has a positive effect on employment and investment as well. Productivity is higher in the less protected industries. Thus after reviewing the above literature and various government reports the following objectives are framed:

1. To study the income generated in the Indian manufacturing sector from 1981 to 2014.
2. To see the growth of contribution of four factors of production to total income.
3. To relate the findings with the changes in the Indian business environment.

Data Analysis

For data analysis annual and relative growth rates have been calculated. For comparative decadal analysis of pre-reform and post-reform data has been regressed to the time trend.

Table 1 Percentage of Four Factors of Production in Net Value Added.

Year	Total Compensation to employees and workers as % age of NVA	Profit As % of NVA	Rent As % of NVA	Interest As % age of NVA	Total
1981	52.91	23.40	1.16	22.53	100
1985	55.89	15.43	1.44	27.24	100
1991	45.94	17.57	2.17	34.31	100
1995	39.88	31.60	2.78	25.75	100
2001	43.97	24.17	2.60	29.26	100
2005	28.44	59.15	1.70	10.71	100
2011	32.51	49.59	2.12	15.78	100
2014	35.12	45.93	1.71	17.25	100

Source: Calculated from the Annual Survey of Industries 2014-15 published in 2017.

Table 1 makes it clear that the contribution of total compensation to employees and workers in 1981 was approx. 53%, interest 23%, rent 1.16% and lastly,

During 1990-2014 the percentage of compensation to employees and workers has been constantly decreasing and in the year 2014 it came down to 35.12.

profits 24 % of total net value added. This scenario of distribution of net value added underlines that the compensation to employees and workers was given more importance; their shares being more than 50 % till 1989-90. But during 1990-2014 the percentage of compensation to employees and workers has been constantly decreasing and in the year 2014 it came down to 35.12. Further, in 1981 the share of profits in net value added was 24%.Although subjected to fluctuations; the profits of the factory sector have been increasing in its share from 1981 to 2014. In 2014 the share of profits was found to be around 46% which is approximately double of what was in 1981.

The growth in the profits has been found to be highest amongst the factors of production. The profits are followed by an increase in total compensation to workers. The contribution to employees and workers found to have gone down drastically .The share of rent component has remained relatively unchanged or less changed. The share of interest has also grown until 1991but has fallen during the subsequent years.

Table 2 The Compounded Annual Growth Rate of Four Factors of Productions in Indian Manufacturing Sector (%).

Compounded Annual Growth	Total compensation to employees and workers	Profits	Rent	Interest	Net Value Added
(From 1981-2014)	11.36	18.71	14.98	10.86	13.79
1981-90	12.89	8.18	19.87	16.85	13.11
1990-00	10.81	21.32	21.31	13.13	14.38
2000-10	12.70	32.21	13.76	6.58	19.32
2010-14	13.12	4.90	4.23	17.34	9.33

Source: Calculated from the data of the Annual Survey of Industries 2014-15 published in 2017.

Table 2 shows the decadal growth rate of four factors of production in study period from 1981 to 2014. It is clear that the growth rate of profits was the highest (18.71%) followed by rent i.e. 14.98%. The compensation to employees and workers was 11.36% which is much below that of the profits (18.71%).The growth rate of interest in the same period was 10.86%. During 1981-90 the growth rate of profits was the lowest (8.18%) among all the factors of production whereas the rent was the highest (19.87%) followed by interest with the growth rate of 16.85%. The trend of growth rate totally changed during 1991-00. Profits and rent recorded the highest the growth rates, profit's being 21.82% which was just 8.18% during the previous decade. On the other hand, the growth rate of interest and compensation to employees and workers has decreased to 13.31% and 10.81% respectively.

Further, the analysis of 2000-10, found that the growth rate of profits increased to 32.21% which was again much higher than the previous decade. On the other hand, the growth rate of rent and interest decreased to 13.76% and 6.58% respectively. Last four years of analysis, i.e 2010-15 the growth rate of profits and interest was found to be decreasing whereas interest and compensation had been increasing by 17.34% and 12.13% respectively. In addition to the above analysis, dummy variable regression has been used for ascertaining the statistical significance of structural break (normally claimed to occur in1991) in functional distribution of income in Indian manufacturing sector. The H_0 for this test is that there is no structural break in the data set with regard to the specific year (1991).

Table 3 Dummy Variable Regression Results Where Dependent Variable=Profits.

	Regression Coefficients	t value	Sig
Constant	12.429	55.02	.000
D_t	0.035	0.111	.911
X_t	0.111	3.071	.004
D_tX_t	0.049	1.315	.1984
R^2	0.967		
Adjusted R^2	0.963		

Dt=Dummy variable for time, Xt= Time trend.

The dummy variable regression for the structural break in profits at observation 1991found to be statistically insignificant. (Table 3) Thus we failed to reject the Null Hypothesis

Table4 Dummy Variable Regression where Dependent Variable = Interest.

	Regression Coefficients	t value	Sig
Constant	12.509	81.019	.000
D_t	1.177	4.583	.000
X_t	.171	8.131	.000
D_tX_t	-.094	-4.174	.000
R^2	.950		
Adjusted R^2	.945		

Y_i= 12.509+1.177(D_t) +0.171(X_t) -.094(D_tX_t)

1981-1990 Y_i=12.509+0.171 (X_t)

1991-2015 Y_i = (12.509+1.177) + (0.197-.094) X_t

Y_i= 13.686+0.103X

Dummy variable regression for the structural break at observation 1991 has been found to be statistically significant for Interest at 1% significance value (Table 4).Thus the H_0 is rejected. There is a break in 1991 and series needs two equations for pre and post 1991 data.

Table 5 Dummy Variable Regression where Dependent Variable=Total Compensation.

	Regression Coefficients	t value	Sig
Constant	13.455	63.078	.000
D_t	.193	1.134	.238
X_t	.123	4.951	.000
D_tX_t	-.019	.714	.183
R^2	.981		
Adjusted R^2	.979		

The dummy variable regression for the structural break at observation 1991 for total compensation has been found to be statistically insignificant. (Table 5)

H_0: There is no structural break. Thus we failed to reject the null hypothesis.

Table 6 Dummy Variable Regression where Dependent Variable=Rent.

	Regression Coefficients	t value	Sig
Constant	9.430	78.427	.000
D_t	1.639	8.195	.000
X_t	.197	12.045	.000
D_tX_t	-.101	-5.748	.000
R^2	.983		
Adjusted R^2	.981		

Dummy variable regression for structural break at observation 1991 found to be statistically significant. Thus H_0 is rejected.(Table 6) The two regression lines of pre and post reform are mentioned below.

$Y_i = 9.430+1.639(D_t) +.197(X_t) - .101(D_tX_t)$

1981-1990 $Y_i=9.430 +.197(X_t)$

1991-2014 $Y_i = (9.430+1.639) + (.197-.101) X_t$

$Y_i=11.069+0.096X_t$

The results of dummy variable regression show that in case of interest and rent test found to be statistically significant at 1% alpha level. But in the case of total compensation and profits, results found to be insignificant. Thus it can be concluded that the policy reforms which took place in the year of 1991 posed relatively less sudden impact on the compensation of workers and profits. The impact was gradual and started from late 1980's i.e. the pre-reform era. But at the same time impact was more vibrant on rent and interest.

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Discussion

From the time of Independence till the early 1980's, the orientation of Indian laws and policies has been biased

towards the laborers. During numerous instances, even the Indian courts have favored the stakes of laborers. There were many laws and policies like licensing, quota system, MRTP Act which resulted in the restricted growth of the corporate sector in the country. Due to the prevalence of such laws and policies, the payment or compensation made to employees and workers had been highest amongst the four factors of production. These laws and policies had put considerable impact on the efficiency of the Indian labor market. The wage rates had continued to rise but at the same time, labor productivity could not match the pace of growth in compensation paid. Micco and Pages (2007) conducted a study based on multi-country manufacturing data and asserted that employment protection-related laws and legislations constraint the growth of economiy. David et al (2007) using firm-level data found that strict enforcement of labor regulations affects and alters labor productivity and job flows.

This rise in compensation to employees and workers resulted in increased demand for consumer durables due to the increased purchasing power of the people. This again helped in the expansion of the private sector in the country. But during the late 80's, the country saw a paradigm shift in Indian policies and laws. At this time the Indian economy was getting ready for the major economic reforms; this was due to the adoption of liberalization, privatization and globalization (LPG). These economic reforms turned the orientation of Indian laws and policies towards the business class. Since then, many reforms like economic, industrial and financial have taken place which altogether helped in mushrooming of corporate and business sector in India. All these reforms had changed the orientation from laborers to capitalists or owners of the business. The laws which were restricting the growth of the corporate sector were relaxed in favor of business owners. Ideally expecting, this should have led to the growth of the new business class in India, which actually happened in India. Several studies in the last couple of decades, pertaining to Indian corporate and business sector did highlight relatively better performance in terms of their annual results and share prices. The Indian business has a very important component of the manufacturing sector which again has a big component of the small and medium sector. Some people have classified the same as the registered and unregistered sector. In India; the data pertaining to the manufacturing sector represents the big, large and medium enterprises. The present study attempts to analyze the performance of Indian manufacturing sector based on factor income method i.e. how the income generated is distributed among four factors of production.

Conclusion & Suggestions

The present paper highlights the changing dimension of four factors of production in the Indian manufacturing sector over the period of the study i.e. 1981-2014. It is very clear from the analysis that the share of compensation paid to employees and workers, out of total value added in the economic pro-

cess has gone down drastically from 52.91% in 1981 to just 35.12%in 2014.On the other hand in nominal terms, the compensation to employees and workers has witnessed a CAGR of 11.36%.

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From the analysis, it emerges that in general, the entrepreneur, in particular, has been able to generate high profits during the last couple of decades. The profits which had a share of only 23.40% of NVA in 1981 came to 45.93% in 2015. During the study, period profits have grown at the relatively high rate of CAGR 18.71%. This may be attributed to the policy of LPG initiated during late 80's and through 90's.The fact can be affirmed from CAGR figures. During the pre-reform decade i.e. 1981-90 the CAGR of profits was just 8.18% and it improved drastically from 1990-00 to 21.32%. It further increased to 32.21%.This has promoted the cause of business in India. On the other hand, we have witnessed a large scale growth in the real estate business in India which have helped and motivated the business class to start owning their own buildings and structures which in turn has led to a downfall in rent component of the manufacturing sector. The CAGR of rent was 19.87% in pre-reform decade i.e. 1981-00. It increased to 21.31% in 1991-00. In 2000-10 the CAGR of rent came down to 13.76%. Further, in recent years, its CAGR has reached 4.23%. In the last three decades, the economic and other related policies have promoted the low rate of interest and adequate supply of capital to Indian manufacturing sector. This has led to the growth of the interest at a CAGR of 10.86% in the manufacturing sector of India. Further, there has been a consistent demand in the country to promote the cause of labor and employee class in India but nothing substantial has been done and achieved for the same. On the contrary, the labor class has been relatively on the reverse side because the country has witnessed the increase in the number of contractual jobs and more policies towards payments of wages as per marginal total productivity. This has definitely led to higher wages but more of the contractual or casual jobs. Similarly, the capital class has provided more capital and money to the business at less rate of interest. The real estate sector infrastructure has also grown over the decades. As a result the role of land and capital in the value generation has gone down. The present study has highlighted this very phenomenon. Among the four factors of production, only entrepreneurs/ business community has been major beneficiaries of Indian reforms in comparison to the other three factors of production. Therefore it calls for stringent measures and more liberal policies for promoting the cause of the labor class. So the third generation economic reforms should be targeted especially towards generating more employment and more efforts should be made for compensating the employees in this very direction.

Note:

The term 'total compensation paid to workers' represents total wages, salaries and all other welfare expenses made to workers and employees.

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