

# **LABOUR LAW AND INCLUSIVE DEVELOPMENT**

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By

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## **Abstract**

This paper, based on the V.V. Giri Memorial Lecture for 2013, argues that labour law should be seen as a developmental institution, capable of promoting both equality and efficiency, and hence inclusive development. Labour law rules, precisely because they redress the inequality of bargaining power inherent in the employment relationship, may promote economic efficiency, since they counteract the effects of contractual incompleteness, while mitigating labour market risks. The World Bank view that laws designed to help workers often harm them is neither theoretically well informed nor empirically supported. There is a need for new thinking to escape the intellectual rigidities currently afflicting labour law.

**Keywords:** labour law, development, equality.

**JEL Codes:** J88, K31,

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## 1. Introduction

It is my great privilege to give the 2013 Memorial Lecture in honour of the scholar and statesman V.V. Giri. The theme I have chosen is ‘labour law and inclusive development’. The nature of the contribution of labour law to economic growth, and to human development more generally, is highly contested. For the past three decades, a neoliberal policy consensus has taken hold around the world, according to which labour law rules do more harm than good: as the World Bank has put it, ‘laws created to protect workers often hurt them’ (World Bank, 2008). During this period, collective bargaining has been pushed back in many countries, minimum wages have been reduced or left to stagnate, and employment protection laws have been deregulated with a view to allowing employers to take advantage of flexibilities associated with part-time, fixed-term and temporary agency work. This is also a period during which new rigidities have emerged in labour markets: not the supposed rigidities affecting employers which are given so much emphasis in contemporary policy discourse, but rigidities arising from growing inequalities between occupational groups (Piketty and Saez, 2003), between ‘core’ workers and an increasingly insecure ‘precariat’ (Standing, 2011), and between those in the ‘formal’ and ‘informal’ economies (Bremen, 2003). The decline of collective labour market institutions has been accompanied everywhere by the rise of social division and exclusion (Stiglitz, 2012).

This process poses fundamental issues for our understanding of the relationship between economic growth and social progress. For the developed world, it appears to imply a reversal of the long-term trend towards greater equality which most industrialised economies experienced from the 1920s to the 1980s. For emerging markets, it suggests that economic development can take place without bringing about the reduction in inequality which was once thought to be an inherent part of the shift from a pre-modern economy to an industrial one. Either way, the optimistic prediction of the Kuznets curve, according to which rising inequality in the early stages of industrialisation gives way to a more equal distribution of earnings and incomes over time (Kuznets, 1955), appears to have been refuted.

I wish to take a fresh look at the contribution of labour law to inclusive development, that is, to a process which combines economic growth with social cohesion. I will consider, in turn, theoretical, historical and empirical perspectives. The theoretical perspective (section 2 below) is concerned with competing conceptions of the relationship between labour law and the labour market. I will argue for an institutionalist point of view which sees the law not as an interference with otherwise free-standing market relations, but as one of the mechanisms through which market relations are constituted. The historical

perspective (section 3) looks at evidence for the role of labour law in supporting the emergence and mature development of capitalist economies. I will argue that for countries in the global ‘north’, labour regulation has played a much more pivotal role in supporting the transition to a market-based economic order than is often supposed. My empirical analysis (section 4) looks at the growing body of evidence which is tracing the economic impact of labour law rules in contemporary economies, both developed and developing, using novel statistical techniques for quantifying the effects of law and estimating their effects. It is increasingly clear from this evidence that the empirical case for the deregulation of labour law is not just weak, but is essentially refuted across a range of different country contexts.

## **2. Theory: labour law as the ‘law of the labour market’**

Behind the World Bank’s claim that labour laws hurt workers is a body of theory which posits a fundamental trade-off between equality and efficiency: ‘in an economy that is based primarily on private enterprise, public efforts to promote equality represent a deliberate interference with the results generated by the market-place, and they are rarely costless’ (Okun, 1975). This view is the result of ‘relentlessly and unflinchingly’ applying the neoclassical economic axioms of ‘maximising behaviour, market equilibrium and stable preferences’ (Becker, 1976) to the case of the labour market. The core assumption here is that the labour market is in a unique and perfectly efficient equilibrium prior to the intervention of labour law. The idea of the market as a self-equilibrating order sets up a normative standard by which to judge labour law rules which, as ‘deliberate interferences’, are inevitably regarded as sub-optimal.

Neoclassical economics recognises a few exceptions to the principle of the self-equilibrating market, such as the presence of monopsony power which can justify a role for minimum wage regulation. Most neoclassical accounts, however, regard monopsony as an exceptional situation, and, a brief period in the mid-1990s aside (Card and Krueger, 1997), the mainstream consensus has been that minimum wages induce unemployment and other labour market distortions (Neumark and Wascher, 2008). In the final analysis, however, the assumption of market equilibrium is little more than that, an assumption. It has almost no empirical validity in real-life market settings, and as Coase (1988) recognised, those markets which most closely approximate to the idea of perfect competition are, like capital markets, also the most intensely regulated.

Labour markets are in practice highly regulated but even so fall far short of the competitive market ideal. Bounded rationality, uncertainty and asymmetries of power and information are structural features of labour markets rather than contingent or accidental ones. They originate in the form of the employment

contract, which is not a naturally occurring exchange, but one structured and constituted from the outset by a particular configuration of property rights. Ex ante, the worker sells his or her capacity to work ('labour power') to the employer for an agreed wage. Ex post, residual control rights ('managerial prerogative') and income rights ('surplus value') are allocated to the employer. In Marxist terms, it is the form of the employment contract which permits the extraction of surplus value by the employer, the exploitation of the worker, and the wider set of inequalities which characterise the social relations of production (Marx, [1867] 1975). In Coasean terms, the 'authority relation' under which the employer assumes the power to direct the worker is an 'efficient' means of reducing the transaction costs inherent in repeated contracting (Coase, 1937). Either way, it is the fundamental asymmetry of the employment contract which creates the occasion for labour law to enter the picture, compensating the worker for exposure to the employer's unilateral power by inserting norms of reciprocity and mutual insurance into the wage-work bargain, in ways which stabilise the exchange relationship (Deakin and Wilkinson, 1999). But even before that point is reached, the employment relation itself is structured by the rules of private law which assign control and income rights in the enterprise to the employer, and, at a deeper level still, by foundational notions of property and contract which in a market economy are supplied by the legal system (Supiot, 2007).

Marxist legal theorists writing in the early decades of the twentieth century had a firmer grasp of the 'deep interconnection' (Pashukanis, [1927] 2009: 63) of law and economy in a market order than the neoclassical law and economics school which began its rise in the 1960s. The rise of a capitalist economy entailed the appearance of a legal order based on the general, abstract categories of private law, 'from which every trace of the organic has been eradicated' (Pashukanis, [1927] 2009: 42). The legal mediation of social relations under capitalism involved the displacement of pre-modern relations of dominance and subservience by the formal equality of contract law. For Marxist writers attempting to model the role of the legal system in the transition to a socialist society, there was no sense in trying to construct a new type of 'proletarian law': 'there is absolutely no formula... which can transform the legal transactions arising out of our Civil Code into socially useful transactions' (Pashukanis, [1927] 2009: 99). Rather, private law would 'wither away' once the means of production were placed in the hands of the state. As part of this process, the law of abstract 'juridical' forms would give way to the 'scientific' administration of the technical norms needed for society to function.

It follows that it is not possible to point to any meaningful system of labour law operating in 'real socialist' economies in the period between the Bolshevik Revolution and the fall of the Berlin Wall. In these societies, there were rules governing the allocation of labour to different sectors of the economy and norms of coordination for the operation of enterprises, but no wider body of legal principle into which these regulations could be integrated. The suppression of the juridical followed from the rise of authoritarian political relations (Supiot, 2007). It turned out that legal form, whatever its shortcomings as a mode of regulation, was a more or less effective technique for controlling and diffusing the exercise of power, both public and private. While the 'real socialist' states were attempting to build a post-market economic order through the unmediated use of sovereign executive power, the democracies of the west were constructing welfare states and labour law systems which infused the categories of private law with the values of social solidarity and collective freedom of association (Marshall, [1949] 1992).

The emergence of labour law systems in the democratic west contradicted the Marxist argument that the forms of private law could not be adjusted to the goals of the social state (Ewald, 1986). Their persistence in the face of the neoliberal turn in economic policy since the early 1980s (on which, see Deakin and Wilkinson, 2011) amounts to a living refutation of Okun's 'law'. There is no inevitable trade off between equality and efficiency. The institutions of labour law, by countering the inequality of bargaining power which is inherent in the employment relationship, also mitigate the effects of information asymmetries and uncertainty in the contractual environment, as recent behavioural studies have emphasised (Bartling et al., 2012). At a macro level, the institutions of the welfare state, in qualifying the tendency of market economies towards the unequal distribution of wealth and resources, also operate to guarantee access to the labour market. Universal health care and state provision of education, funded through progressive taxation, embed market access as an aspect of social citizenship, in the process deepening the division of labour and creating the conditions for the specialisation on which the market economy depends. Social insurance provides protection against the risks which are characteristic of a market economy in which workers, excluded from access to the land or to the extended family, are compelled to sell their labour power in return for subsistence. Labour law may operate in a fragile equilibrium with the private accumulation of wealth and power in a capitalist economy, but at a deep level it is functional to and coterminous with the emergence of a market order: labour law is 'the law of the labour market' (Deakin and Wilkinson, 2005).

### **3. History: labour law and development in the long run**

The emergence of labour law alongside the rise of the market economy can be understood in historical terms. The conventional wisdom ever since Maine (1861) has been to see the movement of ‘progressive societies’ in terms of a shift from ‘status to contract’, a process apparently complete by the middle decades of the nineteenth century in Europe and north America, and to characterise the ‘rise’ of the welfare state and the consequent ‘fall’ of freedom of contract (Atiyah, 1979) as a later trend. This view has influenced policy prescriptions for emerging markets since the early 1990s: under the ‘Washington consensus’, post-socialist systems should implement reforms in a particular sequence, beginning with the liberalisation of trade and production, before contemplating measures of social protection (Sunstein, 1997).

The conventional wisdom is misleading. The historical record suggests that the characteristic institutions of labour law systems, including wage regulation and social insurance, did not postdate the appearance of market economies. They did not appear overnight in the late nineteenth century. They evolved over many centuries, coterminously with the rise of market relations. The English case is among the most instructive even if it only illustrates a wider trend, found also in other western European countries in the period from the decline of feudalism in the late middle ages, to the rise of industrial economies in the late eighteenth and early nineteenth centuries (Lis and Soly, 1979).

England had an embryonic form of social insurance underpinned by its legal system, the poor law, from the sixteenth century onwards. The poor law was incomplete in its coverage and often harsh and punitive in its operation, but it was recognisably an attempt to institute mechanisms of social assistance and insurance to deal with the pressures of an emerging market economy based on wage labour. In the formative period of these institutions, the idea of ‘poverty’ denoted not indigence as such, but propertylessness and wage-dependence. There was a recognition that wage dependence implied exposure to risks of a particular type. Thus the author of one of the first of many legal textbooks to be devoted to this field could characterise the poor as ‘here to be understood not vagabond beggars and rogues, but those who labour to live, and such as are old and decrepit, unable to work, poor widows, and fatherless children, and tenants driven to poverty; not by riot, expense and carelessness, but by mischance’ (Dalton, 1746: 164).

In the long evolution of the English poor law, we can see all the issues which dominate discussion of welfare state systems today: how to divide responsibility for the financing and administration of the system between the central state and local government, how to deal with the risk of moral hazard, and how to

regulate labour migration (see Deakin and Wilkinson, 2005: ch. 3). At all stages these debates were conducted through public deliberation and prompted solutions which were embodied in a mix of executive orders and parliamentary legislation. The process was not a spontaneous one. At a time when state capacity was rudimentary by modern standards, national legislation was used to institute a system of mostly local taxation and administration, which affected the whole of society in some way or another. The propertied were obliged to contribute through the poor rate which local officials were required by law to organise. Expenditure outstripped population growth during the seventeenth and eighteenth centuries: by 1800 Britain was spending seven times the amount of poor relief per head of population than its near neighbours on the continent (Solar, 1995). At this point, while between a third and a half of the population had insufficient income to pay local rates, around a tenth were in regular receipt of poor relief in the form of cash doles or payment in kind, and a quarter of households could expect to receive support of some kind in the course of a given year (Arkell, 1987). Replacement rates for unemployment and retirement were not markedly lower than they were to become at various points in the twentieth century (Thomson, 1984; Snell and Millar, 1987). Because the system was publicly organised, the payment of relief came to be seen as, if not exactly a legal right in today's sense of that term, then certainly a customary expectation which the state would respect, the 'peculiar privilege of the poor' (Snell, 1987).

Economic historians have, for some time, been reevaluating the contribution of the poor law to England's early industrialisation. The emerging view is that the poor law helped to normalise wage labour in a period during which most of the working population had some access to the land as a means of subsistence, but when this access was declining as a result of enclosures and the loss of common land-use rights. The poor law was a response to these developments, as well as triggering some of them. Mass migration within the rural economy and from the land to the cities caused the system of poor law 'settlements', according to which a worker acquired a right to poor relief in return for a year's service, to buckle in the early nineteenth century, leading to a retrenchment of provision which was reflected in a more austere and coercive legal regime, culminating with the attempted national implementation of the workhouse system through the Poor Law Amendment Act 1834 and its successors. Designed to be punitive, the workhouse model could never be fully realised in practice (Williams, 1981). Its demise in the early decades of the twentieth century can be attributed in part to the rise of a progressive politics which was itself the result of the extension of the franchise, but also to a growing realisation that the workhouse regime was counter-productive. As the conditions for the receipt of poor relief were being made progressively more degrading throughout the 1890s, but without bringing about any measurable reduction in unemployment



or in the volume of claims, official opinion came round to the view that the expenditure involved in administering the harsh workhouse regime was not justified. The workhouse system itself was causing casualisation and under-employment. By deliberately depressing the conditions under which poor relief was made available, the workhouse model removed any pressures on employers to supply a living wage and stable employment: the system ‘facilitates and encourages the worst kind of under-employment, namely the unorganised, intermittent jobs of the casual labourer’ (Webb and Webb, 1909: 34).

In the first half of the twentieth century, social insurance gradually displaced the workhouse, introducing systems of unemployment compensation and retirement pensions, financed by joint contributions from employers, workers and the state (Baldwin, 1990). At the same time, the spread of collective bargaining was leading to decasualisation in industries including mining and engineering (Wilkinson, 1977). Between the 1940s and the 1980s, macroeconomic policy formed a third pillar of the welfare state, as successive governments used fiscal and monetary policy to manage demand in the economy, in such a way as to favour stable or ‘full employment’. As Beveridge put it, ‘it must be the function of the state to defend the citizens against mass unemployment, as definitely as it is now the function of the state to defend the citizens against attack from abroad and against robbery and violence at home’. This meant that ‘the labour market should always be a seller’s market rather than a buyer’s market’ (Beveridge, 1944: 17, 19).

Since the beginning of the 1980s, macroeconomic policy in Britain, as elsewhere, has undergone an about turn, reviving nineteenth century notions of self-adjusting markets and fiscal constraint, and the social insurance system inherited from Beveridge’s mid-century reforms has been weakened and fragmented (Deakin and Wilkinson, 2005: chs. 3 and 4). Despite these changes and the associated emphasis on the promotion of labour market flexibility as a goal for policy, labour law, even in Britain, has proved surprisingly resilient. Deregulation of basic labour standards in the 1980s and early 1990s did not endure into the 2000s, as legislation setting a new floor of rights in minimum wages and working time was put into place. Collective bargaining has declined in depth and extent, but has to some degree been replaced by employment protection legislation and, to some degree, equality law, as forms of labour market regulation.

The standard employment relationship (‘SER’) has also proved more durable than many expected. The SER is the concrete expression of the fusion of private law forms with the values of social solidarity of the welfare state. This fragile compromise is open to attack from free-market critics, on the one hand, who see it as a fetter on efficiency (Epstein, 1984), and from radical critics of

the status quo, on the other, who see it as an unnecessary concession to the logic of private law (Collins, 1986). From a feminist theoretical perspective, the association of the SER with the concept of the male breadwinner wage marks it out as a source of new forms of structural inequality (Vosko, 2010). The SER has nevertheless persisted, in the dual sense that the indeterminate employment contract continues to constitute the majority of labour hirings in Britain as elsewhere in Europe and north America, and that the SER provides a normative benchmark for labour law rules, not least those which provide a limited right to equal treatment for workers employed on part-time, fixed-term and temporary agency work contracts (Deakin, 2013).

The SER has survived in part because it is flexible: it is not confined in its operation to large-scale industry, being equally relevant in the contexts of services and new technologies, and it has adjusted to the growing participation of women in the labour force, offering growing numbers of them access to the stable employment patterns once reserved for male breadwinners (Bosch, 2004). The survival of the SER can also be ascribed to its continuing functionality. The model of indeterminate employment continues to provide employers with the flexibility associated their unilateral power to direct labour within the broad terms of the wage-work bargain, while providing workers with access to insurance against labour market risks. The inability of the SER to perform its protective function in parts of the economy characterised by new forms of casualisation, such as zero-hours contracts, is not a result of weaknesses in the model itself, so much as the inevitable consequence of the decline in collective bargaining and the weakening of the floor of rights in social security law (Deakin and Wilkinson, 1991).

The British case is instructive not least because of England's early industrialisation, but it is not unique. It is characteristic of the shared experiences of most of the economies of Europe and north America since the final quarter of the nineteenth century. While there are significant differences of labour market institutions across industrialised economies, as well as in terms of the substance of labour law, there is a high degree of continuity in the emergence of mechanisms to diffuse labour market risks and channel distributional conflicts. The partial reversal of the gains made by labour at the height of the post-war welfare state has gone so far as to entail a reversion to pre-capitalist employment forms. What are the lessons of this experience for the global south?

It is important to avoid viewing the evolution of labour law in teleological terms. Industrialisation is a necessary but not sufficient condition for the emergence of labour law. The institutions of labour law help provide solutions to collective action problems which are characteristic of market economies.

However, in the political sphere where labour legislation is enacted, labour law reforms can be stymied by vested interests and the entrenchment of wealth and power. Labour law are often compatible with labour market efficiency, but they also involve redistribution, and may create losers as well as winners. When the potential losers are in a position of power, change may be delayed or forestalled. Labour law systems can regress, as in many Latin American countries at various points over the course of the past century (Fraile, 2009), and as some European countries are in danger of doing, in response to the European Union's sovereign debt crisis (Countouris and Freedland, 2013).

The models of Lewis (1954) and Kuznets (1955) which predicted the stabilisation of wage labour as industrial economies developed, and a consequent reduction in inequality over time, therefore need to be qualified by an analysis which identifies barriers to reform within the political process (Acemoglu and Robinson, 2002). We are far from having a complete theory of the political economy of law reform, but we can identify factors in the history and institutions of particular countries which may make them more or less likely to develop enduring labour law systems. We must also not neglect the role of conscious policy choices. The path of institutional change is not fixed, so that at any given juncture there is scope for political decision making to play a role in shaping its direction.

There are many reasons why the labour law institutions of the developed world cannot be straightforwardly transposed to emerging markets. The adverse consequences of late development for low and middle-income countries include the negative impact of colonisation on the resources and infrastructure and the negative terms of trade they experience with wealthier countries (Singer, 1950; Prebisch, 1950). In addition, the experience of developed countries may, to a certain extent, be non-replicable. Labour market institutions in the global north have been endogenous to the particular patterns of industrialisation of those countries; transplanting them out of context, to countries at different stages of development, may not work. In the British case, the institutions of labour law coevolved with the emergence of wage labour over many centuries. In emerging markets, this process cannot easily be repeated over a few years or even decades.

Having acknowledged the barriers to the effective diffusion of labour law systems, it is important that we recognise the extent to which labour law has become a global phenomenon over the past century, and to acknowledge the active role that it can play in promoting development. Labour law institutions can perform a number of functions in emerging markets, just as they have done, and continue to do, in the global north. They can assist economic coordination in markets and firms by reducing information asymmetries and mitigating the

effects of collective action problems, and they can counter the exposure of wage-dependent workers to labour market risks. They can be used to stimulate demand for locally produced goods and services. They may also be used to promote voice in the workplace and democratic empowerment in society more generally.

It is perhaps because of its importance as a developmental institution that labour law reform is currently on the policy agenda in many low and middle-income countries. While labour law is stagnating in the USA and undergoing a crisis of confidence in Europe, in Latin America, east Asia and parts of Africa the recent emphasis has been on legal reform to build enduring labour market institutions. One of the most discussed examples is China, although it is not the only one (see Fraile, 2009 on Latin America). It is entirely consistent with the argument set out above that China's rapid industrial development should have prompted a debate about labour market institutions, and that recent reforms should have sought to embed a more comprehensive system of social insurance, encourage collective wage determination, and formalise the employment relationship (Cooney et al., 2013). China's experience since the late 1970s can be described in terms of informalisation and casualisation, associated with the decline of stable employment state-owned enterprise sector (Kuruvilla et al., 2013). However, China did not have a labour market in any recognisable sense until relatively recently: labour was centrally directed and there was no wage system as such, with subsistence needs being met directly by the enterprise. For much of the period from the mid-1960s to the late 1970s, China did not have a functioning legal system either; juridically informed adjudication and dispute resolution were actively suppressed. From this starting point, the institutional construction of a labour market based on contractual relations, in place of the 'iron rice bowl' model of enterprise-based welfare provision, represents a move towards the SER, not away from it.

#### **4. Empirics: quantifying labour law rules and their economic effects**

The claim that labour law systems have beneficial economic effects which are often combined with progressive distributional outcomes is one that is increasingly supported by empirical evidence. In this field there has been a slow accretion of data, together with an improvement in the techniques used to measure the effects of legal rules. Many of the earlier papers have a decidedly dated feel. It is unfortunate that, since they were first, these studies have tended to shape the field, and to inform the views of policy makers. Studies such as those by Fallon and Lucas (1993) and Besley and Burgess (2004) on India have been widely cited. As later analyses have shown, these early studies use elementary coding techniques and econometric methods which are no longer among the most advanced (Bhalotra, 1998; Dutta Roy, 2004; Bhattacharjea,

2006, 2009; Anant et al., 2006; Jha and Goulder, 2008; D'Souza, 2010; Deakin and Sarkar, 2011). The considerable influence of the early studies perhaps owes less to any empirical validity they may have than to their apparent confirmation of a theoretical view held by most neoclassical economists, namely that labour regulation is harmful to productivity, employment and growth. This claim is in need of a much more thorough empirical testing than it has so far received.

An empirically informed assessment of the effects of labour law should take into account a number of features of legal rules. A first of these is their partial endogeneity: legal rules reflect economic conditions as well as shaping behaviour. Legal systems co-evolve alongside developments in the economy and the political system (Armour et al., 2009). Thus quantitative economic analysis must be able to take on board the possibility of reverse causation or of multi-directional causal flows between legal and economic variables. It further follows that econometric analysis of law should be longitudinal. Cross-sectional analyses can indicate correlation but not, normally, causation.

A second relevant feature of legal rules is their mutability. Legal rules rarely have a completely fixed meaning or unique interpretation. Thus the application of a legal rule is rarely a matter of 'either/or'. Binary variables, which purport to measure the presence or absence of a legal rule using a simple (0, 1) coding scheme, may well not be an appropriate way of conceptualising the operation of regulatory norms (Armour et al., 2009).

A third feature to consider is the gap between law in action and law in the books. The formal enactment of a legal rule may tell us something about its practical effects, but legal rules are not self-enforcing. If a given legal rule reflects an existing social consensus, it may well take effect without the need for regular enforcement. In other contexts, general respect of the law, the efficiency of the court system and the amount of resources devoted to enforcement may be critical variables to add into the analysis (Fagnäs, 2010).

More generally, there is a case for using 'leximetric' coding techniques when constructing legal indices (Siems and Deakin, 2010; Buchanan et al., 2014). Leximetric method involves breaking down the process of index construction into a series of stages, beginning with the identification of a *phenomenon* of interest ('labour law') which be expressed as a conceptual *construct* ('regulation', from the viewpoint of the employer, or 'protection', from that of the worker). Then one or more *indicators* or *variables* are identified which, singly or together, express the construct in numerical terms. A *coding algorithm* is then devised, setting out a series of steps to be taken in assigning numerical values to the primary source material. The algorithm incorporates a *measurement scale* of some kind. Finally, a decision must be taken on whether

and/or how to apply *weights* to the individual variables or indicators. The result is an *index* which provides a measure of the phenomenon of interest, which can be used in statistical analysis.

Indices used to study the effects of labour laws range from the relatively unsophisticated, such as the cross-sectional index with binary codings presented by Besley and Burgess (2004), to complex, longitudinal data sources such as the OECD Employment Protection Index (OECD, 2013: ch. 2). Even the OECD index has its limitations, in particular providing only an incomplete time series, and omitting some variables of interest if we are to get a fully rounded view of labour law systems, such as those relating to working time law and strike law. The dataset prepared by Botero et al. (2004) and subsequently used by the World Bank to develop its labour law indices, published in its annual *Doing Business* reports (World Bank, various years), covers more ground, but is cross-sectional only. The World Bank datasets which draw on a similar methodology have a very limited time-series dimension to them. The longitudinal labour regulation index (LRI) constructed at the Centre for Business Research in Cambridge over the course of the last decade addresses these limitations by coding for five areas of labour law (alternative employment contracts, working time, dismissal, worker representation and industrial action) for an extended period (1970 to the present day).

The Cambridge dataset can be put to use in time-series econometric analysis, to study the effects of legal change, and to identify the direction of causality in the law-economy relation. Vector autoregression (VAR) and vector error correction (VEC) models, which can distinguish between the short-run and long-run effects of a change in legal rules (Juselius, 2006), are appropriate here. If the law-economy relation is essentially one of coevolution, we need a statistical method capable of identifying two-way causal flows, and of indicating when a change in the law induces a long-run shift in the evolutionary path of the economy or just a temporary adjustment after which the economy resumes its previous path.

Indian dismissal law is strict by international standards. This is particularly the case with regard to Part V-B of the Industrial Disputes Act 1947, which, as introduced in 1976 and amended in 1982, requires state authorisation for retrenchments (economic dismissals) in establishments of more than 100 workers. The long-run effect of these changes in the law, conjunction with other occurring in the course of the period from 1970, can be estimated using the vector error correction method. This analysis shows that after controlling for changes in the level of industrial production over time, increases in worker protection were correlated with lower unemployment, with the direction of causation running from the economy to the law: in other words, lower

unemployment led to the enactment of worker-protective laws, reflecting the greater strength of organised labour in periods of upswing in the economic cycle (Deakin and Sarkar, 2011). Thus changes in labour law rules in India in this period were largely endogenous to the growth path of the economy and to the business cycle. There is no evidence from this study to suggest that the enactment of worker-protective labour laws, including those contained in Part V-B of the Industrial Disputes Act, caused unemployment to rise in India.

Two more recent studies throw light on the effects of laws governing employee representation on inclusive development, defining that term to include the impact on efficiency, measured in terms of the level of employment in the economy, and on equality, measured alternatively in terms of labour’s share of national wealth and by reference to the Gini coefficient. In the Cambridge index, employee representation laws are defined to include constitutional protections for freedom of association and the right to collective bargaining, laws governing codetermination and employee consultation in the workplace, and laws underpinning the application and enforcement of collective agreements. Trends in the evolution of this body of law are set out in Figures 1 and 2 for six OECD countries (France, Germany, Japan, Sweden, the UK and the USA) and the five ‘BRICS’ countries (Brazil, Russia, India, China and South Africa). It can be seen that developed countries generally offer a higher level of protection for these rights than developing countries do, although the gap is not large. The level of protection to employee representation rights in India is below that of Brazil but above that of China.

Figure 1. Employee representation laws in six OECD countries. Source: CBR Labour Regulation Index: <http://www.cbr.cam.ac.uk/research/projects/project2-20output.htm>.

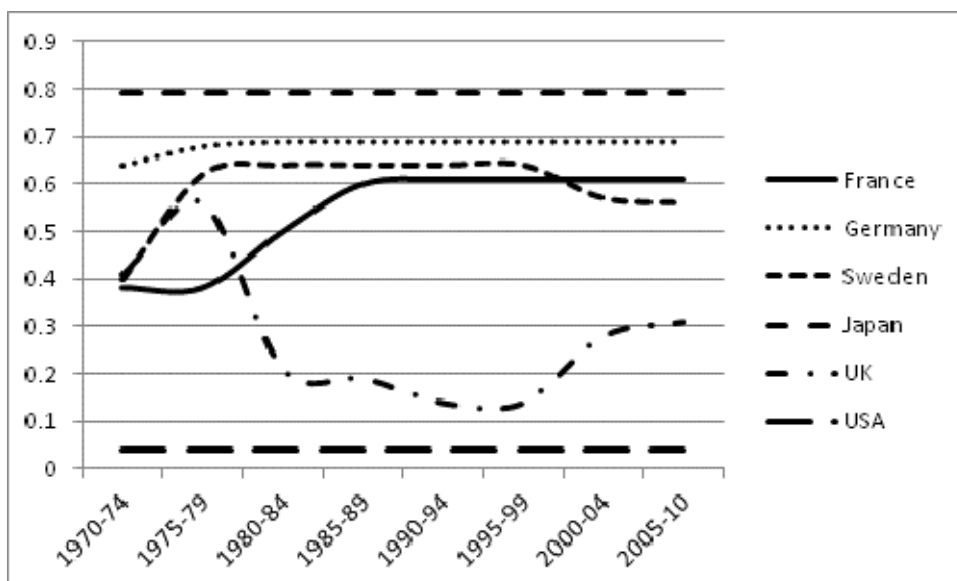
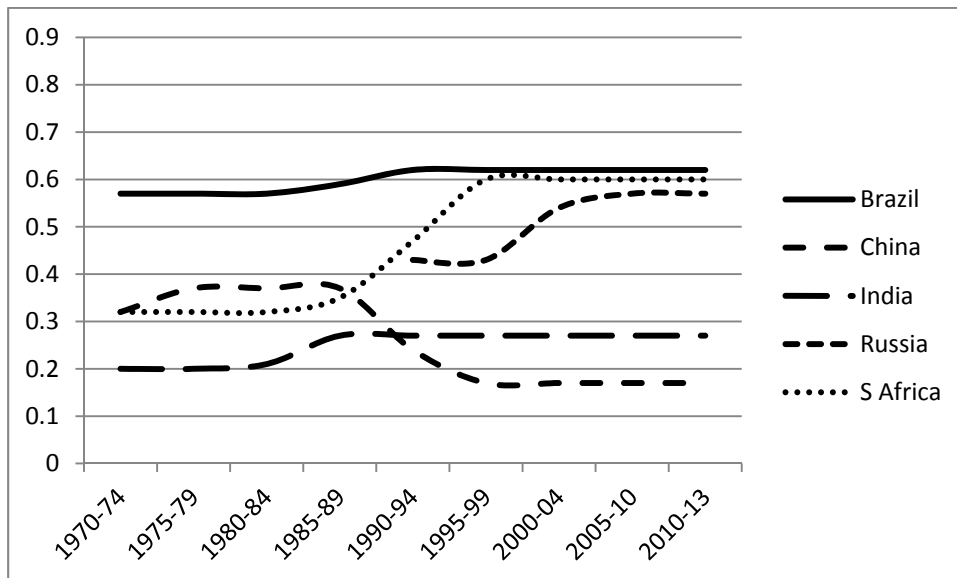


Figure 2. Employee representation laws in BRICS countries. Source: see Figure 1.



Econometric analysis shows that the effects of employee representation laws are generally positive in both contexts. In the OECD countries, a higher score on this part of the Cambridge index is correlated with a higher labour share of national wealth and with higher employment (Deakin, Malmberg and Sarkar, 2014). In the five BRICS countries, a higher score for employee representation is correlated with greater equality (as indicated by a lower score on the Gini index) without any negative employment effects (Deakin, Fenwick and Sarkar, 2014). These findings are consistent with the suggestion that laws protecting worker voice improve economic outcomes, by enhancing productivity, while also promoting equality, by narrowing the earnings distribution and putting a floor under wages (Sengenberger and Campbell, 1994).

## 5. Conclusions

I have argued that labour law should be regarded as a developmental institution which is capable of enhancing both equality and efficiency: inclusive development. This is not to say that labour law rules are always and everywhere efficient. The optimal level of labour law regulation is not necessarily the most protective. However, the claim that there is an inherent trade-off between equality and efficiency in the operation of labour law rules rests on weak foundations. Institutional and behavioural theories point to the efficiency-enhancing effects of fairness norms operating at the level of employment contract, and to the macro-level benefits provided by collective



labour market institutions, in particular social insurance and collective bargaining. New empirical evidence, based on the systematic coding of labour law rules, supports the argument that protective labour laws tend to equalise income and wealth while also increasing employment, in some contexts, or without having any identifiable negative effect, in others.

In the global ‘north’, worker-protective labour laws emerged alongside and in response to the process of industrialisation. In developing countries and emerging markets, economic development can be expected to produce similar pressures for institutions capable of mitigating labour market risks. However, economic development is a necessary but not sufficient condition for the adoption of egalitarian labour law rules. Labour law occupies a space in the political sphere which will always be highly contested. It is not in the interests of the powerful to cede social protection, even if labour law rules were welfare-enhancing in aggregate terms. It should surprise no-one to see opponents of the welfare state attempting to roll it back in industrialised economies, and to prevent it being embedded in developing ones. It would, however, be a mistake to accept that labour market deregulation in general enhances labour market efficiency, or that it somehow assists the unemployed or those employed in precarious work.

The evolution of labour law has shaped above all by economic forces, by conflict, and by social activism. Ideas and evidence also play their part. Lawyers and social scientists should be prepared to challenge the intellectual rigidities which are currently holding back the future of labour law, and of economic and human development more generally.

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