

# AN ANALYSIS OF THE BONUS PROBLEM

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"People must come to accept private enterprise not as a necessary evil; but as an affirmative good."

—EUGENE BLACK

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by

Dr. M. C. MUNSHI \*

Starting as an *ex-gratia* payment, especially on the occasion of festivals, by the end of the First World War bonus came to be a payment in place of what in the Second World War was called and "claimed" as Dearness Allowance occasioned by the rising cost of living. During the Second World War, the employers as well as the Government vied with each other in pacifying labour by paying "bonus" and other "allowances" (perquisites) as a share in their "profits". Towards the end of the War in 1944, the then Chief Justice of the Bombay High Court, Mr. M. C. Chagla, gave a decision in the case of General Motors that if an industry made profits the workers must be "compensated" to a certain extent.

Immediately after Independence, "The Fair Wages Committee" and the Profit Sharing Committee, especially the latter, suggested that there were claims on "profits" of industry by shareholders and the workers. The most important stage was reached when the Labour Appellate Tribunal propounded in 1950 its famous formula about "available surplus" after the deduction of "prior charges" from gross profits, out of which a bonus was "claimable" by labour.

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This formula seemed acceptable to both employers and organized workers between 1950 and 1958. In the meantime, however, the Bombay Tribunal threw in a spanner. It decided that an officer was not entitled to bonus as the workers alone contributed to the profits of the company. Secondly, if no depreciation was provided in the annual accounts of the company, no deduction from "available surplus" on this account could be claimed. Thirdly, in a similar way, if a company was not liable to pay tax in any year, the tax amount was not to be allowed from the available surplus. The Labour Appellate Tribunal then tried to reverse this decision, but this Tribunal itself was abolished and 15 cases went to the Supreme Court in 1959.

There was a further development during this period in the bonus issue. In 1955, in the case of Kanpur mills, the workers demanded a bonus even when the former incurred a loss in their working. The Supreme Court, deciding the above-mentioned joint appeal, laid down certain *obiter dicta*, viz., (1) that bonus was no longer to be paid at the discretion of the employer—(much less was it a gift) but could be "claimed" by workers if they showed that (a) they were not getting a wage which could be termed "fair wage", and (b) that the "industry" made profits. (2) They also opined that the L.A.T. formula had worked well, but if it was thought otherwise, a high-powered commission should be appointed to go into all issues and make recommendations. This recommendation was repeated in 1961. (3) The Court also opined that the payment of bonus should not lead to the formation of a "privileged class" amongst workers.

It can be safely asserted at this stage that perhaps the most interesting aspect of all these decisions of the courts is that in spite of the issue of "bonus" being primarily an economic one, no economist was consulted or referred to in these judgements.

There was also another development during this period. In 1955, the millowners of Bombay entered into an agreement with the workers for a period of 5 years which pro-

vided for a bonus at 4 per cent minimum even if the mills made losses. And this was followed by the Ahmedabad and later by Coimbatore and Indore textile mill employers.

## The Bonus Commission and After

Thus we come to the Bonus (Meher) Commission of 1962 and we need only briefly review its work as these developments have become fairly well known. This Commission rejected the claim of the workers to bonus as a deferred wage; but stipulated that a 4% bonus must be paid irrespective of profits (or losses). Further that while the textile workers' agreement on 4 per cent (minimum) bonus was on the *basic wage*, the Commission made it on the *total wage*, that is, including allowances. It is quite well known that in the post-war era, the basic wages had lost all moorings with the allowances, especially with the Dearness Allowance. Thus, for instance, while the basic wage in an engineering firm was Rs. 39/- per month (i.e. Rs. 1.50 *per diem*) the D.A. was Rs. 229.00 per month. The workers readily accepted the recommendation when the Payment of Bonus Act was passed in 1965.

Secondly, out of the "available surplus", i.e., after deducting 8% on subscribed equity capital and 6% return on reserves utilised as working capital, 60 per cent was to go to the workers and 40 per cent was to remain with the employers for use in the industry. To this, the Government added a "development rebate". Under the Income Tax Act, in addition to depreciation an industry was allowed to deduct a development rebate provided 75 per cent of it was utilized for development only.

## Payment of Bonus Act, 1965

The 1965 Act, while accepting the 4 per cent minimum, even in the event of a loss, also considered a ceiling on the maximum, for the Planning Commission as also the National Commission on Labour and the Pay Commission had observed that such payments would lead to the creation of a privileged class of employees. Thus out of the 60 per cent

bonus, 20 per cent of the annual earnings of the workers concerned (i.e.  $2\frac{1}{2}$  months salary) was fixed as the maximum. If in spite of that any amount remained in that 60 per cent the amount equal to 20 per cent was to be carried over for 4 years so that if the profits declined in the following years, the amount could be utilised for making up the minimum statutorily required. If there were losses and the employers paid 4 per cent and in the next year bonus came to 9 per cent they could deduct 4 per cent and pay 5 per cent only.

These formulae were accepted by the employers and the trade unions. Some companies which were making larger profits even supplemented the statutory bonus payments by giving *ex-gratia* amounts to workers—giving up to 12 to 20%. By 1972, with continually rising prices, a concerted effort was made by trade unions to get the 1965 formulae revised and the then Deputy Labour Minister of the Government of India made an announcement that he favoured  $8\frac{1}{3}\%$  as the minimum bonus claimable. A demand followed from trade unions for the revision of the statutory minimum and the Government announced that in addition to 4% minimum, a further 4% should be paid which would be treated as “advance” (given to workers) and that a Bonus Review Committee would be appointed to go into the whole question of revision.

By this time, the workers of Government industrial undertakings as also those of the Bombay Municipal Corporation raised a demand for 8% minimum bonus.

## Results of the Bonus Act, 1965

It was believed largely by the Government that as a result of such settlement of the bonus issue, *industrial peace* would prevail, especially because figures showed that in the preceding years the percentage of bonus disputes in industrial strife was growing. Indeed, the bonus question had taken the pride of place in industrial disputes. These hopes, however, did not materialise. In terms of mandays lost, the incidence of bonus disputes became more severe. In 1966,

1970, 1971 the proportion of mandays lost due to this single cause varied between 16.5 per cent to 30 per cent while in other years it was less than 11 per cent. The proportion of bonus disputes which formed less than 10 per cent of total disputes in 1965 rose to 11 per cent in 1966 and to 14 per cent in 1971. Industrial peace cannot be legislated into existence. Industrial peace, as John Stuart Mill long ago pointed out, cannot be thought of so long as the present employer-employee relations remained.

By jettisoning the link between "profits" and bonus and making this a compulsory minimum payment, in any case, it gave the liberty to organised workers under Section 34(3) to demand a higher bonus than the maximum laid down under the Act under a formula different from that of the Act. The reason for the floor and ceiling rates was that labour cannot be expected to accept a reasonable formula that provides for a ceiling on bonus without also providing for a floor.

We have already noted that the Act made bonus payable not on the basic wage but on the basic wage + D.A. etc. In this way, the further complication of wage structures—that had already been brought about by the "allowances"—to which we have referred, rendered the adoption of a wages policy all the more difficult.

The higher payments raised the cost structure of industries. Some of them complained of recession and the labour intensive industries had to face serious difficulties.

The compulsory minimum payment avoidably, though perhaps unwittingly, gave encouragement to the theory of bonus payment based on the concept of a "deferred wage" that had been long rejected.

More seriously, it helped to create a privileged class of workers in Indian society. The 1½ to 2 per cent of the labour force simply because they were organised could impose an additional burden for their benefit on the remaining 98 per cent—as consumers—as much as on the rest of the community.

On the plea of encouraging collective bargaining in India, the floor and ceiling concepts of the Bonus Formula were also given up. This collective bargaining concept is often linked with "Industrial Democracy".

Under the pressure of demands for higher bonus in January, 1969, Section 5 of the Bonus Act was amended with the result that the available surplus was increased by adding tax rebate (which hitherto accrued to the company) on account of bonus payments under the Act.

### **Bonus Review Committee**

In April, 1972, an expert committee under the chairmanship of Dr. B. K. Madan with seven other members was appointed. A feature of this committee was that it included a trade union economist also. Having regard to the urgency of the matter, the committee made an interim report although it could not arrive at any concensus about the bonus issue. What is more interesting is that despite the divided counsel of the Review Committee, the Government raised the statutory minimum bonus payment from 4 to 8 per cent. This was recommended only by the workers' representatives and the public sector nominee for the years 1971-1973.

The final Report of the Review Committee was submitted to the Government in October, 1974. It has to be emphasised that the document has not been officially published. But the newspapers did report its summary—more especially its recommendations—which, of course, were divided into minority and majority recommendations. The following lines about the Review Committee recommendations are, therefore, necessarily based on such Press reports.

*Coverage:* The majority of the Committee recommended that there was no need to change the coverage of the Bonus Payment Act. This meant that establishments having less than 20 employees or workers in enterprises run by Government Departments and Government employees should not be eligible for Bonus. Some members, however,



recommended that the Act be applied to non-competitive public sector undertakings.

*Minimum Quantum:* In regard to minimum bonus, the committee opined that the *status quo* then obtaining (i.e., 8.33 per cent) should be maintained. It may be interesting to note that the labour representatives demanded that this 8.33 per cent shall be raised to 10 per cent for 1973 and 12.5 per cent for the following year. On the other hand, the employers' representatives wanted a reduction to 5 per cent minimum. The majority, however, agreed to retain the existing 8.33 per cent.

*Maximum Bonus:* The maximum bonus to be raised from 20 to 25 per cent was recommended by a majority of 4 to 3--subject to the proviso that the additional amounts were not to be paid in cash to workers drawing a salary of over Rs. 1,000/-. Two of the members recommended that the additional amount should be deposited either in the respective provident funds of the employees or in some kind of Deposit Scheme. One Member, Mr. Mahesh Desai, felt that there should be no upper limit to bonus payment and that it should be left to collective bargaining. It will be seen that this cleavage of opinion has characterised most of the Committee's recommendations and presumably this must be the reason why the Report was not officially released.

*An Unanimous Recommendation:* An unanimous recommendation of the Committee on the other hand stated that the salary limit for the purpose of coverage of the Act might be raised from Rs. 1,600/- to Rs. 2,000/- per month and that the maximum bonus payable should be calculated on the basis of Rs. 1,000/- per month instead of the prevailing Rs. 750/-.

*Collective Bargaining about Bonus Payments:* (a) Section 34(3) of the Bonus Act (1965) provides for a statutory option to the employers and workers for collectively bargaining for determining the quantum of bonus. The Chairman, the Employers' Representative, the Labour Econo-

mist and the Public Sector representatives desired that this Section should be deleted and any payment of bonus at a rate above the maximum (under the Act) should not be counted as expenses for the purpose of taxation. (b) On the other hand, labour representatives recommended the retention of the Section on the plea that "collective bargaining" should be encouraged in the context of industrial relations in India. This is in complete opposition to the plea of the aforesaid five members that the Government should not entertain disputes on demand for bonus above the quantum laid down by the Act.

*The Formula for Available Surplus:* We have seen that the 1965 Act provided for computing the Available Surplus as: Gross Profits: Less Prior Charges, viz., (i) Statutory Depreciation; (ii) Taxes; (iii) Development Rebate; (iv) A Return on paid-up Capital at 8.5%; and (v) Reserves utilized as working capital at 6%.

The Available Surplus was to be allowed in the Ratio of 60:40 between Labour and Management.

In calculating this allocable surplus, account was to be taken of the set-on and set-off for good and lean years.

As may be expected, there were wide dissensions in the Committee as regards the retention of this formula. The majority favoured retention. The Committee, however, was unanimous in recommending the continuance of the existing provision in regard to deduction of taxation.

*Settlement of Bonus Disputes:* The existing Act provided (under Section 22) that a dispute relating to bonus payments should be deemed "an industrial dispute", under the 1947 Industrial Disputes Act, thus capable of being adjudicated upon under the latter Act. The majority of the Bonus Review Committee recommended that the Industrial Relations Commissions, proposed by the National Commission on Labour, must deal with these bonus disputes. Pending the establishment of these Commissions, the majority proposed the setting up of a Tripartite Bonus Board with a

Chairman who should be a sitting judge of the Supreme Court or a High Court.

*Exemptions under the Act:* Section 36 of the 1965 Act provided that the Government could exempt any establishment from its operation, if it found that it would not be in public interest to apply all or any of the provisions of the Act having regard to its financial position or other relevant circumstances. This exemption could be granted for stated periods and be subject to suitable conditions. Here too, only the majority proposed that this Section (36) might be so amended as to incorporate specific relaxation to the minimum quantum obligation in the event of continued losses.

Even before the Bonus Review Committee commenced its labour, a strong plea had been made in the Press for linking the payment of bonus to the performance of workers, in other words, to productivity. In order to meet this plea, Section 32(vii) of the Bonus Act had provided that the Act would not apply to such cases when the employees concluded a settlement with their management providing for a production or productivity bonus rather than the other payments under the Act. It is pertinent to note that firstly the Act did not define the concept of productivity and, secondly, strictly speaking this so-called productivity bonus is a type of "incentive payment" (wage incentives), though it must be added that the bonus in any case covers a wider field than performance or payment by results. The Review Committee suggested that such productivity bonus payments should be made under the Payment of Bonus Act and, therefore, Section 32(vii) should be retained.

This brief survey of developments of Bonus payments in the post-Independence period leads to certain conclusions:

(1) The Concept of Bonus was studiously left undefined.

(2) The attempts to quantify 'payments' by the Commission and the Committees, let alone the legal attempts in law courts, have succeeded only in complicating the issue. This is evidenced by the varying decisions or recommendations of the Reviewing Committee and by the unpreparedness of the Government to officially publish its findings.

(3) The more the attempts were made to avoid scientifically to analyse bonus payments, the more the attempts were made to circumvent the concept, consequently, the more involved and difficult has become the search for a solution by the Government.

This is also seen from the fact that the previous Government tried to correct the situation by admitting that the payments prevalent then were a mistake and by discouraging the bonus grant of additional payments. In fact, the Bonus Act was amended by an Ordinance in October, 1975, so as to make the bonus payments conditional upon profits and pegging the minimum at 4 per cent.

Thus, in September, 1975 an Ordinance was issued and in the following year an Amending Act was passed imposing certain restrictions on the payment of bonus. Section 31-A of the new Act provided for bonus based on production or productivity in lieu of profits, subject to a maximum of 20 per cent. The Act, however, did not provide for any universal formula or lay down any principle, much less define the concept, for calculating productivity, unit-wise or industry-wise. As a result of this legislation, and particularly because of the Emergency that came to prevail until the first quarter of 1977, there was a lull in labour demands and some kind of discipline was visible in the working of industries. This was only a lull before the veritable storm of demands, agitations and strikes in the post-General Election period.

In this connection, it is also important to note that the Election Manifesto of the Janata Party included a significant paragraph in which the Party promised to restore bonus payments and conceded the "theory" of "deferred wages".

## Growth of the Indian Concept of Bonus

We are now in a position to trace the stages in the growth of the concept of bonus—

(i) From an *ex-gratia* payment, to a compulsory payment “claimable” by workers and, therefore, a justiciable issue in law courts.

(ii) Profit sharing: Ostensibly, the generally acceptable concept. But here too from “extraordinary” (or excess) profits, such as during a war boom, to payments even in years of losses.

(iii) These payments have also been described as prosperity-sharing compulsory payments in all years.

(iv) An opportunity to advance from a minimum (or need-based) wage to a “living wage”—without defining or quantifying this concept and by jettisoning the intermediate stage, viz., the “Fair Wage”.

(v) As a compulsory payment in all cases (Profit or Loss) and as a measure of “filling in the gap” noticeable in the previous stage. Can it then not be easily claimed as a “deferred wage”?

(vi) As against these stages of growth, the Supreme Court as also the National Commission on Labour have shown, the former in the Greaves Cotton case (1954), that bonus does not figure in costs of an enterprise, that it is *not cost-based* but is *surplus-based* and it cannot be a deferred wage.

### Basic Issues to be faced

To solve the bonus problem, certain basic issues should be considered:

(1) What is the real nature of the Available or Allocable Surplus—out of which bonus becomes claimable? How does that surplus arise in the Income and Expenditure statement?

(2) To whom does that surplus belong? Only to the employers and employees (together)?

(3) What is this Theory of Deferred Wages—deferred in relation to which wage—especially in the total absence of a wage policy?

(4) What is the implication of the dangers of creating “a privileged class of workers”? As a corollary to this query. What effects do such payments have on prices? Cumulatively, do these payments feed wage—inflation?

(5) For the Bonus Review Committee, “Productivity Bonus” was a specific term of reference—“Whether the entire bonus payment should be related in *some way* to production—productivity in the undertaking”. In the absence of the official release of this report, it is not possible to comment on the manner in which it has faced this issue. But from all accounts, it appears that like the basic concept of bonus the Committee has not dealt with this issue.

On the other hand, when the bonus payment is based on or related to the rise in the quantum of output, does it not become a wage incentive payment—collective wage incentive—rather than a “bonus”?

Let us start with last query first: this wage-incentive is a well-known method and cannot raise any doubts about its justification. But there is another general question. We have seen that much importance was attached to bonus arrived at by collective bargaining between labour unions and employers, so much so that for these agreements no maximum limits to the quantum were to be applied. This collective bargaining and the resulting agreements are also taken as manifestations of “industrial democracy”. But we may legitimately raise the question: Is it democracy when a principal party that is called upon to bear the burden of higher payments, in the form of higher costs and higher prices, is conspicuous by its absence at the bargaining table? Where is the Consumer?

## Profit-sharing among whom?

It will be easily conceded that the real origin of bonus and its primary justification lies in the concept of profit-sharing. This is a legitimate concept understood all over the world and schemes of profit-sharing have been tried with varying degrees of success in different countries. But the basic questions are: In an era of inflation, closed or controlled markets and planned production, what are these profits? How do they rise? Do they emanate from the "risks of enterprise" that the entrepreneurs bear and the labourers share? Strictly termed, these profits are adventitious gains. These profits and, therefore, the available surpluses come out of the higher and higher prices that the consumer is compelled to pay in these protected markets. In other words, the available surplus can be claimed by consumers too in respect of the additional burden that he is called upon to bear. Briefly, then, this part of the available surplus should go back to him in the form of lower prices, if these "profits" are to be equitably shared. While the other two sharers, employers and workers are organised, the consumer remains unorganised and hence his claim has gone by default or has been forgotten.

The third issue to be considered is the thesis advanced by labour unions, as early as 1962, and which has been turned down both by the Supreme Court and the National Commission on Labour after showing that bonus was based on surplus and not cost-based. This claim to additional payments is sought to be justified on two arguments:—

(1) That the value of the whole product belongs to the labour—in other words, the old Marxian theory of Value that labour is the cause and measure of all value and that the returns to other factors of production constitute "theft" (the theory of Surplus Value). It is hardly necessary today to dwell on this when we remember that the Labour Theory of Value was exploded nearly a century ago in the economic doctrines. Why is it then still raised? The answer is found in the words of a writer whose sympathies with labour can-

not be doubted. Says he: "This term 'deferred wages' has become a parrot cry, some using this with a full awareness that it is merely a slogan, but if it could produce a benefit, it is worth pedalling it, and others naively sold on the idea that a deferred wage to allegedly bridge the gap between minimum and fair(?) Wage.....Workers and their leaders avidly welcome this piece of chicanery simply because it puts a little more money in the pockets of labour constituency whom labour leaders also view as nothing more than beggars." (S. R. Mohan Das in "Economic Times" of 10-6-1977)

(2) In fact, the foregoing quotation also easily disposes the other ground on which the deferred wage thesis is based: namely, somehow obtain an increase in payments under this slogan. Otherwise, in the absence of any policy or idea of a fair wage or a living wage, what is the gap to be filled up? In fact, it is well known that the absence of any wages policy has not only come in the way of the solution of the bonus problem, but also of the problem of rising prices in the Indian economy.

On the other hand, if wages are accepted as contractual payments or disciplined payments (cost-based as we have seen), how can there be deferred payments? Indeed, as the result of an I.L.O. convention the Government of India passed the Payment of Wages Act (in 1948) which "disciplines" the quantum factor as well as the time factor. These references, then should suffice to prove that the deferred wage thesis has no scientific basis.

Sometimes, another argument with reference to deferred wages is advanced. This relates to the perquisites ("side benefits") which are allowed especially to higher ranks of managerial cadres. If the higher echelons of managers get fantastic allowances, why should the workers not claim them? When we look at the many perquisites which managers are allowed, both in the private and the public sector, there is substance in this claim. It is apparent that the Government has now awakened to the need of scrutinising



these perquisites as can be seen from the recent circular of the Company Law Board to the joint-stock companies to apprise the former of these additional payments.

## Privileged Class

The remaining basic issue, viz., the creation of a "privileged class of workers" can be easily examined. The organised sector of labour constitutes nearly 3 per cent of our working population. Those covered by the bonus payments will number much less than the total organised labour. Therefore, there cannot be any denying the fact that such bonus cannot fail to give rise to a privileged class. In fact, students of concentration of economic power in India have already noted that such a class already has come to exist (and to exercise influence) in our economy and that the bonus would only add to such concentration. We have already adverted to the earnings of a worker in our industries (and to the Dearness Allowance that he gets). It also frequently happens in industrial towns that a family of workers has more "earners" than one and so the family budget income is enlarged thereby as contra-distinguished from the conditions that prevail in the other, including rural, sectors of labour force. On the other hand, we have to bear in mind that 40 per cent of our population lives below the levels of subsistence and another 30 per cent or so just above that.

## Is there a Way Out?

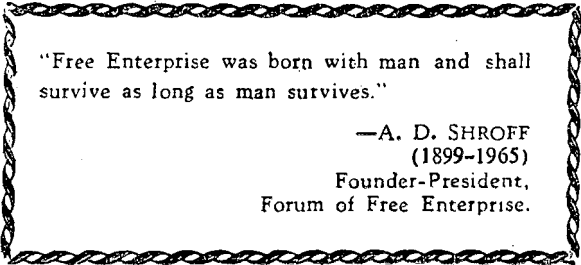
The bonus issue in India has not only been complicated by the strange manner in which the real concept has not been analysed and clarified, but also by the *ad hoc* payments that have been granted such as (i) 4 per cent minimum in any case and later (ii) 8.33 per cent, later withdrawn to 4 per cent again and (iii) further sought to be substituted by collective incentive or production bonus. There is no wonder then that the question of this payment has of late been generating so much heat that it will require no ordinary courage for any Government to declare that they propose

to make a rational analysis of the whole problem taking into account not only the justifiability of such payments but also the interests of the whole society of consumers and their share in the "profits" that must go to them as well.

The Government must declare that bonus is a form of profit sharing and the labour has to share the prosperity of industry. At the same time, the burden that the consumer is called upon to bear must be lightened and the real nature of profits properly clarified. It must be shown that in periods like the present, the allocable surplus arises also because of the higher prices that producers are able to charge for their products—that these profits are not merely the results of the "risk of enterprise". Perhaps in the initial years, until a wages policy and a price policy are worked out, the Government may seek to compensate those who may stand to lose by the removal of a statutory minimum by granting an increase in their wages for the interim period.

In this wage policy, it should be feasible to include a Wage-Incentive Scheme for each industry so that the objective of relating gains to performance could be worked out. But a word of caution may be uttered, viz., Profit Sharing Schemes in other parts of the world have not been uniformly successful.

*The views expressed in this booklet are not necessarily the views  
of the Forum of Free Enterprise.*



"Free Enterprise was born with man and shall  
survive as long as man survives."

—A. D. SHROFF  
(1899-1965)  
Founder-President,  
Forum of Free Enterprise.

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