Consortium for Development Policy Research

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Interaction of Labour Law and Economic Growth - Case Study of Sheikhupura

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International Growth Centre

About the project

Funded by: International Growth Center (IGC)

Impact: This work informed policies of the federal government to strengthen existing penalties for various forms of labour force exploitation and exposure to hazards. The report proposes a series of recommendations to incentivize companies to voluntarily improve working conditions and standards.

This policy brief is based on a report "Interaction of Labour Law and Economic Growth - Case Study of Sheikhupura", prepared by Dr. Mir Anjum Altaf (Former Dean of the Gurmani School of Humanities and Social Sciences at the Lahore University of Management Sciences). It has been compiled by Mehroz Alvi (CDPR).

In brief

- Representatives of small cities have consistently drawn attention to violations of labor laws and their negative impact on worker welfare and productivity.
- This case study of Sheikhupura, a half-million sized industrial city, about 30 miles from Lahore, identified five labor laws with a major impact on worker welfare and productivity.
- The balance of power among the three key players – workers, factory owners, and government regulators – was determined to be completely one-sided with the latter two holding all the cards. This collusion allowed gross violations of all the laws with various subterfuges and mechanisms.

Earlier research on small cities in Pakistan[1] had identified the significant impact of labour laws on both the welfare and productivity of industrial workers. To formally test this relationship, Sheikhupura, a half-million sized city with an industrial base ranging from small factories to multinational companies, was chosen for a case study.

There are five major provincial labour laws with the most impact on the labour market in Sheikhupura. [2] Examination of the relevant case law including fieldwork identified several violations in its application:

- **Workers are hired indirectly** to diffuse legal liability of factory owners under the labour law. Factory owners enter into a "contract for services" with a subcontractor who hires labour informally and is in a better position to work with regulators.
- **Monthly compensation for unskilled workers is less than the minimum wage.** It ranges from Rs. 7,500 to Rs. 10,000 for duty shifts of 8 to 10 hours a day (against the official minimum wage of Rs. 10,000)[3].
- **The workers don't receive the legal minimum wage** due to this arrangement with the subcontractor, even if factory owners comply with the rule, since the subcontractor takes a cut.
- **There is no effective social security or job** security for workers hired indirectly by factory owners through subcontractors.
- **Trade unions are largely absent** from Sheikhupura. The few that do exist are headed by individuals appointed by employers and hence fail to satisfy the critical condition of "free association".
- **Females report lower average wage** than their male counterparts.
- **Working conditions are unsatisfactory.** Factory owners do not ensure safety measures for workers exposed to hazardous materials. Female workers also report incidents of sexual harassment.
- **Employers violate laws frequently.** They under-report the number of employees, pay wages below the minimum wage, employ child labour, and discriminate against workers who complain.
- **There is lack of awareness** amongst workers about their basic rights. Those aware of them have little faith in the judicial process. The expensive and cumbersome judicial process also acts as a deterrent to raise voice against injustice.
- **There is surplus unemployed labour** in the market. Fear of losing the only means of employment (especially for those with informal contracts) restrains the need of labour to report violations.
- **The balance of power among the three key players: workers, factory owners and government regulators is one-sided** with the latter two in a dominating position. Collusion between employers and labour inspectors generally means that factory owners are aware of "surprise visits" by inspectors and hence violations of the law are not curbed.
- **Legal loopholes** allow employers to evade compliance, accountability and prosecution. Subcontracting remains an avenue for evasion. Fines, where imposed, are an insufficient deterrent to violations. Fines and compensation combined are much less than the cost factories would incur to comply with the labour laws. Additionally, the slow and cumbersome judicial process militates against compliance in the labour market.

Analytical Summary of Findings in Sheikhupura

Small-scale industry in Sheikhupura is characterized by an undesirable low-level equilibrium – there is low output and productivity, less than full utilization of labour, low income, low domestic demand, and weak investment in human capital by the poor. Additionally, industry in Sheikhupura is stuck in a prisoner's dilemma - no individual firm on its own can afford to change the terms of engagements with either workers or regulators.

Useful parallels can be drawn with the case of the Southern part of United States of America in the 20th Century where a combination of a low-level equilibrium and prisoner's dilemma existed in a private market-oriented economy. The victims, African-Americans, were discriminated against on account of their Race.[4] It was grassroots political mobilization along with promulgation of federal laws that managed to overcome the prisoner's dilemma and enabled industry to break out of the lowlevel equilibrium trap. It seems that similar activism and federal action may be needed if the conditions of social injustice in small-scale industry are to be improved in Pakistan.

Recommendations

Labour contracting could be recognized as a separate category in the service industry. A formal structure within the existing legal framework should be made for contractors who supply informal labour to factories and other establishments. Companies should be allowed to hire only from registered contractors. This will provide an incentive for contractors to register

[1] Anjum Altaf (2013), "Small Cities Initiative: 'Listen and Learn' Phase", International Growth Centre.
[2] The Factories Act, 1934; Minimum Wage Ordinance, 1961; Payment of Wages Act, 1936; Punjab Industrial Relations Act, 2010; and Workmen's ompensation Act, 1923.
[3] Minimum Wage Ordinance, 1961.
[4] Gavin Wright (2013), "Sharing the Prize: The Economics of the Civil Rights Revolution in the American South", Harvard University Press.

themselves to be able to operate in the labour Market.

Surprise visits or checks at factories to penalize and control malpractice are imperative. Since the government's inspectors have largely failed in this regard, the function could be outsourced to private audit firms with contract renewals based on performance.

The government needs to increase the severity of punishment for violations and ensure their timely enforcement. The fines currently being imposed are too low to deter firms from violating laws. Furthermore, while some offences carry prison sentences by law, they are rarely enforced.

Resisting unions should be recognized as a criminal offense. The right to organize, to form unions independent of government or employer influence, and to bargain collectively are all recognized by the International Labour Organization in the 'Declaration of the Fundamental Principles and Rights at Work'.

Encourage training and human capital development. Training and human capital development needs to be encouraged to trigger a positive cycle of human capital accumulation and increase awareness of labour rights. TEVTA and PBTE could assist firms in providing training[5].

The monitoring and regulatory structure needs to be redesigned to better align the incentives of industrialists, government and workers.

Labour welfare standards need to be introduced for all the workers in a factory including those employed through subcontractors. Independent monitoring units should periodically assess factories and assign a rating based on the degree to which the standards have been achieved. Employers who receive high ratings can be rewarded through tax benefits.

Compliance with standards should be made public. Public disclosure has proved to be successful in many countries. The results in Indonesia under PROPER[6] are well documented. PROPER made it mandatory for all participating companies to self-rate themselves subject to verification by independent third-party auditors. Ratings were color-coded for simple interpretation and disseminated to the public. Disclosure was also required on the packaging of company products.

Citizens' labour board should be set up. It should include representatives from the media, academia, youth organizations and women's groups.

Conclusion

Our case study of Sheikhupura reveals that the problem in the labour market is not caused by the absence of laws but by their poor implementation. However, institutional and bureaucratic decay is so pervasive that effective implementation seems nearly impossible without extraordinary measures. Given the situation, some progress is possible if alongside the strengthening of punitive measures, an incentive regime is put in place to generate the impetus for progressive employers to voluntarily introduce better measures thus triggering a virtuous cycle. Additionally, in the context of weak labour rights, the importance of grassroots political mobilization and consumer activism cannot be ignored, as a much-needed catalyst to promote social justice and economic growth.

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[5] TEVTA is the Technical and Vocational Training Authority and PBTE is the Punjab Board of Technical Education.

[6] Asian Environmental Compliance and Enforcement Network (2008), "Environmental Compliance and Enforcement in Indonesia", Rapid Assessment.

The Consortium for Development Policy Research (CDPR) is an umbrella organization that provides a platform for research centers, local academic nstitutions and think tanks to promote evidence-based policy-making. It aims to bring latest research findings on important policy issues to policy makers, edia, citizens and political parties. CDPR is funded by the International Growth Centre (IGC).