

## 1. Introduction

This paper aims to critique some of the legal principles under which industrial disputes are resolved in India. The contents of the paper are divided into two parts. The first part, which is largely descriptive, begins by listing some aspects of the Industrial Disputes Act, 1947. This legislation operates by judicially intervening in the contract of employment in the event of a substantial dispute between employers and employees and aims to ensure an equitable outcome to the dispute. The role of trade unions in India is briefly discussed in this context, and the section concludes by posing some questions regarding the efficacy of the Industrial Disputes Act. The second part of the paper attempts to discern the impact of the law on the process of reaching agreements by placing the discussion around the positive and normative consequences of the law. The discussion in this paper is confined to the class of issues where labour and their employers can gain by co-operating but run into a tussle over the precise apportioning of gain, compelling the analysis to be organised around the Nash solution to the bargaining problem. After a brief narration of the normative content of the Nash bargaining solution, it is shown that the constraints imposed by Indian labour law in the quest for justice, encourage outcomes which signify normative effects of a dubious nature. It is also pointed out that the institutional constraints created by the Industrial Disputes Act, act not only to encourage inefficient outcomes, but can also have the additional effect of stalling agreements. Finally it is suggested that instead of intervening judicially, it might be preferable to give workers rights that improve their bargaining position and enable them to directly interact with their employers.

The Industrial Disputes Act 1947, among other things, provides the basis for settling disputes that may arise between employers and employees. A typical list of disputes that are covered by the Act include discharge or dismissal of workers, interpretation of standing orders, wages, bonus, conditions of work, rationalisation, lay-offs and retrenchments.<sup>1</sup> According to the Act if concerned parties are unable to resolve a dispute, they have several options open to them. One possibility is to set up a so called Works Committee consisting of workers and employers which tries to sort out the dispute.<sup>2</sup> However since the recommendations of such committees do

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<sup>1</sup>. The Industrial Disputes Act 1947 Section 2(k). Also the second and third schedules of the Industrial Disputes Act.

<sup>2</sup>. Id Section 3

not have any legal standing, this route of resolving disputes is very rare.<sup>3</sup> The more common option is to initiate a process called conciliation, which involves the active participation of the government. The government steps into the picture, if one of the disputing parties asks for it and the government considers the demand valid or alternatively if a dispute appears to be persistent in the perception of the government.<sup>4</sup> Initially, a conciliation officer from the labour department<sup>5</sup> or a board of conciliation appointed by the government if the dispute is particularly complex,<sup>6</sup> is required to try working out a settlement. A settlement, though binding on all parties, does not have the same status as a court order. As a consequence it is widely believed that conciliation is viewed as just a stage before adjudication.<sup>7</sup> If a settlement is not worked out, a failure report is tabled by the conciliation officer or board.<sup>8</sup> At this point, parties to a dispute can ask for an arbitrator to resolve the conflict,<sup>9</sup> but this is again not very common as the award of the arbitrator does not have legal standing.<sup>10</sup> Instead, proceedings then move to the final stage called adjudication, upon a reference being made by the government.<sup>11</sup> The Industrial Disputes Act gives the government the power to appoint labour courts and tribunals to adjudicate disputes.<sup>12</sup> There are three kinds of courts - labour courts, industrial tribunals and national tribunals. Labour courts deal with relatively minor matters and concerns that affect less than 100 workmen, while disputes of greater import are looked after by industrial tribunals. These bodies consist of a person who is or has been a judge of a High Court or has been a district or additional district judge for a period not less than three years. The judgements and awards of labour courts and tribunals are final and not subject to regular appeal. If some party to a dispute is not satisfied with the judgement or award, they can move for special leave appeal to the Supreme Court under Article 136 of the Constitution of India or seek writ jurisdictions of the relevant High Court under Articles 226 and 227 of the Constitution of India. Broadly speaking, these steps can be taken only on the grounds that the judgement or award of the labour court/tribunal is inconsistent or faulty on a substantial point of the law.

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<sup>3</sup>. Manik Kher(1985) *Conciliation and Adjudication Today* Pune The Times Research Foundation pp. 1-26

<sup>4</sup>. The Industrial Disputes Act 1947 Section 10.

<sup>5</sup>. Id Section 4

<sup>6</sup>. Id Section 5

<sup>7</sup>. Manik Kher *op cit*

<sup>8</sup>. The Industrial Disputes Act 1947 Sections 12 and 13

<sup>9</sup>. Id Section 10-A

<sup>10</sup>. Manik Kher *op cit*

<sup>11</sup>. Id Sections 10 and 11.

<sup>12</sup>. Id Sections 7, 10(1), 7A, 7B and the second and third schedules.

## **2. The Industrial Disputes Act and the Contract of Employment**

### ***Judicial Intervention in the Contract of Employment under the Industrial Disputes Act***

As a point of departure into the many implications of the Industrial Disputes Act, it might be useful for a moment to look at the background behind the legislation of the Act. Around the time of the Indian independence, legislators faced the choice between orienting the labour law towards a system where collective bargaining between unions and employers would be encouraged, or developing a legal system that would emphasise judicial intervention in the resolution of labour conflicts. Protagonists favouring the latter approach won, on the grounds that this approach would better serve the cause of social justice. It was felt that social justice would be best administered by a labour judiciary because it would keep in mind the power position and susceptibilities of workers.<sup>13</sup> The country already had a legislation on hand - the Defence of India Rule 81-A, that provided the basic structure of the Industrial Disputes Act. The British Government had enacted the Defence of India Rule 81-A to ensure that industrial disputes did not disrupt the war effort. Among its provisions was the facility of referring industrial disputes to adjudicators, and thus with a few minor changes the Defence of India Rule 81-A became the Industrial Disputes Act of 1947.

To get a sense of the role that the labour courts and tribunals were envisioned to play in the task of ensuring social justice, it is instructive to look at some of the early judgements of the Supreme Court of India. In fact before the Supreme Court was set up, a judgement of the Federal Court - *Western India Automobile Association v The Industrial Tribunal Bombay and others*, provided the basic parameters that have come to define Indian Labour Law.<sup>14</sup> The issue raised in this case was whether an industrial tribunal can direct the employer to re-instate a worker. The judgement said that while a civil court could not re-instate an employee, an industrial tribunal most definitely could do so. It was pointed out that the object of adjudication was to substitute for strikes and lock-outs by doing justice to the workers claim, and that this could not be done if the focus was going to be on the enforcement of contractual agreements. Instead it was felt that the law was so structured that industrial tribunals adopted a different approach to the problem. The tribunals were in effect creating new rights since they are empowered to modify or change existing contracts and thus existing contracts could be

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<sup>13</sup>. For a detailed account of the debates see V.D Kennedy(1966) *Unions, Employers and Government* Bombay, Manaktalas

<sup>14</sup>. *Western India Automobile Association 1949 I L.L.J 245*

overwritten. A ratification of this judgement was made in one of the early Supreme Court judgements - *Bharat Bank Ltd v Their employees*.<sup>15</sup> To quote

"It is its [Tribunals] duty to adjudicate on a serious dispute between employers and employees as affecting their right of freedom of contract and it can impose liabilities of a pecuniary nature and disobedience of its award is made punishable. The powers exercisable by a tribunal of the nature were considered in a judgement of the Federal Court of India in *Western India Automobile Association v Industrial Tribunal Bombay*, and it was observed that such a tribunal can do what no court can, namely add to alter the terms or conditions of the contract of service. The tribunal having been entrusted with the duty of adjudicating a dispute of a particular character, it is for this reason that it is armed with the extraordinary powers."<sup>16</sup>

Another passage from the same judgement says

"In settling the disputes between the employers and workmen, the function of the tribunal is not confined to administration of justice in accordance with law. It can confer rights and privileges on either party which it considers reasonable and proper, though they may not be within the terms of the existing agreement. It has not merely to interpret or give effect to the contractual rights and obligations of the parties. It can create new rights and obligations between them which it considers essential for keeping industrial peace."<sup>17</sup>

This, then is the definitive thematic of Indian labour law – any labour contract/agreement can be overridden and redefined on the basis of notions held by the labour courts as to what is just, fair and expedient.

### ***The Contract of Employment under Common Law and Collective Bargaining***

This kind of intervention is quite in contrast to the Common Law perception of the contract of employment, which is rooted in the general law of contracts. Common Law sees the contract of employment as a legally binding agreement between "master and servant" or to state

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<sup>15</sup>. *Bharat Bank Ltd. v. Their Employees* 1950 II L.L.J. 921

<sup>16</sup> Id

<sup>17</sup>. Id

it in more contemporary language between employer and employee. The employer derives a benefit from the employee working under his directions, and the employee in turn is compensated with wages. One of the corner stones of the Common Law of contracts, is that contracting parties are free to lay down their own terms and that there can be no intervention by anyone not party to the contract. As any standard legal text points out, contracts can be rescinded only under circumstances where it can be shown that the contract involved fraud, duress, mistake or misrepresentation. Thus, the law of contracts does not typically concern itself with the adequacy of consideration, leaving the contracting parties to make their own bargain, howsoever inequitable.

As industrialising societies have sought greater equality in society, one institutional response has been to progressively substitute collective for individual bargaining.<sup>18</sup> Specifically, as regards labour and industrial relations, collective bargaining of some sort has more or less displaced the master and servant relationship as the rubric around which employers and workers interact. Apart from this, the modern welfare state compels the inclusion of statutory terms along with the terms agreed on by parties. Typically such terms include the provision of safe working conditions, reasonable work hours and the payment of minimum wages. Though collective bargains of a sort have come to dominate many of the interactions between employers and employees all over the world, there is a good deal of variation as to both the extent to which the law regulates collective bargaining and the manner in which the law intervenes with the collective bargaining process. An exhaustive description of the relationship between the legal system and collective bargaining in various parts of the world cannot be seriously attempted here, but it is important to mention a couple of broad features present in diverse legal systems, so as to provide a working comparison with the Indian law. Two common features of labour law in most Common Law countries (also many Civil Law countries) are of particular relevance. One, a number of legal systems require by statute that the contracts of employment include certain standardised terms regarding minimum wages, working hours and safe working conditions. Second, the process of collective bargaining which has replaced the individual bargain, involves trade unions as legal representatives of the worker and the agreements worked out between unions and employers have a legal standing. In other words

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<sup>18</sup> See the chapter titled "The Changing Function of Contract" in Wolfgang Friedmann(1972) *Law in a Changing Society* Middlesex Penguin Books 119-160

trade unions typically negotiate terms of employment on behalf of individual workers and these terms are usually enforceable by the courts.

### *Trade Unions*

In India the relationship between employers and employees cannot in general be described as being confined to a direct bargain between the employer and the trade union. The problem stems from the legal framework within which Indian trade unions operate, coupled with the presence of the State and the Judiciary as additional actors.

According to the Trade Unions Act of 1926, any seven adults can gather and register themselves as a trade union. As a consequence, independent of the size of membership, all registered trade unions enjoy the same legal rights, powers and privileges. Very broadly these rights include conferring on every trade union the status of a corporate body which can hold property, contract and litigate. In addition to this trade unions can call for a strike and, if they do so, they are exempt from criminal liability. However, the Trade Unions Act, does not set up any rules that oblige employers to recognise a particular union as being representative of the workers interests. Court decisions have made it very clear that obligatory recognition of a particular trade union as a bargaining agent is not supported by any law.<sup>19</sup> At the same time Section 36 of the Industrial Disputes Act states

"A workman who is a party to a dispute shall be entitled to be represented in any proceeding under this Act by

(a) any member of the executive or other office bearer of a registered trade union of which he is a member ;

(b) any member of the executive or other office bearer of a federation of trade unions to which the trade union mentioned in clause (a) is affiliated;

(c) where the worker is not a member of any trade union, by any member of the executive or other office bearer of any trade union connected with or by any other workman employed in the industry in which the worker is employed and authorised in such manner as may be prescribed."

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<sup>19</sup>. See for example *T.C.C Thozhilali Union v T.C.C* 1982 *I L.L.J* 425. In this judgement it is explicitly stated "Recognition by an employer of a trade union as a representative of its members and as their bargaining agent is a matter of volition on the part of the employer."

Therefore, it is the volition of the employer to decide who is a representative bargaining agent; but if a "dispute" arises even the smallest union can bring up the grievances of its members before the labour department of the local government for conciliation. As a consequence, multiple unions can exist, each winning the support of a fraction of the labour force employed in the concern, and the employer is obliged to deal with all of them.<sup>20</sup> Under this legal framework, the relationship between an union and an employer cannot be characterised by the usual understanding of the term - collective bargaining. Both the sides are not confined to a framework where a direct confrontation decides what each side will give and receive, because each side can always initiate or threaten to initiate the conciliation - adjudication process.

As described earlier, the conciliation - adjudication process involves government participation at many of the crucial stages of dispute resolution. The process of conciliation initially put in the hands of the labour department, may later end up involving the labour minister or even a higher executive functionary. Also, as noted earlier, if conciliation is not successful, the next stage involves the government as well. It is entirely the discretion of the government as to whether the dispute is referred for adjudication or not. Such involvement of the government at various steps of dispute resolution causes large - scale political interference in the process. In fact almost all union activity in India is controlled by prominent political parties and the independent union movement is quite weak.<sup>21</sup> Political parties see industrial workers as a source of votes and therefore actively patronise unions. Unions supported by the ruling party can look forward to favourable treatment of disputes raised by them. A study based on a sample of dispute cases shows that unions affiliated to the ruling party were favoured by referring demands raised by them for adjudication, while reference of demands raised by rival unions was wilfully prevented.<sup>22</sup> In a similar manner the government can engineer the progress of a dispute in favour of an employer who has political patronage.

Adjudication, as conceived by the Industrial Disputes Act, was to have been procedurally more flexible than civil suit resolution. However, in practice labour courts and tribunals have come to follow very strict civil procedures – in the sense that court procedure and the evidence delivered follow the dictates of the Civil Procedure Code 1908 and the Evidence

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<sup>20</sup>. E.A. Ramaswamy and Uma Ramaswamy(1981) *Industry and Labour: An Introduction* Delhi Oxford University Press 86-94

<sup>21</sup> . E.A. Ramaswamy and Uma Ramaswamy *Id*

<sup>22</sup>.Debi S. Saini(1993) "Reference Power of State in Industrial Disputes Adjudication: A Study with Reference to Industrial Disputes in Faridabad" 35 (Part II) 4 *Journal of the Indian Law Institute* 233-252

Act I 1872. It appears that disputes get settled on the basis of legal norms and procedures rather than on the inherent matter of the case.<sup>23</sup> Thus unions have to be represented by individuals who are conversant with legal procedures, particularly so in a situation where employers are represented by advocates. It has been observed that these legal and political considerations have given rise to the phenomenon of "outsider union leaders" who man key positions in trade unions. These individuals, who are not workers, position themselves as having the requisite skill to see disputes through administrative, political and legal hurdles. Such outsider union leaders may not have the interest of workers as their central objective and have been documented as being susceptible to working out underhand deals with employers that ultimately result in weaker unions.<sup>24</sup> Of course the exact orientation of such leaders would vary from case to case, but the point to note is that the relationship between workers and employers is not at all direct. Instead the relationship is mediated by a number of exogenous elements that include outsider union leaders, politicians, judges and administrators.

### **3. The Problem with Adjudication**

Legal scholars have pointed out many problems with adjudication as it has come to be practised. Some of these problems are endemic to the Indian legal system such as long term delays and the fact that there are too few judges and courts in relation to the number of cases. Current estimates indicate that there are over three lakh cases pending disposal with labour courts and tribunals. Once a case is initiated it can take up to ten years for the judgement to be passed.<sup>25</sup> However there are other specific problems with adjudication that have also been highlighted. As has been mentioned earlier, the judges appointed to the labour judiciary are transferred from the civil judiciary. It has been noted that labour courts and tribunals emphasise formal civil court procedure rather than working with a more flexible inquisitorial method which is more likely to bring out the essential issues in a dispute. Furthermore, since the judges are transferred to labour courts and tribunals from civil courts, they are poorly informed about the issues at stake in labour disputes. The Industrial Disputes Act does allow for experts to assist labour tribunals and courts but this option is reported to almost never being exercised. Instead, the judge acts as a passive individual, while parties to the dispute present their case in the

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<sup>23</sup>D.A. Desai(1994) "Industrial Adjudication and Social Justice in India" in Debi S. Saini (ed) *Labour Judiciary, Adjudication and Industrial Justice* New Delhi, Oxford & IBH Publishing Co.

<sup>24</sup>Debi S. Saini(1995) "Leaders or Pleaders: Dynamics of Brief- Case Trade Unionism Under Existing Legal Framework" 37 *1 Journal of the Indian Law Institute* 73-91

<sup>25</sup> Upendra Baxi(1994) "Industrial Justice Dispensation: The Dynamics of Delay" in Debi S. Saini (ed.) *Labour*

adversarial manner used in civil courts. Studies based on a sample of cases brought forth for adjudication indicate that in the proceedings before labour courts, management is represented by management consultants or lawyers, while workers rely on the outsider union leaders mentioned earlier, to represent them.<sup>26</sup> If the proceedings are of an adversarial nature, the representatives of the management are in a better position to present their case than the workers representatives. If, this study and other similar works are taken to be representative of the ground realities, it is ironical that a legal system that jettisoned Common Law doctrines for being iniquitous, ends up generating iniquitous outcomes because the legal system persists in using Common Law procedure and is unable to innovate on procedure.

If one were to locate a schematic, within which to position the adjudication process, one could reflexively categorise the adjudication process as an exercise in arbitration. The term arbitration<sup>27</sup> as commonly understood by economists refers to a process where a third party makes an efficient decision regarding the terms of a contract, which could not or have not been specified properly by the contracting parties. A popular Industrial Organisation text maintains that the most basic requirement for meaningful arbitration is that the arbitrator must make fair, independent and informed decisions.<sup>28</sup> From the brief description above, interpreting adjudication as arbitration would be a bit of a misnomer because it is not at all clear that the system is geared towards making decisions that are necessarily informed. The contracts specified by adjudication are most likely not fair - at least not in the sense that fairness<sup>29</sup> in an arbitrated settlement would be customarily viewed and are unlikely to be economically efficient as well. To analyse the labour adjudication process, it is necessary to search for a framework that is able to incorporate the institutional idiosyncrasies of Indian labour law.

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*Judiciary, Adjudication and Industrial Justice* New Delhi, Oxford & IBH Publishing Co.

<sup>26</sup>. Debi S. Saini(1994) "Tribunal Procedure and Approach in Industrial-Disputes Adjudication: Industrial Justice on Reverse-Value Hypothesis" in Debi S. Saini (ed.) *Labour Judiciary, Adjudication and Industrial Justice* New Delhi, Oxford & IBH Publishing Co.

<sup>27</sup>.The term as it is being used here, should not to be confused with the definition of arbitration as it is set out in the Industrial Disputes Act.

<sup>28</sup>. Jean Tirole(1988) *The Theory of Industrial Organisation* Cambridge The MIT Press 29-30

<sup>29</sup>. The understanding of fairness here is that the arbitrator will confirm the expectations of the involved parties, in that he will impose terms that would have been specified in a complete contract. For a further discussion on fairness see the next section.

If it is accepted as a premise that there is an intrinsic inequity in the freely drawn up contract of employment and that some intervention is needed to raise the bargaining power of labour, then the central issue that comes up is the appropriate form of intervention. Should rights of workers be gained prescient to the act of forming a contract or should the State allocate rights as it sees fit? Is it preferable that the State guarantee certain rights while other rights are gained contractually? In seeking to answer such questions, given the admixture of normative and positive considerations that are thrown up, it becomes but essential to evaluate the Indian labour legislation, in a manner which is at once cognisant of the concerns of justice and the sense that one is dealing with rational agents who are involved in economic interaction with each other. This is a fairly formidable task because apart from the difficulties of conjoining notions of justice with those of economics, thus far the precursory step of identifying the positive consequences of the current system of legislation, remain inadequately explored. As the brief description of some of the key labour laws and institutions has shown, conflict resolution is a complex affair - it could possibly be a simple bargaining problem, but the presence of the Industrial Disputes Act, which cannot be ignored by the parties, can cause employer-employee interaction to become something far more intricate than a simple bargain. In the next section, the Nash bargaining framework, which is customarily viewed as an useful device to address division problems, is used to enter the conundrum.

#### **4. Nash Bargaining Solution**

To begin with, a resume of the Nash bargaining problem expressed in terms of its essential constituent elements, is in order.<sup>30</sup> The Nash formulation is designed to approach situations where parties can mutually gain over their current states by co-operating but, run into conflict since joint decisions need to be made as to the apportioning of gains across parties. Taking the simplest two party representation for expository ease, the problem is captured in diagram 1.1. The axes in the diagram index the utilities - measured in cardinal units, of two parties A and B. Point X is the status quo point, which represents the utility levels that the two parties are obliged to encounter if they do not agree to a co-operative venture, and the points on the line LM depict the set of Pareto optimal outcomes that could ensue if the two parties agreed to co-operate. The problem is that while any of the co-operative outcomes are better than the option of non co-operation, each point on the co-operative schedule distributes the gains from

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<sup>30</sup>. John F Nash(1950) "The Bargaining Problem" *Econometrica* 18 155 - 162

co-operation at the expense of the other party. Thus this is a problem in search of a solution that specifies a "bargain" between the contesting parties which divides the co-operative surplus in some manner. Nash proposed that a solution to the problem can be gained by maximising the product of the differences between the utilities from a co-operative outcome and the status quo outcome. This solution satisfies a number of formal properties<sup>31</sup> but, apart from noting that the fulfilment of these properties secures the rigor of the solution, this is not the kind of concern that is going to be pursued here. Instead, here one would like to give the Nash construct a run for all it says or might say in terms of justice. Before directly relating the Nash solution to any notion of justice, the ground needs to be established by highlighting the point that the solution is by construction sensitive to the status quo point. This manoeuvre links the solution to the bargaining power of the parties in question. Indeed this is the prominent significance of the Nash solution - it represents the outcome from among the Pareto optimal outcomes that corresponds to the balance of the bargaining strengths innate to the situation.

## 5. Justice and the Nash Bargaining Solution

What, if any, is the connection between this predictive ability of the solution and justice? One position has been to say that while the Nash solution may adequately predict, there is no justification for recommending it as an ethical outcome.<sup>32</sup> Apart from cases of conspicuous inequity, say, to take Sen's example of a worker being offered "subhuman wages and poor terms of employment" where the status quo dooms him to starvation,<sup>33</sup> it is important in general to identify the sense of justice incorporated into the Nash formulation altogether more precisely. Barry points out that the Nash solution belongs to the notion of justice as mutual advantage - where *justice as mutual advantage* is the perception of justice as the constraints that rational people impose on themselves to obtain the co-operation of others, entitling some to have a greater bargaining power than others.<sup>34</sup> Following Barry, the link between the Nash solution and justice as mutual advantage is best brought out by positioning the discussion around arbitration. Rational parties, confronted by the prospect of losing transaction resources in an unfruitful

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<sup>31</sup> .The formal properties satisfied by the Nash Bargaining Solution include the individual rationality of players, independence of irrelevant alternatives, symmetry and invariance to positive affine transformations of the utility function. The important point to note is that while other solutions, such as the Raiffa-Kalai-Smorodinsky solution have been suggested, the Nash solution is the only one that satisfies all these properties, making it to be the only solution that is dependant on the innate bargaining strengths of the parties involved.

<sup>32</sup> . For example see Amartya K. Sen(1970) *Collective Choice and Social Welfare* San Francisco, Holden-Day Inc

<sup>33</sup> . Id 121

<sup>34</sup> .Brian Barry(1989) *Theories of Justice: A Treatise on Social Justice, Volume I* Berkeley University of California Press

endeavour to make a bargain or worse, getting locked into threats that may make them worse off than before the situation for a co-operative venture came up, could benefit from the offices of an arbitrator. In such a situation how can a fair arbitration be personified? The answer to this is to say that fair arbitration will set the outcome to be that which the parties would have themselves come to; for, if arbitrators were to do otherwise, the institution of arbitration would stand discredited and it would become less likely to be used in the future - at least so would argue Hobbes<sup>35</sup> trying to envision the creation of order in a state of nature and, so could one in a modern society where allocation is subject to bargaining. To the extent that the Nash solution can be pre-eminently viewed as the outcome that rational parties given their respective advantages and disadvantages ought to reach, it represents the fair outcome that justice as mutual advantage would have us accept.<sup>36</sup> This is a formulation which is quite akin to the precepts of contract law wherein judges uphold the terms of a contract but do not say anything about fair division, but if asked to, impose terms that the parties themselves would have agreed to.

Those who find the notion of justice as mutual advantage unpalatable, obviously do not see the Nash solution as embodying an acceptable sense of fairness. For instance Rawls,<sup>37</sup> has explicitly stated that any solution that is based on threat advantages of contesting parties, is not acceptable morally.<sup>38</sup> As is well known, his stand is to propose that the ethically correct status quo is the 'original position' - a state envisioned by placing all those who people a society

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<sup>35</sup>. A passage from *Leviathan* says "And Distributive Justice, the Justice of an Arbitrator; that is to say, the act of defining what is Just. Wherein (being trusted by them that make him an Arbitrator,) if he perform his Trust, he is said to distribute to every man his own: and this indeed Just Distribution, and may be called (though improperly) Distributive Justice; but more properly Equity; which also is a Law of Nature.... Also if a man be trusted to judge between man and man, it is precept of the Law of Nature that he deale Equally between them. For without that, the Controversies of men cannot be determined but by Warre. He therefore that is partiall in judgment, doth what in him lies, to deterre men from the use of Judges and Arbitrators; and consequently (against the fundamentall Lawe of Nature) is the cause of Warre. The observance of this law, from the equall distribution to each man, of that which in reason belongeth to him, is called EQUITY, and (as I have sayd before) distributive Justice: Acceptation of persons." See Thomas Hobbes *Leviathan* ed. C.B Macpherson (1968) Harmondsworth Penguin Books

<sup>36</sup>. In this context it is interesting to note that recently it has been shown by Mariotti that the Nash Bargaining Solution is the only solution that satisfies the two axioms of Suppes-Sen proofness and invariance to affine utility transformations. This result allows the Nash Bargaining Solution to be interpreted as a fair arbitration scheme, if it is held that the restrictions imposed on the choice of an arbitrator by the two axioms captures the criterion of impartiality in distributive justice. See Marco Mariotti (1999) "Fair Bargains: Distributive Justice and Nash Bargaining Theory" *Review of Economic Studies* 66 733-741

<sup>37</sup>. John Rawls (1971) *A Theory of Justice* Cambridge Harvard University Press

<sup>38</sup>. A footnote in *A Theory of Justice* attacking Braithwaite's (R.B Braithwaite (1955) *Theory of Games as a Tool for the Moral Philosopher* Cambridge The University Press) adaptation of the Nash Bargaining problem by introducing threat advantages to make normative claims, says "What is lacking is a suitable definition of status quo that is acceptable from a moral point of view. We cannot take various contingencies as known and individual preferences as given and expect to elucidate the concept of justice (or fairness) by theories of bargaining. The conception of the original position is designed to meet the problem of the appropriate status quo". *Id* 134-135

behind a veil of ignorance which disallows anyone to be advantaged or disadvantaged by chance or existing social circumstances and thereupon requiring them to choose the principles of justice. Thus justice is seen as the substance of an agreement that would be reached by rational people under conditions that do not allow bargaining power to be translated into an advantage. Rawls is primarily being mentioned here in his capacity as one of the prominent critics of the ethics of the Nash solution - in that the notion of equality encapsulated in the Nash solution is stated to be indefensible and in turn a theory of justice is presented which is consistent with placing bargaining agents on more equal terms. The moot point to note here is that, since the problem of equality has been solved by placing everyone behind the 'veil of ignorance', and the interaction between bargaining agents is as between rational beings, the Nash solution continues to predict outcomes but is now shorn of its normative problems. In other words, the Rawlsian theory of justice in itself does not propose to direct bargaining between individuals in society as a means of effecting just outcomes, contrary to Indian labour law which seeks to intervene directly with the contracting process to manufacture just outcomes.

While no easily discernible formal theory of justice can be said to be behind the constructs of Indian labour law, as the depiction of the law in the previous section has suggested, the genesis of a distinct Indian labour law is rooted in a concern about the inequality of bargaining power between industrial labour and their employers. In key judgements a discontent has repeatedly been voiced over treating labour contracts under the aegis of conventional standards of contract law; which in turn apropos to the discussion on the sense of justice innate to the Nash bargaining problem, can be interpreted as expressing disagreement with notion of justice that drives the Nash solution. To remedy the inequality in bargaining power, the Industrial Disputes Act suggests third party(possibly fourth, fifth ... party)intervention to effect a just outcome when negotiating parties explicitly admit to division problems. Thus if one uses the Nash representation of the bargaining problem as the basic analytical unit to approach the bargaining problem among industrial labour and their employers in India, the impact of the Indian labour legislation is best seen as redefining the status quo in a recondite manner. This manipulation of the status quo is performed by allowing the contesting parties to make selective and simultaneously strategic use of rights that have been given to them by legislation. The nature of these rights is idiosyncratic in that they are not the conventionally alienable rights such as those that cover property, but are rather rights that are gained by selective mediation of the State and its functionaries. Once such rights are gained, the process of intervention can culminate with the labour courts designing what are best labelled as *exogenous contracts* -

termed so since the contract is specified by a body other than the contractors. This act of mediation also has the added distinction that, what is essentially a dyadic problem is converted into a multidimensional problem - one which necessitates an interplay between many objective functions.

The account of the actions of contesting parties provided in the first part of this essay, makes it quite clear that both employers and workers possess a number of avenues to engineer outcomes by expending resources. In addition to pitting one union against another aided by the trade union law, employers can influence outcomes by networking with politicians and administrators since the government is crucially involved in taking a number of decisive actions at a number of stages of the adjudicating process. In addition to this investment in the services of corporate labour lawyers is yet another mean through which outcomes can be masterminded. Similarly, workers and worker organisations also use political networks and solicit the services of "outsider union leaders" to influence outcomes.

One can schematise this by trying to note the implications of these networks on the bargaining outcome. Interpreted within the construct of the bargaining problem, the bundle of rights that allow these networks to form and be manoeuvred, transform the status quo as it is specified in the conventional bargaining problem. Under Indian labour law, the status quo cannot quite be defined in terms of payoffs accruing to the contesting parties in the absence of an agreement, because the structure of rights advanced by the law allows either party the option of refusing a co-operative outcome in anticipation of an exogenous contract. The status quo under such institutional constraints is transformed into an entity which is better defined in terms of the potential threats that can be made by any one of the parties in the quest to push the case towards adjudication. Such threats are not easy to formalise because they cannot be captured altogether in terms of the utilities of the contesting parties since, the threats involve an interplay with the objective functions of the intervening bodies who play a role in allocating rights to the contesting parties. Nonetheless, a heuristic attempt can be made to capture the consequences of the labour adjudication process on eventual outcomes.

## **6. Adjudication and the Nash Bargaining Solution**

Before proceeding on the strategies of the disputants, a general point needs to be made – the exogenous contracts created by the Industrial Disputes Act are very likely in themselves to

represent economically inefficient outcomes. This is so because the true contents of the core can only be known to the parties aspiring to an agreement, or to put it differently, efficiency may be a professed consideration for the contracting parties but, there is no guarantee that those involved in the adjudication process are going to pursue ends that ensure the group rationality of the contractors. As rational beings, the ends pursued by those involved in the adjudication process are more likely to be in the direction of retaining political power, maximising returns from bribes, appearing just, being promoted to a better post or whatever else politicians, administrators, union leaders or judges aspire towards. The point also being, that given the place that such parties occupy in the structure of things, they are not liable to be weeded out, as would inefficient arbitrators in the Hobbesian prediction. If per chance some adjudicating body is moved to be just and efficient, there persist the many problems of processing data by central authorities.<sup>39</sup> The data that would trickle down to the many bodies involved in adjudication, would be liable to enter as some form of "statistics" which have been created by lumping over disparate categories, distorting the actual relation between things. Thus the decisions made by even the most assiduous adjudicating body, cannot ensure the efficiency that would follow from interaction between individual and therefore group rational contractors. One is compelled to ask then, under what conditions, if any, efficient outcomes can be expected under Indian labour law.

To do this is to enter the opaque territory of specifying the non co-operative game that accurately models the bargaining process. Now, to formally capture the process of bargaining is difficult under the simplest of circumstances and is bound to be particularly intractable when the bargaining process is made subject to the structural constraints of Indian labour law. It could of course be rewarding to attempt a formal model of the bargaining process, but even without undertaking such a venture, some insights are possible; albeit, with some abuse to the graphical representation of the Nash solution.

In diagram 1.2 let D be a status quo point - defined in the standard manner, and  $C_1$ - $C_2$  the set of potentially efficient bargains. If neither of the parties take the division problem to a third party, the outcome is, say, given by point L - the Nash solution. Imagine now that party A, strengthened by the accoutrements offered by Indian labour law, moves unilaterally to push the case for adjudication, with the hope of gaining some advantageous terms from an exogenous contract. Assume also for the moment, that party A can anticipate perfectly the exogenous

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<sup>39</sup>.F.A Hayek(1945) "The Use of knowledge in Society" 25 4 *American Economic Review* 519-30

contract based on some amalgam of the deduced behaviour of those who will set the “contract”. Let such an anticipated exogenous contract, be represented by point Q in the diagram. Then, if Party B were to also anticipate the very same exogenous contract Q, point Q converts into a new “status quo” - or to use a more appropriate term advanced by the bargaining literature – an outside-option pair<sup>40</sup> and the two parties could be perceived of as bargaining over some outcome along curve TR. If this were so, it could be said that the law has both empowered party A and enabled the predicted outcome of bargaining to be efficient. An alternate perception of point Q is to view Q not as a representation of an anticipated exogenous contract, but rather as the actual terms of an exogenous contract, set as an outcome at the culmination of a judicial procedure. If Q is understood in this manner, the two parties come to be stuck with outcome Q, because typically parties are not allowed to renegotiate the terms set by the labour court. Such an outcome is of course inefficient, but with the nebulous potential of transforming into an efficient outcome in the indefinite future. It is important here to be clear about the distinction between Q as a point reflecting the outside-option principle from which the two parties bargain as a part of the initial bargaining process and Q as an exogenous contract outcome from which a subsequent bargaining exercise can be initiated sometime in the future. The former representation of Q as makes sense only if both Party A and Party B know that Q will be the exogenous contract and both the parties know that the other party knows that Q will be the exogenous contract and so on – in other words the parties have common knowledge of Q. The interpretation of the latter representation of Q is, as an outcome of some non co-operative interaction between the two parties. Now, whatever is plausible from the viewpoint of Party A should also be plausible for Party B, which could also push the case for adjudication. From the standpoint of Party B, one can think of an exogenous contract S, construed in the manner of point Q. The point S, as is the case with Q, can be interpreted in two ways. If all parties have common knowledge of S, then S would become the outside-option point and the two parties could bargain over co-operative outcomes WX. If this were so, it could be said the law has empowered Party B and, the eventual bargaining outcome could again be efficient. On the other hand if S is viewed as the actual

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<sup>40</sup> The outside-option principle, initially suggested by Shaked and Sutton (A. Shaked and J. Sutton(1984) Involuntary Unemployment as a Perfect Equilibrium in a Bargaining Model *Econometrica* 52 ) distinguishes between the status quo or the disagreement point and an outside option such as an arbitrated settlement. Broadly speaking the literature has shown that while the outcome of a Rubinstein alternating offers game may be affected(though the outcome remains efficient), the outside option is never used. See K. Binmore(1985) “Bargaining and Coalitions” in A. Roth (ed) *Game Theoretic Models of Bargaining* Cambridge Cambridge University Press, M. Osborne and A. Rubinstein(1990) *Bargaining and Markets* New York Academic Press, C. Ponsati and J. Sakovics(1998) “Rubinstein Bargaining with Two-Sided Outside Options *Economic Theory* 11

outcome of an adjudication process, we have an inefficient outcome that has the shadowy possibility of being transformed into an efficient outcome sometime in the future.

The interpretation of points Q or S as outside-option pairs is in all probability untenable, since undeniably, the design of Indian labour law constrains the information sets of all agents. This in turn implies that the possibility of having it all – empowerment and efficiency – under the confines of the law can be more or less precluded; points such as Q or S are best interpreted as actual, judicially determined, outcomes. To commence on an intuitive analysis of such outcomes, assume that for some reason parties A and B are unable to come up with a co-operative agreement. The reasons for such an inability would be immaterial – any one or any number of diverse contingencies would do. For example, one of the parties may value an anticipated exogenous contract over a co-operative outcome because greater gains are likely to accrue following the former course or the time frame of the bargaining exercise is proving too costly. Under any such condition, empowered by the rights given by Indian labour law, assume that one of the parties acts unilaterally to seek out an exogenous contract, say Party A seeks out Q in diagram 1.2. This course of action will be pursued so long as the benefits from the anticipated exogenous contract outstrip the costs of engineering such a “contract”. If one party has initiated such an action the other is also bound to respond to seek a more advantageous outcome to itself, say S in the diagram. Now the precise manner in which the ultimate exogenous contract is set is very hard to discern a priori, but functionally it can be suggested that the final exogenous contract is in some sense related to the resources expended by both parties. Each party can be seen as trying to seek a favourable outcome through the mediation of politicians, administrators, corporate lawyers and outsider union leaders, described earlier. Since the exogenous contract is engineered through the agency of such actors, it can be claimed that there is a functional relationship between what each party expends and the exogenous contract, though the precise response to such expenditure will vary with the specifics of the case. While all parties may be aware of such relations, they may not be able to simultaneously and precisely predict the exogenous contract; for if they could, this would have led to a co-operative solution. Each party functioning with its own set of tactical private information and networks, which the other party cannot be fully cognisant of, will solicit a particular contract and the adjudicating body will deliver some contract depending on the resources expended, say Y. Such a point Y is bound to be sub - optimal, in so much so as it lies inside the frontier. Thus the statement that emerges is that - Indian labour law provides workers and their employers with idiosyncratic

rights that encourage non co-operative outcomes, where otherwise with a more conventional rights entitlement, co-operative outcomes are more likely to prevail.

To the extent that the results insinuated here are akin to those predicated in Prisoners Dilemma problems, repeated plays may lead to co-operative outcomes. However, while such plays are being repeated, there is bound to be substantial loss of resources, because with every move, agents have to expend large sums on the numerous intermediaries that man the adjudication machinery. A recent longitudinal study of industrial relations in one firm, spanning a period of twenty years, shows that it takes a very long time for players to realise that direct interaction between labour and management is preferable to third party intervention.<sup>41</sup> Thus in terms of Diagram 1.2, the two parties may just reach the frontier from Y at some point in time, but in the meantime the social loss in terms of resources expended on the bargaining process may have outstripped the social gains of reaching the frontier. This is obviously a manifestation of the ubiquitous rent-seeking behaviour that the Indian liberalisation endeavour has somewhat stalled in the product markets, but continues to be endemic in determining outcomes in the labour market.

To highlight yet another source of inefficiency, one can invoke a model of the contracting process suggested by Coleman.<sup>42</sup> Following Coleman, the process of contract formation can be seen as the resolution of three distinct but interconnected problems of co-operation, division and compliance. The first sequential step is for parties to recognise opportunities for co-operative gain, followed by a decision on the division of the gain and the final step consists of mutual compliance of the terms that have been agreed upon. Now, since decisions taken at an earlier phase in the contracting process depend on expectations regarding decisions at a later stage, the order in which parties safeguard their interests is the reverse. If there is some apprehension among the contracting parties about a later stage in the contracting process, say non-compliance of agreed terms, then the fear of outcomes worse than status quo could inhibit contract formation. Much of the substantive content of contract law such as the doctrines that cover breach of contract can be seen from this perspective - as essential safeguards against defection. By analogy, to the extent agents working under the shadow of Indian labour law look out and see unfavourable outcomes, they are bound to reject the initiation of many co-

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<sup>41</sup> E.A. Ramaswamy(1994) *The Rayon Spinners: The Strategic Management of Industrial Relations* Delhi Oxford University Press

operative ventures. Put another way, by offering detrimental ex-post resolutions, the Industrial Disputes Act ends up affecting the ex-ante behaviour of agents, resulting in a substantial loss to the sum of co-operative undertakings that could have been secured.

It is also not unequivocal that the current structure of dispute resolution necessarily leads to equitable results. In the final analysis of things, the mode of intervention with the division problem does not resolve the problem of inequity between workers and employers because employers often have better resources and networks to take on the adjudication process. Apart from the obvious advantages gained by employers on account of possessing superior resources, yet another source of inequity is the endemically slow processing of cases by the judicial machinery. Such delays can and often do work to the detriment of workers and to the advantage of employers. The quest for equitable outcomes is probably better met by giving workers endowments and entitlements that act to consolidate their bargaining power. It may be argued that by seeking a unilateral outcome some labour group *is* able to alter its position and indeed it may, but to borrow a point made by Sen in the context of gender inequality, this is performed by treating labour as one would a "patient" rather than as an "agent".<sup>43</sup> Expanding the agency of labour by empowering them as a group is a far more preferable device, than the ad-hoc tinkering favoured by the Indian legal system. Indeed, the substance of Sen's analysis of gender inequalities has significant bearing on the inequity faced by labour. Sen has suggested that the co-operative bargaining model is a useful device to study gender inequality because of its ability to capture elements of co-operation and conflict simultaneously, though he maintains that the information base of standard bargaining models consisting only of utility information, may be unduly restrictive. Instead he calls for a more plural information base which incorporates a more 'objective' notion of well being. For instance, in relation to gender inequalities, he points out that the manner in which women value their worth, in terms of their well being and contribution to the household, affects the construction of the status quo or breakdown position. Thus a woman who values her own well-being below the interests of others in her household or does not perceive of herself as contributing to the economic prosperity of her household, is in a more vulnerable position than a woman who is able to value these aspects of her life in a better light. Such concerns are manifestly related to the levels of education and productive employment

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<sup>42</sup> Jules L. Coleman(1992) *Risks and Wrongs* Cambridge Cambridge University Press

<sup>43</sup>Sen's Statement is "[T]here is also danger in seeing a woman, in this context as a "patient rather than as an agent". See Amartya Sen "Gender and Co-operative Conflict" in Irene Tinker(ed)(1990) *Persistent Inequalities: Women and World Development* New York Oxford University Press 149

opportunities available to women, because access to such possibilities can only act to improve their status quo or breakdown positions. Correspondingly, the status quo of workers as a group can be influenced by a host of circumstances that can raise their well-being, say, by increasing productive employment opportunities, by encouraging norms that work in favour of collective bargaining and by legally ensuring good working conditions for all workers. It is the witting point of this paper to suggest that future discourse on Indian labour law be re-oriented in this direction.

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There are two figures also (Diagram 1.1 & 1.2) whose electronic material has not been received and so it has only hard copy in the original copy of Working Paper.