



Case Study:

Voluntary Redundancy Programs in India

**Prepared by Adam Smith International
for the Workshop on Labor Issues in Enterprise Restructuring**

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I. INTRODUCTION

1. This paper provides an overview of the theory and practice of Voluntary Redundancy Schemes (VRS) in India. Through the 1990s a number of Indian States developed VRS for employees of Public Sector Undertakings (PSUs).

2. As overstaffing is said to be one of the main contributory factors to the heavy losses of many PSUs, governments recognised that it was simply impossible to reform, restructure or modernise PSUs without tackling the difficult question of staff reduction.

3. In the absence of a VRS, reform of PSUs is otherwise frustrated by the legal and procedural difficulties inherent in shedding labour in India as well as the political and ethical objections to dismissing people in a country where there is no effective system of social security.

4. Staff reduction through compulsory retrenchment¹ in PSUs is difficult:

- The enforcement of retrenchment is a cumbersome process. Although the Industrial Disputes Act (IDA) provides a statutory compensation to workers of 15 days pay for each year of continuous service, there are onerous requirements² on enterprises to submit detailed applications and rationales for retrenchment³.
- There is a propensity for employees and/or trades unions to contest compulsory retrenchment in the courts, so making the process very time consuming. Involvement of the courts greatly increases the cost and effort involved in pursuing retrenchment⁴ and delays the reform of the enterprise, often by years.
- Decisions on employment in PSUs have been politicised. Attempts to drive through an aggressive programme of large-scale retrenchment and enterprise reform⁵ will face concerted political opposition. Reform may be technically possible, but politically uncertain.

5. In view of the difficulties caused by the IDA and the need for PSU reforms to be “sold” to a number of stakeholder groups, the specific objectives of state level VRS schemes are to encourage employees to leave their employment without recourse to expensive and time consuming procedures.

6. Clearly workers will only do so if the financial benefits on offer are greater than those available under the IDA which provides a “floor” for any VRS. In addition many of the VRS

¹ The IDA defines retrenchment as “the termination by the employer of the service of a workman for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action, but does not include: voluntary retirement of the workman, or retirement of the workman” (Industrial Disputes Act, 1947 para 2.(oo), inserted by Act 43 of 1953).

² See, for example, form S1 of the Orissa Rules which includes a requirement to submit balance sheet, profit and loss accounts and audit reports for the last three years together with the application for retrenchment. For many PSUs there have been no audited accounts for many years, thus providing an immediate (albeit technical) basis for workers and their representatives to challenge the validity of the retrenchment action in the courts.

³ The Budget Speech of 2001 proposes to increase the statutory compensation to 45 days, but to make the need for prior application to Government a requirement only for units of more than 1,000 workers (Appendix G).

⁴ Even if an enterprise is defunct, the employer remains liable for salary and related costs. For GoO these build up as significant arrears, which GoO remains legally responsible for paying.

⁵ Some of the opposition to enterprise reforms such as privatisation arises because these reforms remove influence and power from the political and bureaucratic sphere, and decisions on enterprise investment are made on commercial grounds rather than for political, or rent seeking, reasons.

schemes can provide ex employees with non-financial benefits in the form of a Social Safety Net Programme (SSNP) of counselling and retraining to ease their exit from public sector employment.

7. The application of an effective VRS schemes, hence facilitating PSU reform has enabled State Governments to address underlying budgetary and fiscal problems.

II. WHAT MAKES FOR A SUCCESSFUL VRS? THE THEORY

8. A successful VRS must “work” for both employees and employers alike⁶. In essence, the best measures of whether a VRS is a success is the willingness of employees to apply for it and the readiness of employers to continue to offer it. In theory at least a successful VRS scheme should have the following characteristics.

Attractiveness to Employees: The VRS must be attractive enough to encourage employees to apply. One can consider here:

- *Financial benefits:* At a minimum any VRS must provide compensation greater than that offered through legal retrenchment, otherwise why would anyone accept VRS?
- *Non-financial benefits:* These include access to counselling or retraining opportunities. In some large central Public Sector Units⁷, the VRS has offered recipients continued access to medical facilities, or preferential access to facilities.

Attractiveness to Employers: the VRS should be attractive for the employer (i.e. the government):

- *Financial benefits:* To implement VRS, Governments must make large one-off initial payments, but thereafter gains from reduced salary and staff-related bills in future years. Governments can therefore assess the financial costs and benefits of a VRS in a similar way to the appraisal of an investment project. As with all projects, the key financial issues are the profile of the net cash flows (how fast is the pay-back?) and how to finance the initial investment.

Fairness and Consistency: The VRS must be seen to be fair and consistently applied; discriminating between different groups of employees is risky. It will attract criticism and damage the whole VRS.

9. If a government makes a special additional allowance for one PSU or one group of workers, then this will quickly raise expectations and become the new norm.

10. A VRS should not change frequently, so that someone taking VRS today does not do better or worse than someone taking it later. There should be no arbitrary changes in VRS, and as far as possible, the terms offered should be consistent across PSUs and over time.

⁶ This section on the attributes of a successful VRS scheme draws primarily on Adam Smith International research and design work 1997 – 2004 and practical experiences of implementation in several Indian states.

⁷ For example in Steel Authority of India Ltd (SAIL) or Bharat Heavy Electrical Ltd (BHEL) offered continued medical facilities, while the Department of Telecommunications (DoT) planned to offer STD/ISD booths to non-officer category employees who were accepting VRS from ITI and HTL. (reported by SK Goyal in “Privatisation in South Asia – Minimising Negative Social Effects through Restructuring” ILO, 2000)

Targeting: The VRS must allow targeting. PSU managers must be able to identify and decide which employees are to be offered VRS and which will be retained. The Gol VRS is explicit in this regard. Consider two ‘real life’ examples:

- In an enterprise that is being downsized, in order to facilitate its privatisation as a going concern, the ideal would be to retain the best staff.
- In an enterprise which is being closed, and either the assets sold or the enterprise liquidated, some key staff (e.g. accounts, security staff) will be needed for some time, to deal with bringing accounts up to date, dealing with queries on legal title, collecting any outstanding debts, and assisting in the sale of assets and liquidation of the enterprise.

Communication: The VRS must be well communicated. The PSU managers must understand completely why the VRS is being offered and what the elements of the VRS are. Otherwise they will be unable to apply it at their PSUs.

11. The terms of the VRS must be fully explained to employees⁸, if necessary more than once, so that they can make an informed choice. They must be given the opportunity to ask questions and must be answered fully and honestly.

Management and Credibility: In order to be credible, the VRS must be well managed: The starting point is often a high level of mistrust by employees arising from past failures to manage the PSU properly.

12. Not only must an employee understand the VRS and what is on offer, but s/he must also be confident that if s/he applies, s/he will actually receive the full benefit to which s/he is entitled and receive it in a timely manner⁹

Rehiring: The VRS must prevent rehiring. The so-called “revolving door” scenario, where VRS recipients are later re-employed in the same or a related enterprise, is a clear indicator of a failed VRS. There can be little point in a government promoting a VRS if employees who receive VRS from one PSU are simply rehired elsewhere in the public sector. Such a Scheme could be open to abuse and collusion between employees and managers.

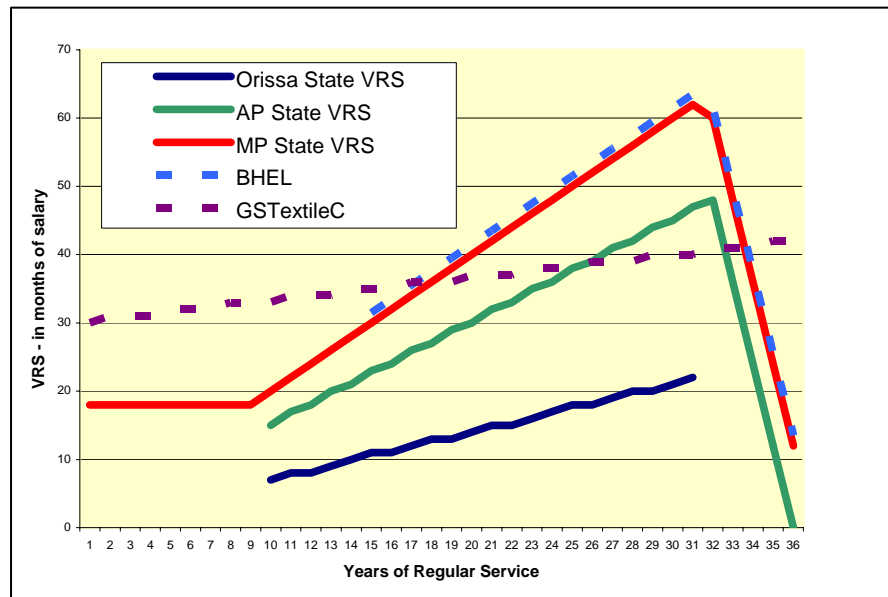
III. STATE LEVEL EXPERIENCES IN PRACTICE

13. In practice VRS programs in India have been principally based on a formula (Figure 1). In the simplest schemes, the formula provides for increasing payments with seniority (years of service). Others adjust by taking into account years remaining.

⁸ Some legal judgements reinforce this point. In April 1998, the Bombay High Court ruled that employers could not withhold the details of VRSs in order to help ensure that employees can make an informed decision. In addition, the court ruled that there should be a mandatory 21 day period between the announcement of the scheme and acceptance of applications so that employees have a cooling off period in which to think through, without undue time pressure, whether to accept VR or not. (Reported in the Indian Express 5 May 1998)

⁹ Experience suggests that a realistic period should be no more than 60 days otherwise workers may start to lose confidence in the management of the VRS.

Figure 1: Comparison of Select Public and Private Sector VRS Schemes in India



Source: Adam Smith International 2003

14. A comparison of some relatively recent state level schemes is presented in Annex 1. In practice, however, the implementation of the formula depends upon a range of eligibility and other conditions that are applied. In some cases (e.g. Orissa) there are restrictions on eligibility, for example, and in others, a cap on total payments (e.g. Madhya Pradesh as set out in the box 1 below).

Box 1: Madhya Pradesh's Severance Scheme

In 2002/3 the Indian State of MP had a well-designed, uniform severance scheme. The scheme was generous (60 days per year of service) but capped at Rs 500,000 (approximately \$5,000). However the scheme defined salary, for the purpose of severance, as the average of the last 10 months salary, and provided for a notice period of one month. In practice, this combination proved difficult to implement, when dealing with larger numbers – over 5,000 - of retrenched workers in the MP state bus company. Delays in releasing funds and the short notice period meant that severance pay had constantly to be recalculated to the average.

Source: Adam Smith International

15. In India, perceptible differences in VRS compensation exist between Central Government and State Government Enterprises, and among states. Differences also exist between privatized enterprises and those that have been closed down altogether. VRS payments on average per worker have been around Rs 3 lakh¹⁰ for central PEs and Rs1.6 lakh for state level public enterprises.

16. As Table 1 shows, there has been considerable variation in payments per worker. Orissa is the state with lowest total compensation (Rs1.9 lakh per worker). At the other end of

¹⁰ 1 lakh is 100,000 Rs.

the spectrum are the Central government PEs, where the compensation has been the highest (Rs 6.9 lakh per worker).

17. One of the simplest comparators between state programs, however, is to compare worker payments in terms of the equivalent months of salary that the compensation represents. On that basis, it can be seen that workers receive total compensation packages equivalent to between 45 months (3.75 years) and 75 months (6.75 years) of salary.

Table 1: Components of Total Redundancy Compensation (Rs) by State

	Andhra Pradesh	Uttar Pradesh	Madhya Pradesh	Orissa	Karnataka	Centre
Provident fund	107072	143634	89130	78649	115875	226323
Gratuity	76168	46093	46538	53191	78743	109955
Pension	357	151	12	145	433	75
Leave encashment	27392	24062	23991	11783	17139	20911
Other benefits	10078	22146	21454	10101	11289	1346
VRS compensation	145108	182414	178101	41477	210420	335580
Total Compensation	366,175	418,500	359,226	195,346	433,899	694,190
Average monthly salary	7,486	7,616	6,038	4,329	5,771	10,968
Average VRS as months of salary	19	24	29	10	36	31
Average Total compensation as months of salary	48	54	59	45	75	63

Source derived from: World Bank (India) Survey 2003

18. This comparison allows judgments to be made both between states in India and with international experience. It confirms that the Orissa program is the least generous, but also suggests that the Karnataka program may be unusually generous.

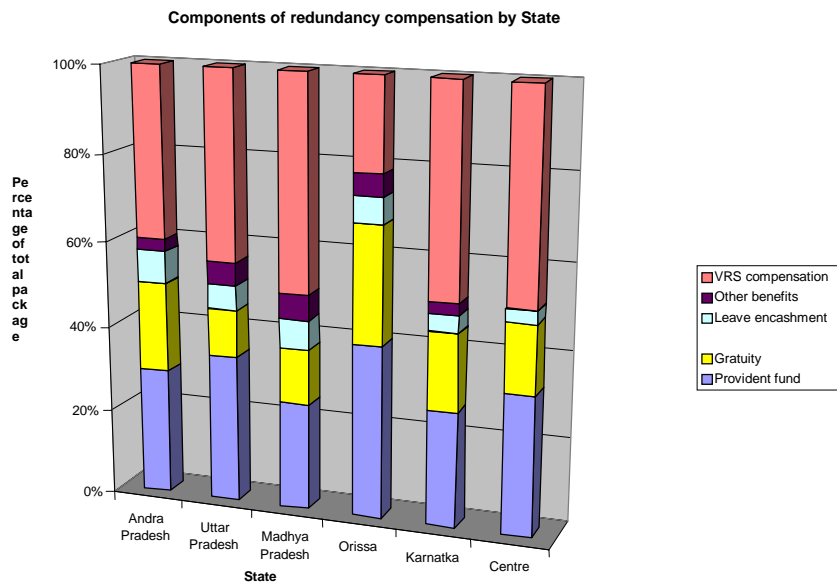
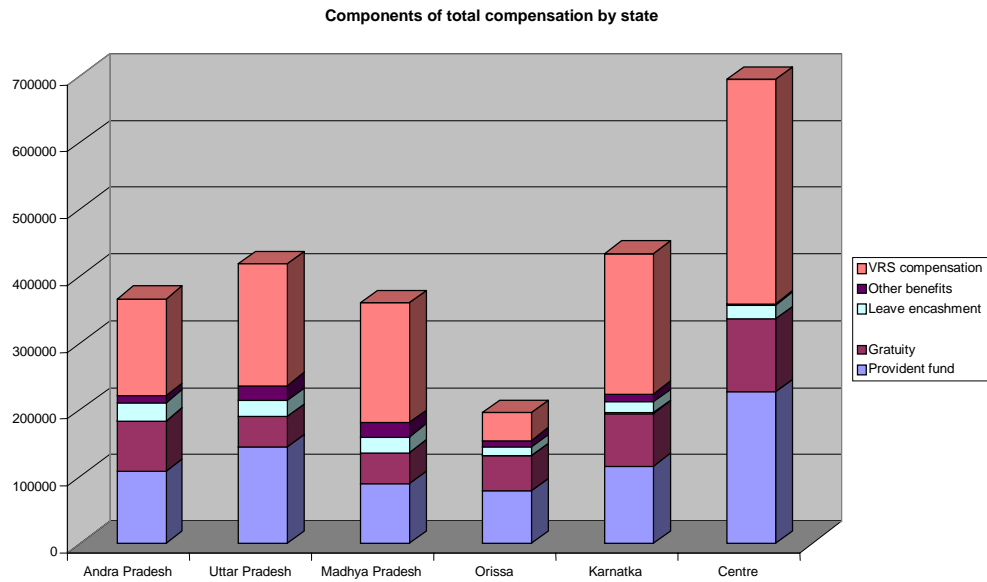
19. Comparisons in the graphs below (Figure 2) suggest that:

- Central government PE workers benefit from their high starting salary, particularly through the benefits when applied to the VRS formula and the gratuity formula.
- Workers in states with the least generous schemes (e.g., Orissa) receive a relatively high proportion of their overall compensation through statutory and contractual end of service benefits, such as gratuity and earned leave.

20. How do VRS payments in India compare with international experience? Table 2 provides some comparisons, drawn from published sources and from a review of World Bank projects. Care is needed when making international comparisons, to ensure that like-for-like alternatives are made. Many of the cases in Table represent downsizing of large infrastructure enterprises whose restructuring was both political and contested by unions and other groups. As such they offer a useful comparison, given that disinvestment in India is also contested. There is considerable variation, and estimating a mean or median would be spurious. As a mid range, however, most programs are offering severance packages of perhaps 16–24 months. Below 10 months and above 30 months are exceptional.

- In international terms then, the VRS schemes offered in Karnataka, central government PEs and Madhya Pradesh appear over-generous; while that of Orissa is low.

Figure 2. Components of Compensation by State



Source: Derived from World Bank/NCAER Survey and Adam Smith International 2003

Table 2. Severance Payments - Some International Comparisons

Country / Enterprise	Severance Package (in months of salary)
Argentina / Steel & Railways	Equivalent to 24 months of salary
Brazil / Banco do Brazil	Average equivalent to 13 months
Brazil / Banrisul Bank	Average equivalent to 10 months
Brazil / CEEE Power	Average equivalent to 25 months
Brazil / Federal Railway	4 to 12 months of salary
Brazil / Rio Grande do Sul Electricity	Capped at 15 monthly salaries
Brazil/ CRT Telecom	Average equivalent to 30 months
Cape Verde / Privatization	20 months of salary if 15 years of service
Croatia / Rail	15 months of salary
Guyana / Telephone & Telegraph	22 months of salary
Lebanon / public sector	Maximum 10 months of salary
Macedonia / Social Support Project	Equivalent of 12 months of salary
Mozambique / Rail	Equivalent to around 24 months of salary
Poland / Rail	24 months of salary
Sri Lanka / Mahaweli Restructuring	Approx. 24 – 36 months of salary
Togo / Public Enterprise Reform	Equivalent to 16 months of salary
Tunisia / Rail	Capped at 30 months of salary

Source: Labor and Disinvestment Survey & ASI Sources 2003

21. These relative amounts do not, however, tell the whole story. In principle, a relatively generous program could be justified if it led to significant increases in the speed of enterprise restructuring. A one or two year delay in labor adjustment reform will itself have costs in terms of:

- Continued expenditure on staff-related costs.
- Reduced privatization revenues. Indian circumstances will be different, but in Mexico *Lopez-de-Silanes (1997)* found an increase of net privatization prices of 12 per cent for every 10 per cent reduction in the labor force (he also found a statistically significant positive impact from replacement of the Chief Executive of the enterprise).
- Delayed implementation of privatization or restructuring program due to opposition from organized labor.

22. Empirical evidence, does not support the hypothesis that more generous payments necessarily allow faster restructuring. For example, Orissa and Madhya Pradesh both formulated a VRS scheme at around the same time: (June 1998). By May 2002, however, Orissa, with its far less generous scheme, had retrenched over 13,600 workers¹¹, whereas Madhya Pradesh, despite its somewhat over-generous scheme, had retrenched around 6,000 workers by May 2001 (Adam Smith International research), and an estimated 8,500 by May 2002.

23. The Orissa experience appears to be based on the fact that high proportions of SOE workers had not been paid for months and in some cases years. Many workers had given up all hope of receiving any money from their enterprises and were happy to receive some money given the state's parlous fiscal condition.

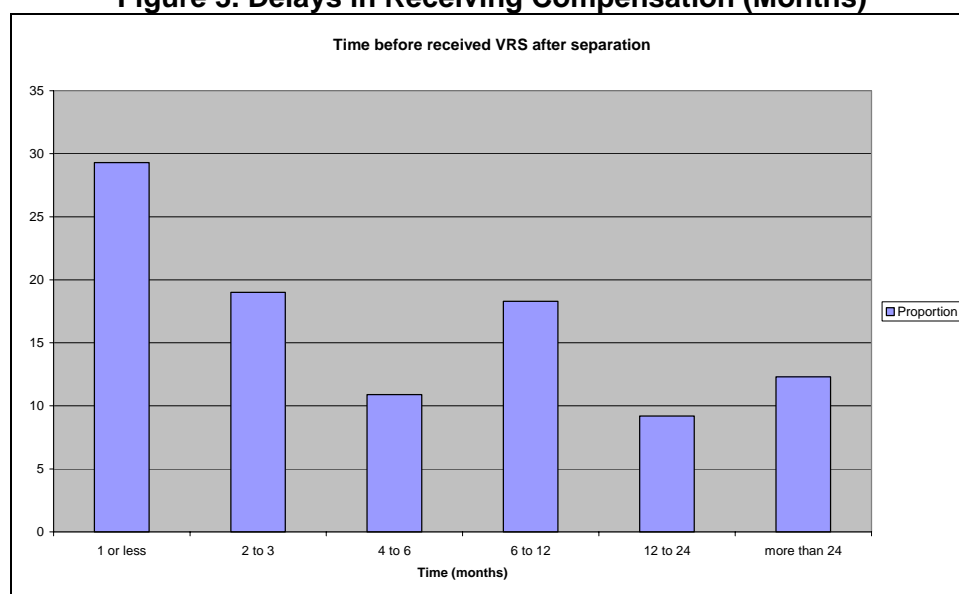
¹¹ Government of Orissa (2002), Data presented at the May 30, 2002 World Bank Workshop on Public Enterprise Restructuring, New Delhi.

24. Legal factors can be as important in determining the pace and impact of PE restructuring. For example, despite Karnataka's generous VRS, problems of court-based legal challenge, procedural bottlenecks and resource constraints have resulted in delays.¹²

25. The financial condition of the PEs in question also plays a role in the speed/success of a VRS. For example, in the case of Orissa, many enterprises were in acute financial distress, and non-functioning well before their closure, and hence few employees or unions challenged the closure through the courts. A donor-funded social safety net program was also established in Orissa some three years earlier than in Madhya Pradesh.

26. A 2003 World Bank funded survey by the National Applied Economic Research Council (NAERC) also indicated that workers preferred payments in lump sum amounts, rather than instalment (phased) payments. In part this is because lump sum payments allow workers to make one-time investments into property or interest-earning accounts, but also because of growing uncertainty in several states about the governments' ability to pay (Figure 3).

Figure 3. Delays in Receiving Compensation (Months)



Source: Derived from World Bank/NCAER Survey 2003

27. Government of India (GoI) and those states with a degree of fiscal stability are often willing and able to finance the costs of VRS. Unfortunately, procedural delays and—sometimes—temporary cash shortages can lead to delays in the disbursement of VRS funds to workers. As the NCAER research shows, these delays can be significant.

28. One unintended consequence of donor support may be that the specific accountability requirements for VRS payments leads to greater attention to on-time, and full, payment, and the reduction of procedural delays. This, together with the poor state of PEs, may help explain the relatively high numbers of workers accepting VRS in Orissa, despite the unusually low level of VRS on offer.

¹² GoK (2002), A Presentations on Public Enterprises Reforms in Karnataka, World Bank Workshop (op.cit.).

IV. CONCLUSION

29. There has been limited empirical research to show how VRS schemes performed in practice.

30. No one state level VRS scheme meets all theoretical criteria of a successful scheme but it is clear that those states that have sought to implement VRS programmes with a degree of energy and consistency (i.e., Orissa and Andhra Pradesh) have been able to progress privatisation and reforms faster than those states that have not.

31. States which have implemented schemes have largely meet the key criteria of being both attractive to employees and to employers but it is fair to say that most of these states have faced real problems with the operational and management aspects of the schemes.

Comparison of State Level VRS Schemes

Characteristic \State	MP	AP	Gujarat	Orissa	UP
Order	VR Scheme VR-98 dated 19-8-98	Government Memo 1038/PE-I of 23 January 1996	Finance Department Circular JNV 1699-1070-A of April 12 1999	Resolution 1743/PE of 6 June 1998	Government Order 288/P.R.C./44-1/93-85/90) of 1993.
Applicability	Government, local authorities, corporations and undertakings owned or controlled by the State, joint ventures with more than 50% equity, grant-in-aid organizations, etc	PEs under the Companies Act, Co-op Institutions, Institutions under the societies registration Act, etc	PEs in the process of downsizing	Public sector undertakings (PEs)	Public sector undertakings (PEs) with a view to reducing surplus manpower
Level of Ex-Gratia Payment	<i>Part A: (Workers who have completed 10 years):</i> 2 months (60 days) of salary for each completed year of service or total salary for remaining period of service up to the date of superannuation, whichever is less <i>Part B: (Workers with less than 10 yeas service):</i> Terminal benefits plus 75% of salary for Year 1; 50% of salary for Year 2; and 25% of salary for Year 3.	1.5 months (45 days) of salary for each completed year of service or monthly salary multiplied by the remaining years of service, whichever is less	35 days of salary for each completed year of service, added to 25 days of salary for each remaining years of service or monthly salary at the time of VRS multiplied by the remaining months of service, whichever is less	21 days of salary for each completed year of service	45 days of salary per year of service or monthly salary at the time of VRS multiplied by the balance months of service, whichever is less
Basis of calculating salary for VR	Basic pay + Dearness Allowance (DA) + IR	Basic Pay + DA	Basic Pay + DA + House Rental Allowance (HRA)	Basic Pay + DA + IR	n/a
Upper limits on compensation	5 lakh maximum for eligible workers	No upper limits mentioned	No upper limits mentioned	No upper limits mentioned	No upper limits mentioned
Lower limited on compensation	No lower limits mentioned	In the case of PE closure, minimum package of benefits of Rs30,000 for employees with less than 10 years of service (see Notice of Amendment 47538/PE of 26-8-98)	No lower limits mentioned	No lower limits mentioned	No lower limits mentioned
Retirement Age	58	Not mentioned	Not mentioned	Not mentioned ??	Not mentioned
Eligible persons	Part A: Workers with over 10 years of service	Workers with 10 years of service or having attained	Workers with 10 years of service or	Workers with 10 years of service.	Workers with 10 years of service or

	Part B: Workers with less than 10 years of service	40 years of age	having attained 40 years of age		having attained 40 years of age
In-eligible persons		The AP VRS Scheme originally stipulated 10 years of service for eligibility and that was not to apply if the employee is to retire within one year of VRS application. These conditions were removed by subsequent arrangements.	An employee is not eligible if he/she is to superannuate within 3 years of VRS application.	Workers 55 years of age or older	
Treatment of temporary workers	Not mentioned. Scheme not applicable	Not mentioned. Scheme not applicable. However, ad hoc payments made	Not mentioned. Scheme not applicable. However, ad hoc payments made	Not mentioned. Scheme not applicable. However, ad hoc payments made. Proposed scheme is Rs5,000 per year of service, up to a maximum of Rs 25,000	Not mentioned.
Right of management to refuse VR	Provided for in scheme	Provided for in scheme	Provided for in scheme	Provided for in scheme	Provided for in scheme
Has the State Government granted exceptions?	Not applicable – schemes just starting up	No. DPE espouses clear policy to keep to 45 days only.	Not known	Profit making PEs have been allowed to formulate their own schemes if approved by the Government.	Government Order allows for exceptions with the approval of the DPE. Not known if exceptions implemented..
Coordination of VR Schemes	Department of Finance	Department of Public Enterprises	Department of Finance	Department of Public Enterprises	Department of Public Enterprises
Financing Arrangements	State Renewal Fund (SRF)	State Renewal Fund (SRF)	State Renewal Fund (SRF)	State Renewal Fund (SRF)	Not known

Source: ASIL Researches 2003