

# Pathways to Jobs: A Review of India's Labour Reforms

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# PATHWAYS TO JOBS: A REVIEW OF INDIA'S LABOUR REFORMS\*

## NCAER Working Paper

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### Abstract

India faces a persistent challenge in generating formal sector, productive jobs for its growing workforce. The four new Labour Codes enacted in November 2025, seek to address the structural imbalance in our workforce by simplifying 29 pre-existing laws into a coherent framework to support job creation, formalisation and improve social protection of workers. In this paper, we unpack and examine each of the four Labour Codes within a unified framework, that includes discussion of the key legal provisions, the chronology of state-level implementation of the code and detailed exposition of potential impacts on employment and worker productivity. The main analytical inferences for each Code are derived from the existing theoretical and empirical research on labour reforms, with a specific focus on the experience of states within India. Based on the extensive review, the paper concludes by making specific policy recommendations on the effective implementation of the new labour codes.

**JEL codes:** J31, J32, J41, J52, K31

**Keywords:** Labor Reforms, Minimum Wage, Social Security, Industrial Relations, Occupational Safety, Employment, Labour Productivity, India

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**Table of Contents**

*Executive Summary*..... 1

Chapter 1: Overview ..... 4

Chapter 2: The Code on Wages ..... 10

Chapter 3: The Code on Social Security ..... 34

Chapter 4: The Industrial Relation Code..... 55

Chapter 5: The Occupational Safety, Health and Working Conditions Code..... 79

Chapter 6: Conclusion and Policy Implications..... 106

References ..... 109

## Executive Summary

India faces a persistent challenge in generating formal, productive jobs for its growing workforce, with only a small share employed in the formal wage sector. The four new Labour Codes seek to address the structural imbalance in our workforce by simplifying 29 existing laws into a more coherent framework that supports formal job creation while ensuring basic worker protections. The broader goal is to create a labour market that is both flexible for firms and secure for workers.

### Legislative Changes

The reforms, rolled out in November 2025, mark a shift from a fragmented legal system to a unified structure aimed at reducing regulatory complexity and improving compliance. By standardising definitions and procedures, the Codes seek to make it easier for firms to operate within the formal system while extending protections to a wider range of workers, including gig and platform workers.

The **Code on Wages (2019)** standardises the definition of ‘wages’ by capping exclusions at 50% of total remuneration, thereby preventing the artificial suppression of the base (pre-tax) wages. It also consolidates four laws and universalises minimum wage coverage beyond scheduled sectors, while introducing a statutory national floor wage anchored in a normative consumption criterion.

The **Code on Social Security (2020)** integrates nine statutes and, for the first time, formally recognises gig, platform, and unorganised workers within the statutory framework. It mandates benefit parity for fixed-term employees from the first day of employment and streamlines compliance through a single registration system and a unified electronic return mechanism.

The **Industrial Relations Code (2020)** unifies three laws governing employment protection and industrial disputes and raises the threshold for prior government approval for worker retrenchment and establishment closure, from 100 to 300 workers. It formally recognises fixed-term employment, enabling short-term hiring with wage and benefit parity with permanent workers. It also introduces the concept of a sole negotiating agent to reduce inter-union fragmentation and streamline labour dispute resolution through a unified Industrial Tribunal.

The **Occupational Safety, Health and Working Conditions Code (2020)** subsumes thirteen predecessor Acts and establishes new licensing thresholds towards worker coverage, such as twenty workers for factory establishments and fifty for contract worker employment. Further, it introduces mandatory annual health examinations for workers above forty, ensures portability of benefits for inter-state migrant workers, and provides a consent-based framework allowing women to work on night shifts.

### Implications for Employment and Productivity

The existing literature and research on labour regulations in India and elsewhere suggest that the impact of the labour reforms will likely be mixed, but with broadly positive implications, for employment generation and labour productivity in the country.

The Code on Wages is likely to raise earnings of eligible workers and may also increase the market real wage due to the setting of a national minimum. Broader minimum wage coverage across industries may curb employer incentives to undercut wages, thereby

reducing wage dispersion. The setting of a national minimum wage can also support employment generation by shifting some bargaining power towards workers. The Code may lead to improvements in labour productivity by linking wage determination to skill levels, creating incentives for skill upgrading, as well as better monitoring of worker productivity. However, these gains depend on the market structure, enforcement of the labour regulations, and the level of the minimum wage floor.

The Code on Social Security has the potential to support formalisation of the workforce and improve job quality by expanding coverage of employment benefits and enabling greater labour mobility. However, the associated compliance costs may weigh more heavily on smaller firms, such as MSMEs.

The Industrial Relations Code is likely to facilitate firm growth by allowing greater flexibility in workforce management and enabling productive enterprises to expand their permanent workforce without fear of regulatory entrapment. The formal recognition of fixed-term employment promotes more adaptable employment arrangements, potentially enhancing total factor productivity through improved matching of labour to firms. However, the potential employment gains are constrained by India's skewed firm size distribution - less than 12 percent of India's enterprises fall within the 50-99 worker band, which is most likely to respond with immediate expansion incentives due to the labour reforms.

The OSH&WC Code can also encourage workforce formalisation by reducing employer-borne compliance costs and enhancing worker productivity through improved workplace safety and working conditions. However, firms may respond strategically to regulatory thresholds by increasing reliance on contract labour, which could dilute some of the intended gains from the new Code.

Overall, the structure and enforcement of the eventual Central and State Government Draft Rules for implementation of the new Labour Codes will be critical in determining the impact of these reforms.

### **Policy Implications**

The policy implications of the new Labour Codes center on their effective implementation and complementary regulatory initiatives to ensure their intended benefits are realised fully.

- **Strengthening enforcement:** Strengthening enforcement is critical, particularly in the informal sector, through digital compliance systems, improved record-keeping, and targeted inspections to ensure that wage, social security, and safety provisions are meaningfully enforced.
- **Calibration of the national floor wage:** The national floor wage must be calibrated to avoid being set either too high or too low. An excessively high floor may reduce employment for low-productivity workers, while a low floor may fail to protect workers. Periodic revisions should account for regional cost differences while remaining sustainable for employers.
- **Revising statutory wage ceilings for social security benefits:** The adequacy of India's social security schemes is constrained by statutory ceilings, that determine benefits, but have not kept pace with earnings growth. The EPF mandatory contribution ceiling is unchanged since 2014, while under the ESIC, workers earning above Rs. 21,000 per month are excluded from mandatory coverage

altogether. Both ceilings require urgent upward revision to ensure social protection commensurate with workers' actual earnings, and that effective coverage does not shrink in real terms.

- **Supporting MSMEs:** Supporting small and medium enterprises through regulatory compliance incentives, simplified procedures, and access to finance can ease the transition to formalisation of the workforce and prevent disproportionate cost burden on small enterprises.
- **Complementary reforms for job creation:** Labour reforms must be complemented by investments in worker skills, broader industrial and trade policies, and stronger institutional coordination across states, alongside leveraging digital systems to improve transparency, and delivery of the labour reforms.
- **Enhancing capacity of the states:** While the new Labour Codes seek to improve uniformity in labour regulations across the country, their effectiveness will eventually depend on the extent to which implementation rules accommodate state-level heterogeneity in labour market conditions, cost of living, institutional capacity, and firm size distribution. Strengthening the capacity of state governments will be critical to avoid uneven implementation of the new codes.

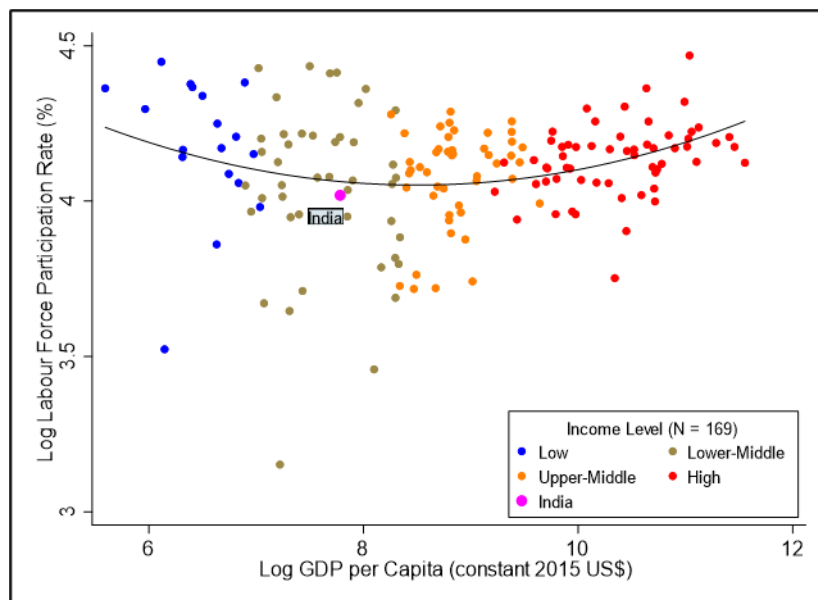
## Chapter 1: Overview

### 1.1 India's employment and labour productivity challenges within a global perspective

India's economic ascent over the past three and a half decades has been striking by any measure. The last decade in particular has seen its economic fortunes rely on the back of a labour force on the cusp of a rare demographic transition. The post-pandemic period further witnessed resilient growth in the face of geopolitical uncertainty and turbulence, with projections of reaching a GDP of \$7.3 trillion by 2030.<sup>1</sup> Much of it relies on the progression of formal employment creation, at a pace commensurate with its expanding working-age population.

The headline numbers also carry a persistent and increasingly urgent tension. Unlike the textbook development pathway from agriculture through labour-intensive manufacturing into services, India has leapfrogged from the industrial middle into tertiarization. The conversion of surplus agricultural labour into stable, semi-skilled formal employment was partially lost in the East Asian race. As a result, only one out of four find work in the formal wage economy, while the remainder are absorbed into informal services, self-employment or low-productivity agriculture (PLFS Annual Report, 2025). Correspondingly, India's labour force participation rate sits below the trend line for economies at comparable economic levels (**Figure 1.1**). This reflects a structural failure to productively engage a young population that is growing rapidly and will continue to do so until the 2040s (NCAER Report, 2025).

**Figure 1.1: Labour Force Participation Rates (LFPR) by Per Capita Income (2024)**



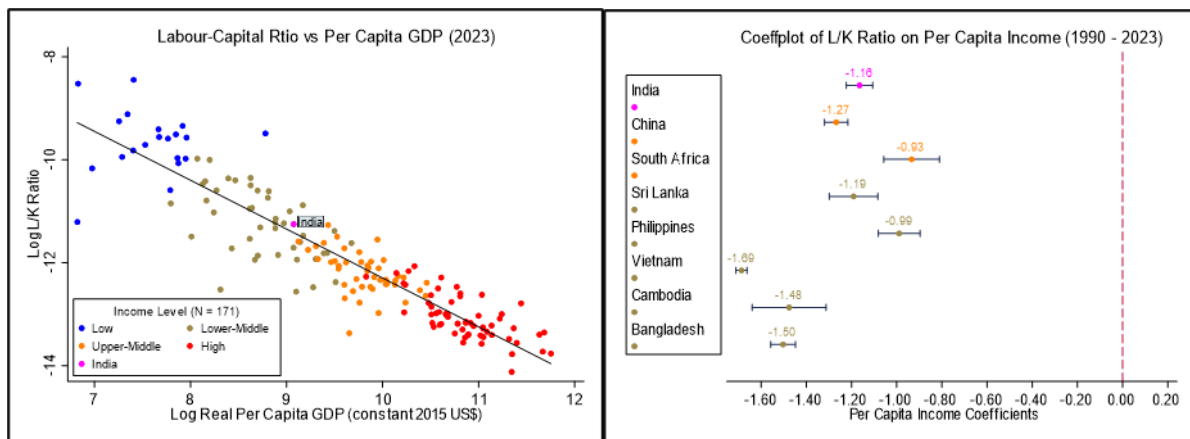
**Source:** World Bank database (2025); Authors' calculations.

**Note:** i. The Per Capita GDP series is measured at constant 2015 USD prices; ii. LFPR is for ages 15+; iii. Per Capita GDP classifications follow the World Bank's FY2025 income group thresholds; iii. Sample consists of 169 countries.

<sup>1</sup> India's GDP Surge: Driving the Growth Story ([PIB](#))

As **Figure 1.2 (left)** illustrates below, a hallmark of global economic growth is the fall in the labour-capital ratio. For a labour abundant country, the policy concern for India is not that it is above the average, but that the capital-intensive transition has already begun, and without persistent labour market reforms, it risks bypassing the stage of labour absorption that shifts workers from informal to formal spheres of employment, a trend often observed in South Asian economies (Ohnsorge and Yu, 2022).

**Figure 1.2: Labour Intensity of Production by Per Capita Income (1990-2023) by country**



**Source:** Penn World Table 11.0 (2023), Groningen Growth and Development Centre; World Bank database (2025); Authors' calculations.

**Note:** i. L/K Ratio is the number of persons engaged (in millions) divided by capital stock measured at constant 2021 USD prices (in millions); ii. The Per Capita GDP series is measured at constant 2015 USD prices; iii. The colour scheme distinguishes the World Bank Income Groups (FY2025 thresholds) with the countries arranged in decreasing order of Per Capita GDP after India (right figure); iv. Sample (left figure) consists of 171 countries; v. 95% confidence interval bands.

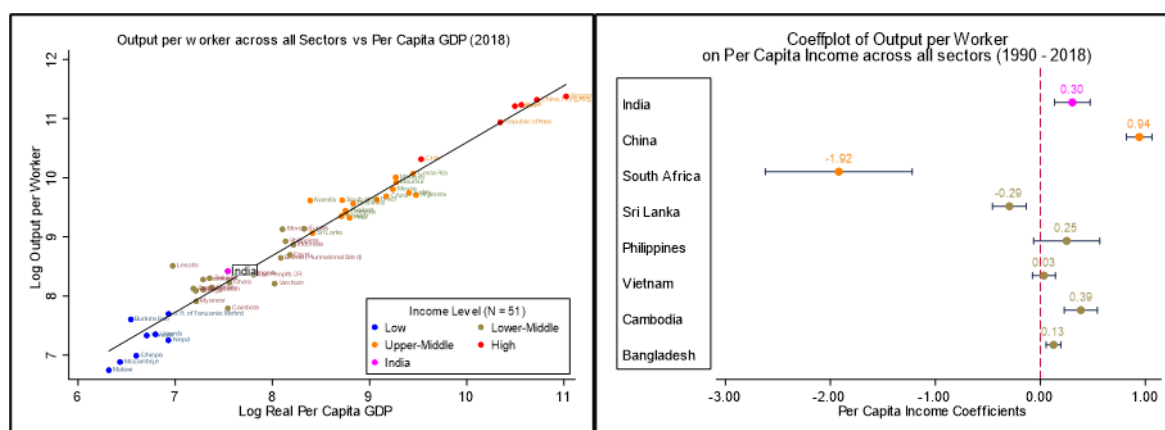
Further, the rate at which India's L/K ratio is declining as income grows (1.16 per cent) is quite sharp in a comparable peer group of economies at similar stages of economic development (**Figure 1.2, right**). The Penn World Table data (v11.0, 2023) also tells us India's capital stock expanded by over seven times between 1990 and 2023, while employment roughly doubled in size. Capital is substituting for labour at a dramatic pace, even in sectors where India's comparative advantage should favour the opposite, thereby decoupling the country's factor endowments.

This substitution dynamic can accelerate, minus major labour-absorbing market reforms. Concerns on the impact of AI adoption on entry-level positions also abound, potentially exacerbating the rate of informalisation at both firm and economy-wide levels (Brynjolfsson, Chandar and Chen, 2025). The corresponding cascading effects on youth, women and vulnerable populations in India continue to disproportionately distort their labour market aspirations as well. Despite this outlook, aggregate demand and social protection systems continue to remain the directives for good job creation strategies, long-term business sustainability and productivity-enhancing transformations (ILO, 2025).

## 1.2 Productivity, Labour Market Constraints and the Formalisation Gap

The productivity dimension reinforces our market imbalance. India's output per worker is slightly above global labour productivity levels, but still has a significant bridge to cross to reach the per capita GDP of high-income countries, even by 2047 (**Figure 1.3 (left)**; NCAER Report, 2025). Cross-country regressions further indicate India's weak relationship between productivity growth and income expansion, reflecting a dual nature of narrow concentration in capital- and skill-intensive sectors, and a larger share of the workforce engaged in low-productivity activities (**Figure 1.3 (right)**; NCAER Report, 2025).

**Figure 1.3: Labour productivity and Per Capita Income (1990 – 2018)**

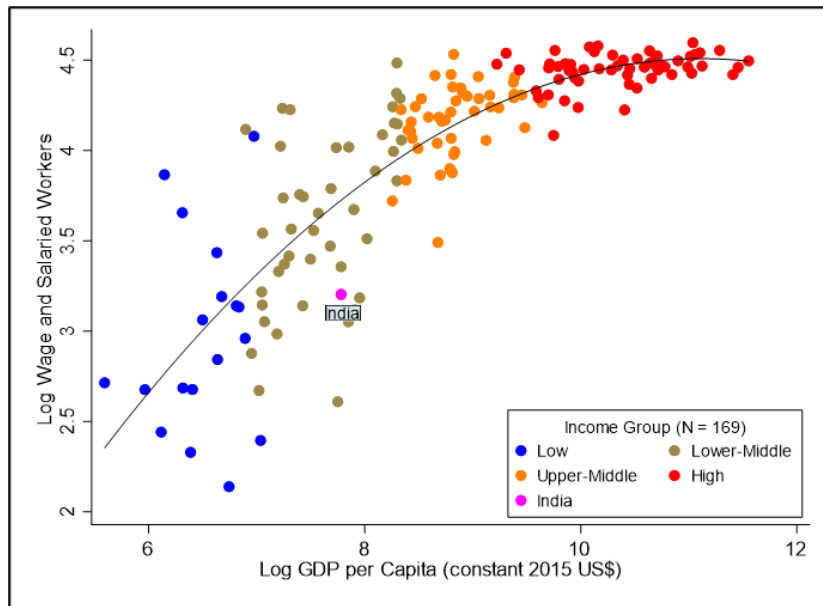


**Source:** Economic Transformation Database (ETD; 1990-2018), Groningen Growth and Development Centre; World Bank database (2025); Authors' calculations.

**Note:** i. Output per worker is Gross Value Added (measured in constant 2015 USD) divided by persons employed; ii. Per Capita GDP is in constant 2015 USD; iii. Income classifications follow the World Bank's 2017-18 thresholds; iv. The colour scheme distinguishes the World Bank Income Groups with the countries arranged in decreasing order of Per Capita GDP (2018) after India; v. Coefficients (right figure) are plotted with 95% confidence interval bands; vi. Sample (left figure) consists of 51 non-OECD countries, as available in the ETD.

The cross-country evidence establishes our benchmark for evaluating India's current labour market performance. Employment growth in the post-pandemic period has picked up in absolute terms, but continues with disproportionate concentration in agriculture and self-employment, and limited expansion in salaried work (PLFS Annual Report, 2025). **Figure 1.4** places India's share of wage and salaried workers below the international average, pointing to a labour market that is absorbing workers, but without commensurate growth in productivity and formalisation.

**Figure 1.4: Proportion of Wage & Salaried Workers by Per Capita Income (2024)**

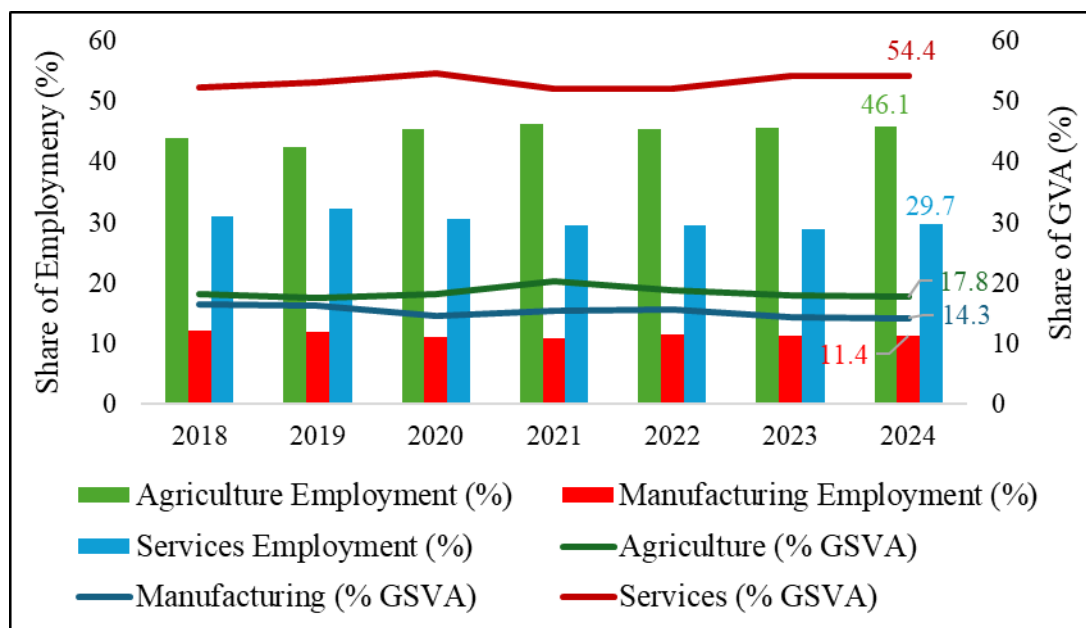


**Source:** World Bank database (2025); Authors’ calculations.

**Note:** i. Proportion of wage & salaried workers as percentage of total employment; ii. Income classifications follow the World Bank’s FY2025 thresholds; iii. Sample consists of 169 countries.

This structural imbalance gets reflected in India’s anomalously higher share of self-employment relative to its per capita income (PLFS; NCAER Report 2025). This formalisation deficit remains the central labour market challenge as a large and increasingly educated work force is unable to access stable contract-based work at scale, even as overall employment rates improve.

**Figure 1.5: Sectoral shares in total Gross Value Added (GVA) and Employment in India**



**Source:** MoSPI, PLFS 2017-18 to 2023-24; Authors’ calculations.

**Note:** Gross Value Added (GVA) is in 2011-12 constant prices.

As seen in **Figure 1.5**, India's agriculture sector continues to house the lion's share of employment (~45 per cent), despite contributing less than 20 percent to total GVA. The expected transition of surplus agricultural labour into formal wage employment remains incomplete. Labour market adjustment is taking place through informalisation, with workers entering the labour force in low-productivity and precarious forms of employment (State of Working India Report, 2026).

This sectoral employment-to-output gap is not cyclical. As India approaches the peak of its demographic dividend, 263 million out of 367 million young people remain 'NEET' (UN DESA, 2024).<sup>2</sup> The effect of bypassing the historical route out of agriculture into services, mediated by the absorption of low-skilled rural labour by manufacturing, is now reflecting in India's below-par formal sector growth capacity.

### 1.3 The New Labour Codes: Rationale and Scope

A consistent prescription from the above diagnosis has been the bottlenecks around formal sector hiring in India's labour markets, compounding the entry barriers to formalisation. Even within, employment elasticities show signs of recovery, but the dominant adjustment mechanism attempts to circumvent statutory obligations, rather than resolve them. This necessitates loosening labour regulations to allow more flexible hiring practices, while simultaneously stimulating domestic demand to incentivize the private sector in capacity expansion investments (NCAER Report, 2025). It is within this context of a formalisation deficit that we evaluate the potential of India's four new Labour Codes.

Our central labour law framework has accumulated over seven decades into a complex judge-ruled network of 29 Acts defining wage statutes, industrial relations, social security and occupational safety. These four broad thematic areas were recommended as guiding constraints by the Second National Commission on Labour (2002). Following years of extended state-level rule-enactments, the Government of India passed all four Labour codes between 2019 and 2020, notifying them into force on 21 November, 2025.

The four Codes consolidate corresponding predecessor Acts into their distinct regulatory domains. The Code on Wages, 2019 unifies the wage floor, bonuses and remuneration into a national framework. The Industrial Relations Code, 2020 takes trade unions, dispute resolutions, fixed-term employment and raises retrenchment thresholds. The Code on Social Security, 2020 integrates nine Acts covering provident funds, insurance gratuity and maternity benefits. The Occupational Safety, Health and Working Conditions Code, 2020 subsumes workplace safety, health, inspection and compliance into a unified architecture while raising firm size thresholds and introducing new guardrails for women, inter-state migrants and contract workers. Together, they mark the most consequential reorganisation of India's central labour laws since independence, reducing administrative loopholes for employers, extending protection for previously uncovered categories and fostering a new regulatory environment to enable formalisation at scale.

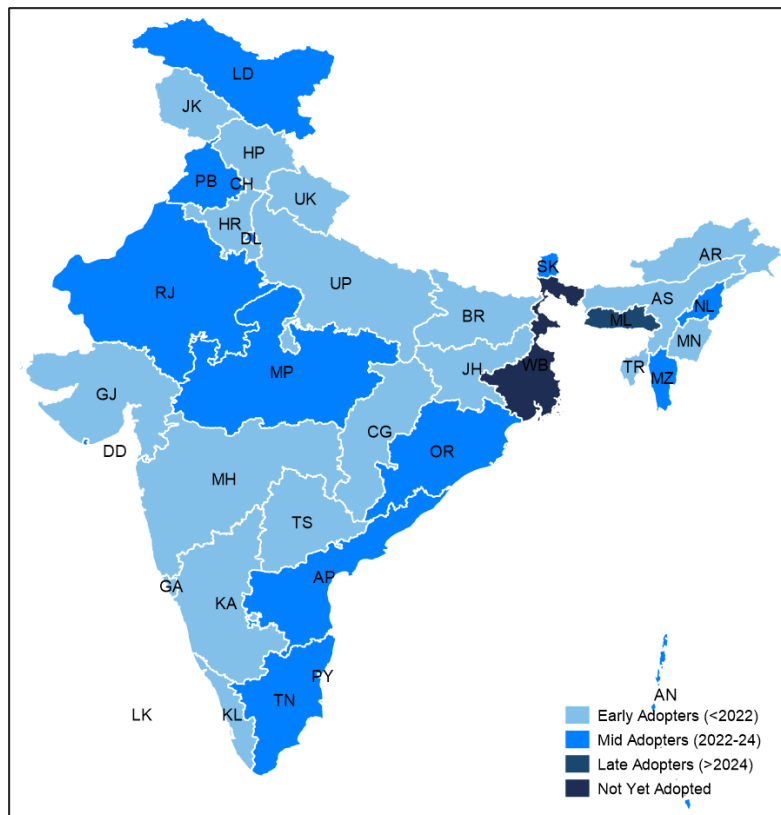
**Figure 1.6** below depicts the corresponding state-level implementation of the four Codes, as of March 2026. While the Codes have been enacted at the Central level, their actual implementation hinges on the notification of rules by individual States and Union Territories. Some States have published draft rules; others have finalized and notified

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<sup>2</sup> Not in Education, Employment or Training (NEET).

them, while a few are still in progress. Arunachal Pradesh and Gujarat are among two states to have taken the next steps of notifying and effecting their rules after November 2025.

**Figure 1.6: Average adoption period of the new Labour Codes for each state**



**Source:** Authors' compilation based on state government gazette notifications on Labour Rules issued by state labour departments (2020–2025).

**Note:** i. The map shows the average year by which states and union territories notified their draft or final subordinate rules under each of the four Labour Codes. Where both draft and final rules were notified, the year of first notification is used; ii. A simple average across the four Codes is used to construct the state-level composite adoption index displayed on the map; iii. West Bengal is yet to notify subordinate rules under any of the four Labour Codes; Tamil Nadu is yet to notify rules under the Industrial Relations Code; and Lakshadweep is yet to notify rules under the Code on Wages.

The remainder of this paper is organised into Chapters 2 to 5 that sequentially unpack and examine each of the four Labour Codes within a unified framework. This consists of a brief introduction to the Labour Code with its chronology and state-level implementation. The main analytical inferences for each Code are derived from a detailed breakdown of the corresponding theoretical and empirical literature, specifically focusing on expected employment and labour productivity impacts, both on the intensive and extensive margin. The literature is divided by their geographic origins, and subsections to provide critical commentary on each Labour Code, examining the bounds of their implications, with policy prescriptions. Chapter 6 concludes the synthesis with cross-cutting policy implications. A comparative study of the definitions and key changes for each Code, relative to the previous repealed labour laws, are summarised in the [Online Appendix](#).

## Chapter 2: The Code on Wages

### 2.1 Introduction: Consolidation of Wage Laws into a Single Code

The Code on Wages, 2019 forms part of the broader legislative reform process through which multiple central labour laws were consolidated into four labour codes. Prior to this reform, wage regulation in India was governed by four separate statutes: the Payment of Wages Act, 1936; the Minimum Wages Act, 1948; the Payment of Bonus Act, 1965; and the Equal Remuneration Act, 1976. Each of these laws operated independently, with distinct definitions, coverage thresholds, enforcement mechanisms, and procedural rules (Government of India, 2019a).

The pre-reform wage regulation framework was characterised by three key limitations.

First, there were significant limitations in coverage, with large segments of the workforce remaining outside the scope of wage regulation. For instance, minimum wage laws applied only to “scheduled employments,” excluding many workers from statutory protection.

Second, weak enforcement and limited compliance reduced the effective implementation of wage regulations, particularly in the informal sector (International Labour Organization, 2016). For example, even where minimum wages were notified, compliance remained low in many sectors, limiting their impact in practice.

Third, there was substantial variation in wage-related provisions across states and sectors, resulting in uneven labour market outcomes (Rani and Belser, 2012). For instance, minimum wage levels varied widely across states and occupations, affecting their binding nature and aggregate impact.

These challenges can be understood through the framework developed by the International Labour Organization (ILO), which conceptualises wage regulation systems along three key dimensions: coverage, compliance, and level (ILO, 2016). Coverage refers to the extent of legal protection, compliance reflects enforcement in practice, and level captures how wage standards compare to prevailing wages and productivity. The interaction of these dimensions shape employment and productivity outcomes.

In this context, the Code on Wages, 2019 represents a major structural reform addressing gaps in coverage, compliance, and wage-setting. It introduces three key improvements.

First, it expands coverage by extending statutory wage protection across all employments (Government of India, 2019). This is estimated to benefit approximately 22.47 crore wage earners, including a net increase of 7.64 crore workers who were previously excluded (Satpathy et al., 2021).

Second, it strengthens compliance through simplified legislation, technology-enabled inspections, and stricter enforcement mechanisms, addressing weak enforcement and low compliance.

Third, it improves consistency in wage-setting by defining clear rules for wage determination and introducing a national floor wage, addressing wide variation in wage levels.

By intervening across these dimensions, the Code addresses key limitations in the earlier framework and is likely to shape employment and productivity outcomes.

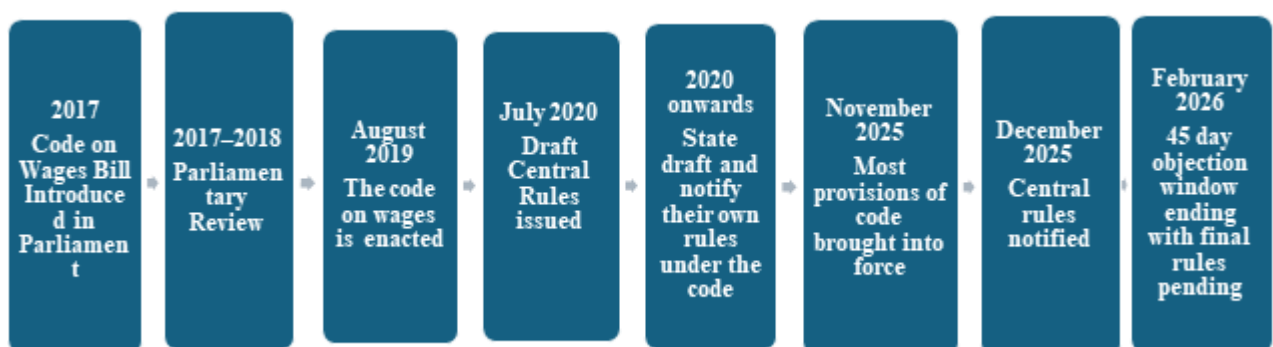
## 2.2 Chronology of the reform process:

### 2.2.1 Legislative timeline

The process of consolidating labour laws into comprehensive labour codes began in the mid-2010s as part of a broader policy initiative aimed at simplifying labour regulation (Bhattacharjea, 2021). The Code on Wages Bill was first introduced in Parliament in 2017 and subsequently referred to a Parliamentary Standing Committee for detailed examination and stakeholder consultation. Following revisions based on the committee's recommendations, the revised Bill was introduced again in Parliament in 2019 and was passed later that year. The Code received Presidential assent in August 2019, formally establishing the new legislative framework for wage regulation and replacing four earlier statutes: the Payment of Wages Act, 1936; the Minimum Wages Act, 1948; the Payment of Bonus Act, 1965; and the Equal Remuneration Act, 1976 (Ministry of Labour and Employment, 1936, 1948, 1965, 1976, 2019a).

However, the provisions of the Code required the formulation of detailed subordinate legislation before they could be operationalised. Accordingly, between December 2020 and March 2021, the central government notified provisions relating to the Central Advisory Board and issued draft rules outlining procedures for wage determination, payment mechanisms, and administrative enforcement (Ministry of Labour and Employment, 2020). Over time, additional notifications brought different provisions of the Code into force, with most operational provisions announced in November 2025. This was followed by the notification of the central rules in December 2025, which provided the procedural framework required for implementation. A consultation period was subsequently opened to allow stakeholders to submit objections and suggestions, with a 45-day window extending into February 2026. The finalisation of rules following this consultation process is expected to complete the regulatory framework required for the full operationalisation of the Code on Wages.

**Figure 2.1: Chronology of the Legislative Reform Process for the Code on Wages**



**Source:** Authors' compilation based on Ministry of Labour and Employment (2019a, 2020).

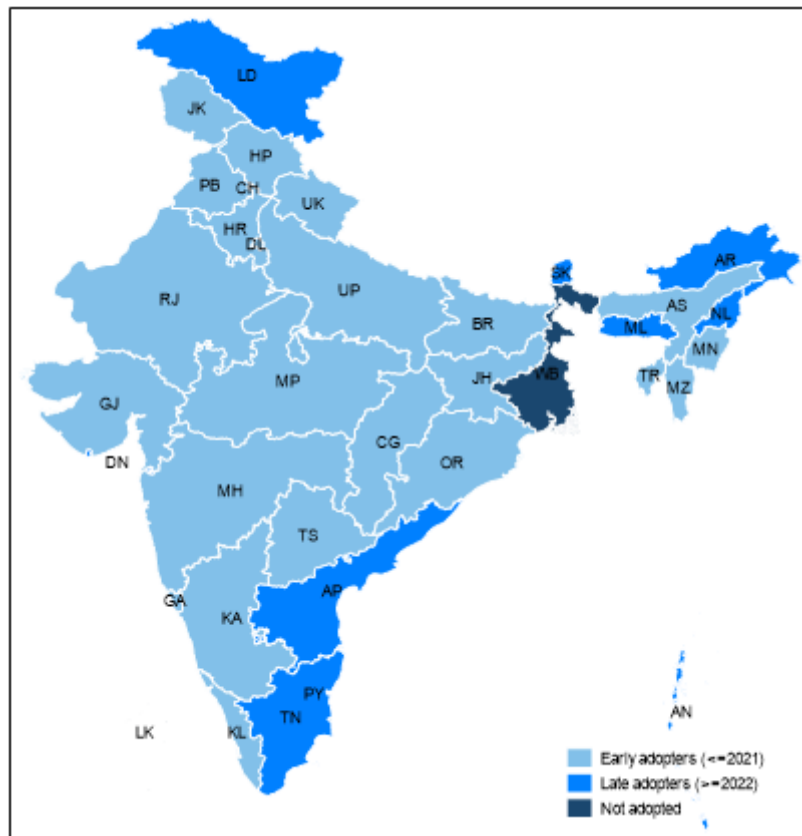
### 2.2.2 State level Developments

Since labour falls under the Concurrent List of the Constitution, the operationalisation of the Code also required the formulation of rules by state governments. Following the release of the draft central rules in 2020, states began issuing their own draft or final rules to align with the provisions of the Code. As a result, the implementation of the Code unfolded gradually across states, with variation in the timing of rule notifications

reflecting differences in administrative processes, consultation mechanisms, and policy priorities.

**Figure 2.2** illustrates the timing of state-level rule notifications across India. The map highlights the year in which states issued draft or final rules under the Code on Wages.

**Figure 2.2: State-wise Timing of Adoption of Rules under the Code on Wages**



**Source:** Authors' compilation based on state government gazette notifications on the *Code on Wages Rules* issued by state labour departments (2020–2025).

**Notes:** The map shows the year in which states and union territories issued draft or final rules under the Code on Wages, 2019. Where both draft and final rules were notified, the year of the first notification is reported. As of April 2026, final rules have been notified only by select states (e.g., Arunachal Pradesh and Gujarat), while most states have issued draft rules.

The figure shows that a large number of states issued draft or final rules relatively early, particularly during 2020–2021 following the enactment of the Code and the release of draft central rules. A smaller group of states adopted the framework later, including Andhra Pradesh, Arunachal Pradesh, Sikkim, Tamil Nadu, and Ladakh in 2022, while Meghalaya and Nagaland notified rules in 2024 and 2025 respectively. A few jurisdictions, including West Bengal, Lakshadweep, have still not issued rules. The complete state-wise timeline of rule notifications is provided in the [Online Appendix](#). Although many states have notified rules under the Code on Wages, the extent to which key provisions of the Code are explicitly incorporated varies across States. The [online appendix](#) presents a comparison of the adoption of a key minimum wage provisions across states and union territories.

## 2.3. Key changes introduced in the Code on Wages, 2019

Building on the consolidation of wage laws discussed earlier, the Code on Wages, 2019 introduces structural changes in definitions, wage determination, payment systems, and enforcement mechanisms. The detailed table on changes in each of these aspects is presented in the [online appendix](#).

**1. Harmonisation of definitions:** These replace the varying definitions under earlier laws.

a) **Wages:** The Code introduces uniform definitions across wage provisions. It defines wages to include basic pay, dearness allowance, and retaining allowance, with exclusions (such as HRA, bonus, commission, overtime, etc.) subject to a 50% cap and in-kind payments capped at 15%. Earlier laws, such as the Payment of Wages Act, 1936 and Minimum Wages Act, 1948, used differing definitions of wages and did not impose a uniform cap on exclusions, leading to inconsistencies in wage calculations and compliance.

b) **Employer:** It adopts a consolidated definition of employer covering persons with ultimate control over the establishment, including occupiers, managers, contractors employing workers, and legal representatives. Earlier, some laws (the Payment of Wages Act, 1936,) treated the wage-paying authority as the employer, while others focused on the entity with ultimate control leading to ambiguity in contract labour arrangements.

c) **Employee:** The definition of employee is expanded to cover all categories of work, including skilled, unskilled, manual, supervisory, managerial, administrative, technical, and clerical roles, irrespective of whether the terms of employment are express or implied. Earlier laws used narrower and fragmented definitions, such as limiting coverage to “scheduled employments” under the Minimum Wages Act or applying wage thresholds under other laws, leading to gaps in coverage.

d) **Worker:** The Code also introduces “worker” as a distinct category, defined to include persons engaged in manual, skilled, unskilled, technical, operational, clerical, or supervisory work, while excluding managerial and administrative roles and higher-earning supervisors.

**2. Universal coverage of minimum wages:** Minimum wage provisions are extended to all employments, replacing the earlier system limited to scheduled employments notified by governments.

**3. Statutory national floor wage:** The Code provides for a statutory floor wage to be fixed by the Central Government, which may vary across geographical areas. The floor wage is determined after consultation with the Central Advisory Board, which considers minimum living standards of a standard working-class family, including food, clothing, housing, and other essential needs. States are required to fix minimum wages at or above the floor wage, and existing wages above the floor cannot be reduced. This replaces the earlier non-statutory floor wage, which functioned only as an advisory benchmark.

**4. Structured criteria for minimum wage fixation:**

a) **Consumption based criteria:** While the components of minimum wage, basic wages, variable dearness allowance (VDA), and cash value of concessional supplies (or an all-inclusive rate), remain the same as Minimum Wages (Central) Rules 1950, the Code on Wages (Central) 2025 Rules codify explicit consumption norms. These include a standard working-class family of three consumption units, 2700 calories per unit per day, 66

metres of cloth per year, housing rent at 10% of food and clothing expenditure, fuel and miscellaneous expenditure at 20% of the minimum wage, and 25% for education, medical needs, recreation, and contingencies.

b) Differentiation: Unlike the Minimum Wages (Central) Rules 1950, under the new Code, minimum wages are to be differentiated by skill category (unskilled, semi-skilled, skilled, highly skilled), geographical area, and nature of work, with a technical committee institutionalised for classification and occupational mapping.

c) Revisions: The Code mandates revision within five years and biannual CPI-IW-linked VDA updates (before 1 April and 1 October).

d) Wage fixation and conversion: It also standardises wage fixation across time and piece-rate work, ensuring that piece-rate workers receive wages equivalent to minimum time rates. It also specifies uniform conversion factors (hourly = daily ÷ 8; monthly = daily × 26), ensuring consistency across states.

### **5. Working Hours and Overtime:**

a) Working Hours: The determination of normal working hours and spread-over is left to the appropriate government through general or special orders, replacing the earlier fixed 9-hour norm under Payment of Wages Rules, 1937.

b) Overtime: Overtime is payable at not less than twice the normal wage rate across all sectors, with no distinction between agricultural and non-agricultural work and no cross-reference to other laws.

c) Weekly Rest: The Code mandates one rest day per week as before but also introduces a cap of ten consecutive working days without rest.

d) Wage Protection: Provisions are retained for full-day wages unless the employee is unwilling to work, proportionate payment for mixed work, and safeguards for piece-rate workers.

e) Night Shifts: The treatment of night shifts is retained, with rest periods calculated from shift end and post-midnight hours counted as part of the previous day.

### **6. Wage Payment Provisions:**

a) Mode of payment: The Code on Wages, 2019 formalises and strengthens digitisation of wage payments (including enabling mandatory bank/e-payments) and, unlike the Payment of Wages Act, 1936, makes issuance of wage slips (including electronic) a clear statutory obligation.

b) Wage period and timelines: The Code on Wages, 2019 replaces establishment-size-based and limited coverage provisions under the Payment of Wages Act, 1936 with a uniform, universally applicable, and clearly period-linked payment framework. Wage periods may be daily, weekly, fortnightly, or monthly (not exceeding one month), with payments due by the end of the shift (daily), last working day (weekly), within 2 days (fortnightly), or within 7 days of the succeeding month (monthly); final wages must be paid within two working days. Unlike the earlier Act, where the two-day rule applied mainly to dismissal or removal, the Code requires final wages to be paid within two working days for all separations, including resignation, retrenchment, and closure.

c) Deductions: The Code consolidates permissible deductions (such as fines, absence, damage or loss, advances, statutory dues, and authorised contributions) and introduces a uniform ceiling of 50% of wages per wage period, removing the earlier 75% exception

under the Payment of Wages Act, 1936. It also tightens safeguards by capping deductions for absence to actual time not worked, limiting damage-related deductions to actual loss with due process, aligning recovery of advances with the 50% cap, retaining strict procedural safeguards for fines (including prior notice, hearing, 3% cap, and welfare use), and shifting the burden of proof to the employer in disputes.

#### **7. Bonus Provisions:**

a) Coverage and eligibility: The Code on Wages, 2019 retains applicability to establishments with 20 or more workers and the 30-day minimum service condition but replaces the earlier fixed wage threshold (Rs. 21,000/month) under the Payment of Bonus Rules, 1975 with a flexible, government-notified wage ceiling.

b) Quantum and computation: The Code largely retains the minimum (8.33%) and maximum (20%) bonus limits and the framework of allocable surplus and set-on/set-off, but clarifies that bonus for higher-wage employees is to be calculated on the notified ceiling or minimum wage, whichever is higher.

c) Payment: While the 8-month payment timeline is retained, the Code introduces a new requirement of mandatory bank credit, replacing the earlier cash-based approach under the Payment of Bonus Act, 1965.

**8. Equal remuneration:** The code retains the principle of equal remuneration but expands and modernises it compared to the Equal Remuneration Rules, 1976 by (i) shifting to gender-neutral protection (covering all genders, including transgender persons), (ii) broadening the definition of “same or similar work” to include experience alongside skill, effort, and responsibility.

#### **9. Institutional and enforcement framework:**

a) Advisory mechanism: The Code establishes a single Central Advisory Board with representation from employers, employees, and independent members, replacing multiple advisory bodies under different laws.

b) Claims and adjudication: The Code replaces fragmented, Act-specific authorities with a unified authority appointed by the appropriate government (not below the rank of Gazetted Officer) to adjudicate all wage-related claims, supported by a common procedure and appellate mechanism, while expanding access through joint claims and extending the limitation period to 3 years.

c) Recovery and enforcement: The Code strengthens enforcement by introducing a uniform process for recovering unpaid wages and related dues as arrears of land revenue replacing fragmented and weaker mechanisms and by granting civil court-like powers to designated authorities.

d) Inspection and compliance: The traditional inspector-based system is replaced with an Inspector-cum-Facilitator model, combining enforcement with advisory functions. The Code also introduces web-based inspections, electronic information systems, and randomised inspections, moving towards a technology-enabled compliance framework.

e) Penalties and compounding: The Code replaces fragmented and inconsistent penalty provisions across multiple laws with a unified, graded structure and introduces compounding of offences, reducing reliance on prosecution for minor violations.

## 2.4 Key implications of the Code on Wages, 2019

### 2.4.1 Structural improvements:

These structural changes have implications for workers, employers, and the enforcement framework, with some provisions strengthening worker protection while others primarily improve compliance and administrative efficiency.

1. **Standardisation and expansion of wage base:** The introduction of a 50% cap on excluded components limits excessive wage structuring through allowances (such as HRA, bonus, commission, overtime, etc.) and expands the base for statutory calculations, including social security contributions. The cap on in-kind remuneration at 15% further standardises the composition of wages.
2. **Clearer accountability of employer in wage payments:** The consolidated definition of employer clarifies responsibility for wage payment across employment arrangements, including contract labour. By explicitly recognising contractors and persons with ultimate control over the establishment within the definition, the Code reduces ambiguity regarding liability for wage payments.
3. **Expanded and more balanced minimum wage coverage:** Minimum wage protection extension to workers beyond scheduled employments, increases its coverage among low-paid workers. At the same time, the introduction of a wage floor provides a common benchmark, which can reduce variation in minimum wages across states, particularly at the lower end.
4. **Increased formalisation and documentation of wage employment:** Bank transfers, digital payments, and wage slips create clear records of wages. This improves transparency, helps workers access formal financial and social security systems, and makes it easier to verify payments and raise claims if needed.
5. **Greater clarity in wage provisions supporting compliance:** Clearer rules on wage periods, payment timelines, permissible deductions, and overtime rates lowers compliance complexity for employers, while also making it easier for workers to understand and verify their entitlements.
6. **Integrated enforcement framework:** The Code simplifies compliance and enforcement by merging four wage laws, standardising definitions and reducing rules and forms. It introduces the Inspector-cum-Facilitator model, enables web-based and risk-based inspections, and shifts compliance to digital systems (electronic records, single return, fewer registers). It also standardises adjudication and grievance redress through a unified authority, common procedures, and an appellate mechanism, supported by extended timelines and provisions for joint claims, thereby reducing fragmentation and administrative burden.

### 2.4.2 Potential areas of concern

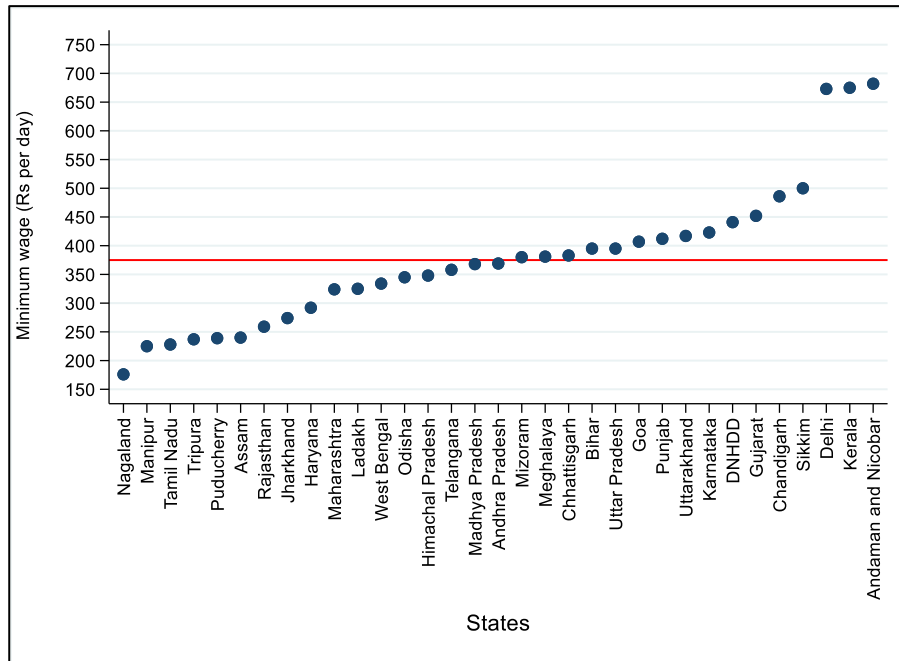
Despite these improvements, several provisions of the Code raise concerns regarding worker protection and the effective enforcement of wage regulations, particularly for vulnerable workers.

1. **Wage definition and take-home pay:** The Code caps exclusions from wages at 50 per cent of total remuneration, requiring any excess to be added back to wages. While this broadens the wage base for calculating social security contributions, it

may reduce take-home pay as a larger share of remuneration becomes subject to statutory deductions. This effect may be more pronounced for lower-wage workers.

2. **Reclassification and Loss of Worker Protections:** Employees redesignated into supervisory roles and paid above Rs. 15,000 may move out of the “worker” category, affecting eligibility for protections such as overtime and working hours regulation that are tied to worker status.
3. **Coverage and enforcement gaps for informal workers:** Although the Code defines “employee” broadly, its applicability remains linked to persons employed by an establishment, which may limit its coverage of large segments of the informal and emerging workforce. Gig workers, platform workers, home-based workers, and other non-traditional forms of labour are not clearly covered within the definitions of “employee” or “worker.” In addition, the absence of formal employment records for many informal workers makes it difficult to establish an employment relationship in practice, limiting their ability to claim wage entitlements.
4. **Gaps in criteria and classification in wage setting:** Minimum wage determination relies mainly on consumption norms and does not explicitly include factors such as productivity or employment conditions. Although these considerations may be indirectly reflected through differentiation by skill level, occupation, or sector, their absence as explicit criteria may limit the economic responsiveness of the wage-setting framework. In addition, the use of both detailed classification systems (NSQF/NCO) and broad skill categories means that the same job may be classified differently, leading to variation in minimum wages for similar work.
5. **Ambiguity in designing national floor wage:** While broad considerations such as minimum living standards are indicated, the methodology for determining the floor wage is not clearly specified. The impact of the floor wage depends on the level at which it is set: if it is below prevailing wages in many states, it may not be binding and may have limited effect; if it is set too high, it may lead to job losses. A comparison of state minimum wages in 2023 with the Rs. 375 per day benchmark recommended by the Expert Committee (Government of India, 2019b) shows that several states, including Delhi, Kerala, Karnataka, and Sikkim, already have higher wage levels. A floor set near this benchmark is therefore unlikely to be binding in these states.

**Figure 2.3: State Minimum Wages for Unskilled Workers Compared with the National Minimum Wage Benchmark (₹375 per day)**



**Sources:** World Bank (2025); Expert Committee Report (Government of India, 2019b). Authors' compilation.

**Notes:** Minimum wage figures refer to statutory minimum wages for unskilled workers based on state government notifications compiled in the World Bank database and reflect wage levels prevailing largely in 2023 (with some revisions effective in 2024). The benchmark national minimum wage of ₹375 per day is based on the recommendation of the Expert Committee on Determining the Methodology for Fixation of the National Minimum Wage (2019).

- Centralised enforcement with potential access constraints:** The Code streamlines key aspects rule-making, registration, inspection, adjudication, and grievance redress, within a unified administrative framework, while restricting direct recourse to civil courts. While this may reduce fragmentation, outcomes depend on institutional capacity and accessibility. Concentration of authority may limit workers' ability to seek redress and ensure compliance, especially for those in informal or vulnerable employment.

### 2.4.3 Cost implications

The primary economic effect of the Code on Wages operates through its impact on labour costs, i.e. the cost incurred by firms in employing worker and compliance cost, i.e. the administrative burden of meeting regulatory requirements. Provisions such as expanded coverage, a broader wage base, and stronger enforcement are likely to raise labour costs. At the same time, the Code includes measures that may reduce compliance costs through uniform definitions, unified provisions, consolidation of authorities, and digitalisation.

Overall, the Code introduces both cost-increasing and cost-reducing elements, as summarised below.

**Table 2.1: Channels affecting labour and compliance costs under the Code on Wages**

<b>Cost Increasing Factors</b>	<b>Cost Reducing Factors</b>
Expanded coverage	Uniform definitions
Higher wage base	Consolidation of laws
Contractor liability	Digitalisation
Record-keeping expansion	Standardised rules
Enforcement strengthening	Unified authority

**Source:** Author’s compilation based on the Code on Wages, 2019

**Note:** The classification reflects the likely direction of impact of selected provisions of the Code on Wages, 2019 on labour costs and compliance costs; actual effects may vary depending on implementation and firm-level conditions.

The net effect of these changes varies across firms depending on their initial wage structures and level of compliance. Industry assessments and practitioner reports suggest that firms with allowance-heavy compensation structures may experience a 5–10% increase in labour costs due to the expansion of the statutory wage base, although the magnitude of this increase varies across firms (Deloitte, 2020). This estimate reflects only the impact of the revised wage definition and does not account for additional adjustments arising from changes in minimum wages or improved enforcement. Firms that are already compliant with formal wage structures are likely to experience smaller cost increases, while those relying on informal practices or contract labour may face higher adjustment costs.

A central component of the Code that shapes these cost changes is the minimum wage framework. The next section therefore examines literature on how changes in minimum wages affect employment and productivity, drawing on theoretical and empirical evidence.

## **2.5 Literature review: Impact on employment**

### **2.5.1. Theory**

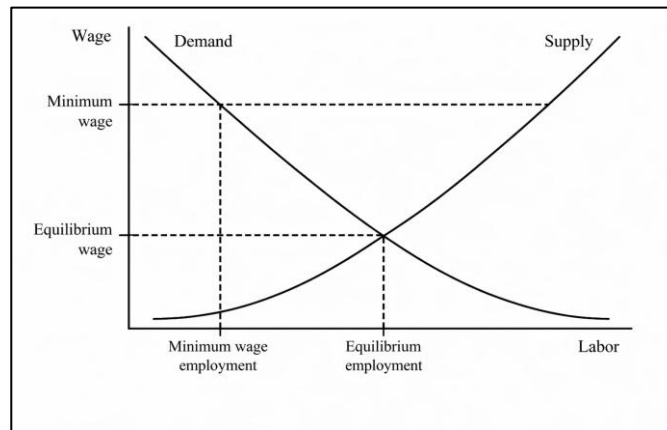
A binding minimum wage raises equilibrium real wages by setting a floor above prevailing wage levels for covered workers. It may also generate a “lighthouse effect,” whereby it acts as a reference point in wage-setting, shifting bargaining norms and raising wages beyond directly covered workers. The impact of minimum wage on employment however may differ according to the underlying economic theory:

**Table 2.2: Theoretical impact of minimum wage on employment**

<b>Predicted Employment Effect</b>	<b>Model</b>	<b>Key Assumption</b>	<b>Mechanism</b>
Negative	Perfect competition (Stigler, 1946)	Labour markets are competitive and firms are wage takers. Firms hire workers until $w = MPL$	If a minimum wage is set above the equilibrium wage, i.e. $w_{min} > MPL$ , wages are pushed above the marginal product of labour, making hiring additional workers unprofitable. And hiring additional workers becomes unprofitable. Firms therefore reduce employment through two main channels: Scale effect: Higher labour costs increase production costs and reduce demand for output. Substitution effect: Firms substitute capital or higher-skilled labour for low-wage workers.
Positive	Monopsony model (Manning, 2003)	Employers have wage-setting power and hence $w < MPL$	When a moderate minimum wage is introduced, the marginal cost of labour for additional workers may fall, as firms can hire more workers without raising wages for existing employees.
Neutral	Search and matching models (Flinn, 2006)	Labour markets are characterized by frictions such as imperfect information and job search costs. Wages are thus determined through bargaining between firms and workers rather than solely by supply and demand. Thus, $w < MPL$ which generates rents within employment relationships.	When minimum wages increase moderately: $w_{min} \approx MPL$ , firms may absorb higher labour costs through reduced profits, lower employee turnover, or productivity improvements rather than reducing employment.

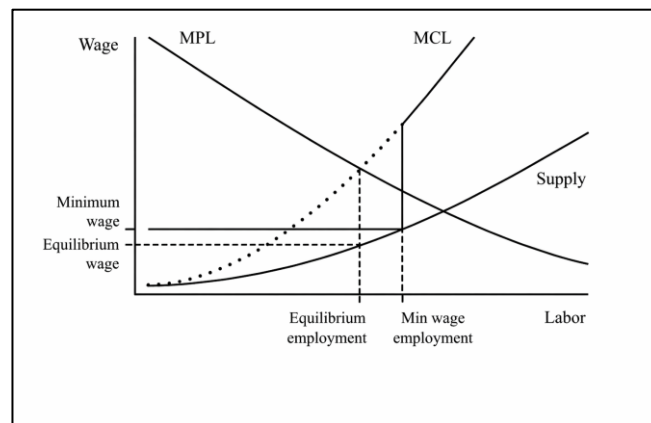
**Source:** Authors' compilation based on ILO (2016)

**Figure 2.4: Impact of minimum wage on employment under perfect competition**



**Source:** Authors' compilation based on Belman and Wolfson (2014)

**Figure 2.5: Impact of minimum wage on employment under monopsony**



**Source:** Authors' compilation based on Belman and Wolfson (2014)

**Macro model based on Keynesian theory:** It highlights the fact that higher wages may increase real earnings and therefore increase consumption demand among the low-paid workers and their families. Assuming there are no large negative effects on external competitiveness or investment, such positive “consumption effects” can lead to increases in aggregate demand and employment. Macro-economic perspectives show that even if some low-productivity firms reduce employment or go out of business, this does not necessarily mean that aggregate employment will be reduced. Employment may expand in other firms and higher wages may attract more people into the labour market (ILO, 2016).

### 2.5.2 Empirical evidence

Empirically, minimum wage legislation is generally associated with increases in real wages, although the magnitude of the effect varies with enforcement, compliance, and local labour market conditions. However, even under weak enforcement, evidence points to “lighthouse” effects, whereby minimum wages act as reference points in wage-setting, raising wages beyond directly covered workers. Empirical estimates of the employment effects of minimum wages, however, vary across countries and labour market contexts. While theoretical models often focus on the degree of labour market competition,

empirical outcomes are shaped by several institutional and structural factors that influence how firms and workers adjust to wage floors. As a result, the effects of the minimum wage on employment are ambiguous and contextual.

The key factors that determine the empirical impact of minimum wage on employment are:

1. **Size of labour market informality:** In economies with large informal sectors, weak compliance limits the binding nature of minimum wage laws. As a result, minimum wage policies tend to have stronger effects in formal employment segments, while informal employment remains largely unaffected. Consequently, the larger the informal sector, the more muted the aggregate employment effects of minimum wage changes are.
2. **Labour market segmentation:** Employment responses to minimum wages may differ across worker groups due to variations in productivity levels and job vulnerability. Workers concentrated in low-productivity or precarious employment, such as some female workers, may face higher risks of employment loss when minimum wages rise beyond their productivity levels. Employment effects may also vary across locations, particularly between rural and urban labour markets. In rural areas, government programmes providing employment at publicly announced wages may make minimum wage regulations more binding. In contrast, weaker enforcement in urban informal labour markets may limit employment effects.
3. **Wage structure and wage bite:** The impact depends on how far the minimum wage lies above prevailing wages. Moderate wage increases may correct underpayment without reducing employment, while larger increases that exceed productivity levels can lead to non-linear employment effects.
4. **Enforcement and compliance:** Stronger enforcement increases the likelihood that minimum wage policies are binding and therefore affect employment outcomes. Where enforcement is weak, employers may avoid compliance by paying below the legal minimum wage or shifting workers into informal or contractual arrangements.

The relative importance of these factors differs across labour market contexts. Consequently, some factors may be more influential in India, while others are more relevant in other developing or developed economies, leading to variation in the observed employment effects of minimum wages.

#### **A. India**

1. **Positive:** Some studies find that moderate wage increases can improve employment outcomes by correcting underpayment markets where employers have wage-setting power. However, when minimum wages rise significantly above productivity levels (i.e., a high wage bite), firms may reduce employment. For instance, Soundararajan (2019) documents a hump-shaped relationship in the formal construction sector, with employment increasing up to a certain threshold but declining once wage floors become sufficiently high, even as aggregate wages increase with the minimum wage.
2. **Heterogeneous effects across worker groups and sectors:** Employment effects vary across labour market segments, reflecting differences in enforcement and

productivity of workers. Menon and Rodgers (2017) show that minimum wage increases raise aggregate wages and employment in rural monopsonistic market for both genders, with gains concentrated in the formal sector. Policies such as the Mahatma Gandhi National Rural Employment Guarantee Act as a wage floor and strengthen the binding nature of minimum wages in rural labour markets. However, these benefits are accompanied by disemployment effects in the informal sector, particularly for women and among the self-employed, especially men. Similarly, Sharma and Viswanathan (2025) find that minimum wage increases lead to exits from the formal sector for female workers, especially the low-skilled, primarily into unemployment or out of the labour force, rather than into informal jobs. In contrast, men in more concentrated labour markets are more likely to move from informal to formal employment following minimum wage increases.

3. **No or insignificant effects:** Some studies find little evidence of employment reductions following minimum wage increases, particularly where enforcement is weak. For example, Mansoor and O'Neill (2021) show that minimum wages increase equilibrium wages, although pass-through weakens under low compliance, while employment effects remain statistically insignificant, especially in low-compliance States. Gudibande and Jacob (2020) find that minimum wage legislation led to short-run increases in wages, but these effects do not persist in the long run, and there is no significant impact on employment in the informal domestic work sector, largely due to weak enforcement.

**Range of the impact of minimum wages on employment in India:** Employment effects span a range from negative to near-zero to positive. The dominant pattern is:

**Formal sector:** Employment effects are generally positive, particularly in settings with employer wage-setting power, such as rural labour markets. Programmes like NREGA strengthen enforcement and act as a wage benchmark, making minimum wages more binding and improving compliance in rural sectors. Thus, moderate increases under stronger enforcement can raise employment by correcting underpayment. However, some heterogeneity in impact of minimum wage on employment may persist across genders as men may benefit through increased access to formal jobs while low-skilled women are more likely to be displaced, often exiting into unemployment or leaving the labour force.

**Informal sector:** The informal sector shows little to no change in employment, reflecting weak enforcement and low compliance. Vulnerable workers displaced from the formal sector typically do not move into informal jobs; instead, they tend to become unemployed or exit the labour force. In some cases, particularly in rural areas and for men, workers may shift from informal to formal employment as minimum wages become more binding in formal sectors.

**Aggregate impact:** Gains in the formal sector are partly offset by adverse effects for vulnerable workers and informal workers in some cases. As a result, the net impact on employment is generally close to zero or slightly positive.

## **B. Other developing countries**

1. **Negative Impact:** A substantial body of evidence from developing countries points to negative employment effects of minimum wages, particularly in the formal sector where compliance is higher. For instance, Gindling and Terrell (2009) find that in Honduras,

employment declined in large formal firms that complied with minimum wage regulations. These negative effects are often more pronounced for certain groups of workers and firms within the formal sector.

a) **Workers for whom the minimum wage is more binding:** Maloney and Méndez (2003) find for Colombia that minimum wage increases raise unemployment, especially among workers near the minimum wage, with smaller effects for higher-wage workers.

b) **Less productive and more vulnerable workers:** Montenegro and Pagés (2004) for Chile find large, statistically significant negative employment effects for low-skilled and young workers.

c) **Smaller or less productive firms:** Alatas and Cameron (2008) for Indonesia find employment declines in smaller or less productive firms, while they find no change in larger firms that are better able to absorb higher labour costs. Similarly, Harrison and Scorse (2010) find that although minimum wage increases reduce aggregate manufacturing employment, there is no significant decline in large, foreign-owned, and exporting firms in Indonesia. Instead, adjustment occurs primarily through the exit of smaller, less productive firms, particularly exporters in targeted regions.

Some studies suggest that these negative effects in the formal sector are partly offset by a reallocation of workers to the informal sector. For example, evidence from Argentina (Groisman, 2015) and Turkey (Pelek, 2011) shows that displaced workers often transition into informal employment, as documented in the survey by Broecke et al. (2017).

**2. No or insignificant effect:** In some cases, firms adjust to higher minimum wages without reducing employment, particularly in the formal sector. Engbom and Moser (2022) find that in Brazil, minimum wage increases lead to a reallocation of workers from less productive to more productive firms, compressing wage inequality without reducing total employment. Similarly, Mayneris, Poncet and Zhang (2014) show that, despite substantial increases in minimum wages, there is no significant reduction in employment among surviving firms in China. Instead, firms absorb higher labour costs through productivity improvements, with labour productivity rising almost proportionately with wages.

**Range of the impact of minimum wages on employment in developing countries:** The impact of minimum wages on employment in developing countries ranges from negative to negligible, and only rarely positive. The dominant pattern is:

**Formal sector:** The dominant pattern is negative employment effects, as higher labour costs lead firms to reduce hiring. In some contexts, however, the effects are insignificant, particularly when firms adjust through other margins (such as productivity or prices). A meta-analysis by Neumark and Corella (2021) reports average employment elasticities in the range of  $-0.06$  to  $-0.10$ , indicating small but negative effects. These effects are stronger among workers for whom the minimum wage is more binding, as well as among low-skilled workers and less productive firms.

**Informal sector:** In contrast, minimum wages generally have little or no direct impact on employment in the informal sector due to weak enforcement and low compliance. However, some studies suggest that informal employment may increase as workers displaced from the formal sector move into informal jobs. This reallocation can partly

offset employment losses in the formal sector, thereby muting the overall negative impact on employment.

**Aggregate impact:** Losses in the formal sector, particularly among vulnerable and low-skilled workers, are only partly offset by absorption in the informal sector. The net impact on employment is generally small and negative or close to zero.

### **C. Developed Economies:**

1. **Positive impact:** Some studies find that minimum wage increases may lead to small positive employment effects in certain sectors. For example, Card and Krueger (1994) examine the impact of a minimum wage increase in New Jersey's fast-food sector and find that employment slightly increased in New Jersey relative to Pennsylvania following the policy change. The paper attributes this result to monopsonistic labour markets, where employers possess wage-setting power due to search frictions and limited worker mobility.

2. **Negative impact:** Meer and West (2016) and Sabia, Burkhauser and Hansen (2012), as cited by Neumark and Wascher (2006), find negative employment effects for low-skilled workers in the United States, as higher wage floors raise labour costs above productivity levels for these workers, leading firms to reduce hiring or substitute towards more skilled labour.

3. **No or insignificant impact:** Many studies find little evidence of employment reductions following minimum wage increases. For example, using Labour Force Survey data, Dolton, Bondibene and Wadsworth (2010) find limited employment effects following the introduction of the National Minimum Wage in the United Kingdom, suggesting that gradual increases affecting a small share of workers can be absorbed by firms without significant employment losses. Similar findings are reported by Dube, Lester and Reich (2010) for the United States, who find no evidence of job losses and in some cases small positive effects when comparing contiguous counties across state borders. More broadly, Belman Wolfson (2014) conclude that employment effects of minimum wages are generally small and often indistinguishable from zero, indicating that estimates tend to be clustered around zero.

**Range of the impact of minimum wages on employment in developed countries:** Although the range varies from negative to neutral to positive, most empirical estimates in developed economies are small and statistically insignificant, clustering around zero (Belman & Wolfson, 2014; ILO, 2016).

### **D. Summary of comparison of minimum wage impact on employment across India, other developing countries and developed countries**

**Table 2.3: Comparison of minimum wage impact on employment across India, other developing countries and developed countries**

Context	Range of Effects	Dominant Pattern
India	Negative → Near-zero → Positive	Formal: positive Informal: little change or small negative due to reallocation from informal to formal sector. Aggregate: near-zero or positive as informal sector adjustments may not offset formal sector gains.
Other developing countries	Negative → Near-zero → Positive	Formal: negative Informal: negligible or sometimes positive due to reallocation from formal to informal sector. Aggregate: negative or near zero as informal sector gains only partly offset formal sector losses.
Developed countries	Negative → Near-zero → Positive	Clustered around zero

**Source:** Authors' computations

The differences across developed countries, India, and other developing economies are driven by distinct labour market structures and adjustment mechanisms.

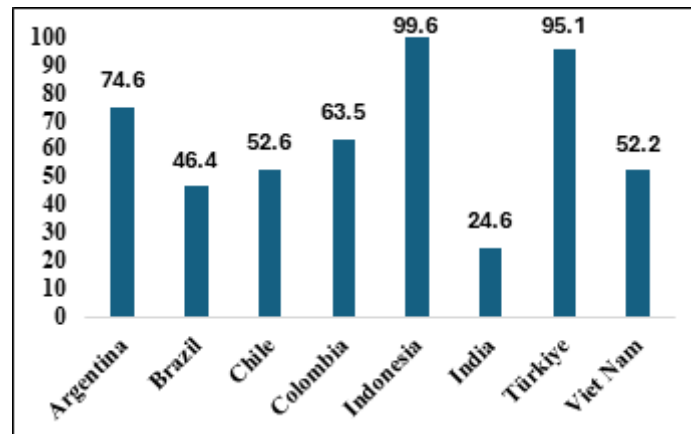
In developed countries, employment effects are usually concentrated around zero because of higher baseline wage levels which allow firms to absorb moderate increases in minimum wages without reduction in employment. In addition, stronger institutions may allow adjustment through channels such as productivity improvements, price adjustments, or reduced profits rather than employment reductions.

In contrast, both India and other developing countries are characterised by dual labour markets with distinct formal and informal sectors, but the nature of adjustment differs across them, that may explain differing findings cross them.

**Formal sector:** In India, higher labour market frictions and monopsonistic conditions, especially in rural areas, mean that wages can lie below workers' productivity. In such settings, moderate increases in minimum wages can raise both wages and employment. In other developing countries, however, minimum wages are often more binding. As a result, firms face higher effective labour costs and adjust by reducing formal employment, leading to negative or negligible employment effects. **Figure 2.6** illustrates the ratio of minimum wage to average wage in in India and other developing countries in 2022.

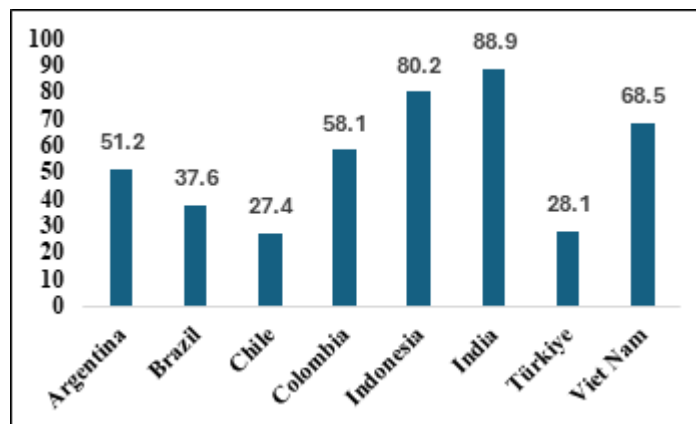
**Informal sector:** The key difference lies in the role of the informal sector as an adjustment margin for vulnerable workers. In many developing countries, displaced workers move into informal employment, so the informal sector acts as a buffer. In India, however, this channel is weaker due to barriers to mobility and the already large size of the informal sector. Unemployment in the informal sector is generally less affected by changes in minimum wages in India. **Figure 2.7** illustrates high size of informality for India relative to other countries in 2022.

**Figure 2.6: Minimum wage relative to average wages across selected developing countries in 2022 (%)**



Source: Authors' Computations based on ILOSTAT.

**Figure 2.7: Share of informal employment across selected developing countries in 2022 (%)**



Source: Authors' Computations based on ILOSTAT

**Note:** i. Estimates are based on national labour force surveys and compiled by the ILO; ii. The data for Chile is taken for 2020 and for Indonesia it is taken for 2023

## 2.6. Literature review: Impact on productivity

### 2.6.1 Theory

A binding minimum wage raises aggregate wages, but its impact on productivity depends on how firms respond to higher wage costs.

**Table 2.4: Theoretical impact of minimum wage on productivity**

<b>Predicted Effect</b>	<b>Labour market theory</b>	<b>Key Assumption</b>	<b>Mechanism</b>
<b>Positive</b>	Firm reorganisation (Lester, 1964)	Higher labour costs push firms to adopt tighter management practices	Firms do close monitoring of workers' performance and higher performance standards, that improves productivity
	Efficiency wage models (Shapiro & Stiglitz, 1984)	Higher wages increase worker effort	Reduced shirking, improved morale, and higher effort raise productivity
	Human capital investment (Becker, 1964)	Firms invest when employment relationships are stable	Higher wages incentivize training and firm-specific skill formation thereby improving productivity
<b>Negative</b>	Dual labour market (Sato & Murayama, 2008)	Firms adjust employment structure under cost pressure	Firms avoid increasing costs by shifting jobs to informal sector where compliance is weaker or hiring contract labour. This may reduce skill investment made by firms in workers, reducing productivity
<b>Neutral</b>	Price pass-through (Aaronson, 2001)	Firms have sufficient pricing power to pass increased labour costs onto consumers, while production remains demand-constrained	Firms absorb costs through prices or profits without changing productivity

**Source:** Authors' compilations based on Riley and Bondibene (2017); Carpio and Pabón (2017)

**Aggregate economy-wide productivity effects:** At the aggregate level, minimum wages may influence productivity through changes in the composition of firms in the economy.

Higher wage floors may reduce the survival probability of low-productivity firms that are unable to absorb higher labour costs, while more productive firms expand. This process of firm reallocation can increase overall economy-wide productivity. As a result, minimum wages may contribute to higher aggregate productivity through resource reallocation toward more productive firms and improved competitiveness among surviving firms.

### 2.6.2 Empirical evidence

The empirical literature suggests that, unlike employment effects, the impact of minimum wages on productivity is more consistently positive, although channels vary across contexts.

The key factors determining the magnitude of the impact and the channels through which minimum wage influences productivity are:

1. **Size of the wage bite:** Moderate increases in minimum wages can induce firms to improve efficiency and increase worker effort. Larger increases may create stronger cost pressures, leading firms to adopt capital substitution or restructure production. Both channels may have a positive impact on productivity.
2. **Compliance and enforcement:** When minimum wages are binding and effectively enforced, firms are more likely to adjust internally through efficiency improvements, capital deepening, or organisational changes. Where enforcement is weak, firms may evade compliance, resulting in muted productivity effects.
3. **Firm heterogeneity and reallocation:** Minimum wage increases can raise aggregate productivity by driving the exit of low-productivity firms and enabling more productive firms to expand. However, the impact at the firm level remains heterogeneous.

#### A. India

Empirical research examining the relationship between minimum wages and productivity in India remains relatively limited compared with the extensive literature on employment effects. Shimane (2008) shows that minimum wage regulations in India's garment sector shows no evidence of reduced efficiency and, in fact, reports improvements in productivity. While Soundararajan (2019) does not directly measure productivity effects, the study suggests that firms may respond to higher wage floors by improving efficiency or reorganising production processes in order to absorb higher labour costs. Similar arguments are made by Rani and Belser (2012), who note that higher minimum wages may encourage firms to improve work organisation and efficiency, although these mechanisms are rarely measured directly in empirical studies.

#### B. Other developing countries

1. **Positive:** Minimum wage increases may have positive effects on labour productivity through capital substitution channel. Evidence from Vietnam indicates that minimum wage increases were associated with higher capital intensity alongside productivity growth (Nguyen, 2019). Productivity gains may also arise through reallocation effects across firms. Mayneris, Poncet and Zhang (2014) find that minimum wage increases in China reduced the survival probability of low-productivity firms while more productive firms expanded and upgraded technology.

2. **Negative:** Using Indonesian manufacturing data, Ni and Kurita (2020) find that minimum wage increases significantly reduce firm productivity. This negative effect arises because firms respond to higher labour costs by contracting production and reducing employment, which disrupts input combinations and lowers scale efficiency.
3. **No impact:** In developing economies, high levels of informality and weak enforcement limit the binding nature of minimum wages, leading firms to adjust through evasion or informalisation rather than productivity-enhancing mechanisms. As a result, productivity effects are often small or insignificant (Gindling & Terrell, 2009).

The dominant impact for impact of minimum wage on productivity in developing countries is positive.

### C. Developed countries

1. **Positive:** Firms respond to higher wage floors by improving organisational efficiency and management practices. Riley and Bondibene (2017) find that increases in the United Kingdom's National minimum wage raised labour productivity and total factor productivity in low-wage firms through improvements in organisational efficiency. Higher wages may also encourage investment in worker training and skill development, as well as reduce labour turnover, increasing worker effort and retention, as shown for the United States (Dube, Lester, and Reich, 2012).
2. **No impact:** Rao and Risch (2024) show that firms adjust to higher minimum wages through revenue and market channels rather than changes in efficiency, implying no significant productivity effects.

The dominant impact for impact of minimum wage on productivity in developed countries is positive.

### D. Summary of comparison of minimum wage impact on productivity across India, other developing countries and developed countries

The empirical evidence suggests that while minimum wages are often associated with productivity improvements, the underlying mechanisms differ across contexts.

For India, the evidence remains limited and does not allow for a clear identification of dominant mechanisms.

In other developing countries, productivity effects are more commonly driven by structural adjustments, including capital substitution, technological upgrading, and the reallocation of resources across firms, with less productive firms exiting and more productive firms expanding. These mechanisms reflect the fact that the wage bite is often higher relative to prevailing wages, which increases cost pressures on firms and leads to restructuring or the exit of less productive firms. However, these effects may be limited by informality, weak compliance, and constraints in access to capital.

In developed economies, productivity gains are more commonly linked to efficiency-enhancing adjustments within firms, including higher worker effort, reduced labour turnover, and improvements in organisational efficiency. Given that wage levels are already relatively high, the effective wage bite of minimum wages is often smaller and may encourage firms to adjust through internal efficiency improvements rather than technology substitution.

## 2.7. Summary of expected impacts in India

### 2.7.1 Impact on Employment

Existing evidence suggests that the code on wages through the minimum wage legislation is likely to have a neutral or mildly positive impact on employment. This is because of higher labour market frictions and monopsonistic conditions that implies wages are below workers' productivity. In such settings, moderate increases in minimum wages can raise both wages and employment. There are additional provisions of the Code further support the possibility of employment gains.

**1. Reduced wage dispersion at the bottom:** Before the Code, minimum wages varied widely across sectors and states, leading to large differences in actual wages, especially at the lower end. The Code on Wages reduces this variation through a clearer minimum wage-setting mechanism, the introduction of a national floor wage, and expansion of minimum wage across sectors. The new code may shift labour market outcomes toward those associated with moderate and predictable wage increases, rather than uneven and large wage increase in the long run. Evidence from India suggests that such moderate increases can improve or leave employment unchanged.

**2. Improved quality of employment:** By ensuring a more adequate wage floor, the Code improves earnings at the lower end and supports more stable employment, thereby enhancing job quality alongside employment levels.

**3. Level playing field to all employers:** Before the Code, variation in minimum wages and limited coverage of minimum wage legislation allowed firms to compete by undercutting wages. The Code reduces this by extending coverage and standardising wage-setting. This limits wage-based competition and may shift adjustment toward productivity.

**4. Administrative simplification and compliance:** Before the Code, multiple laws and rules increased compliance costs. The Code simplifies this through uniform definitions and standardised rules, reducing administrative burden. Lower compliance costs can encourage new enterprises, new investment, and expansion, leading to more employment.

### 2.7.2 Impact on Productivity

As per the evidence from literature, the code on wages through the minimum wage legislation is likely to have a positive impact on productivity, as higher wages can improve worker effort and retention while encouraging firms to invest in more training.

The additional components of the Code further support the possibility of productivity gains.

**1. Rewarding Skill and Competency:** The Code introduces a technical committee to advise on the classification of employees (unskilled, semi-skilled, skilled, and highly skilled) based on the National Skills Qualification Framework. This objective approach is designed to ensure that higher levels of skills, competencies, and experience are appropriately rewarded through higher wages, providing an incentive for workers to improve their productivity.

**2. Incentivizing investment by simplifying legislations:** By simplifying the complex wage structure and reducing "roadblocks" to compliance, the Code aims to encourage

investment, which historically correlates with technological upgrades and higher organizational productivity.

## 2.8 Policy implications

The Code on Wages (2019) represents a structural reform of wage regulation, consolidating multiple laws and introducing significant changes in definitions, coverage, wage-setting, and enforcement. It expands minimum wage coverage to all employments, introduces a statutory national floor wage, and establishes clearer and more standardised criteria for wage determination based on consumption norms, skill categories, and periodic revisions. In addition, it simplifies compliance through uniform definitions, digitalisation, and an integrated enforcement framework, while also strengthening provisions related to wage payments, bonus, and equal remuneration.

This chapter has examined the potential implications of the Code on Wages (2019) for employment and productivity in India, drawing on the existing theoretical and empirical literature on minimum wages. In the Indian context, characterised by labour market frictions and imperfect competition, minimum wages are unlikely to have large negative employment effects and may, under certain conditions, have neutral or mildly positive impacts. The Code introduces additional institutional changes that may further support employment. By reducing variation in wages at the lower end, it limits extreme disparities and reduces the need for large and uneven wage increases over time. By restricting wage undercutting, it creates a more level playing field across firms, supporting fair competition and employment generation. Further, improved compliance and simplified regulations can encourage new investment and enterprise expansion, contributing to increased employment.

The evidence of minimum wage on productivity effects remains limited for India. While some studies suggest that higher minimum wages may be associated with productivity improvements, the underlying mechanisms are not clearly established. Potential channels include efficiency wage effects and improvements in organisational efficiency. The Code may further support productivity by linking wage determination to skill levels, creating incentives for skill upgrading, and by reducing compliance costs, which can encourage firms to adopt more efficient production processes.

However, these outcomes depend on key conditions.

**(i) Labour market structure:** The predicted positive effects on employment rely on the presence of imperfect competition. While this is plausible in the Indian context, where widespread informality allows employers some degree of wage-setting power, outcomes may differ in more competitive labour markets, making the degree of market concentration an important empirical consideration.

**(ii) Enforcement constraints:** Weak enforcement, particularly in informal sectors, may limit the binding nature of minimum wages and mute the aggregate positive impact of code on wages on employment and productivity.

**(iii) Persistent productivity differences across workers:** Differences in vulnerability and productivity across workers may lead to heterogeneous effects impact of minimum wage. While aggregate employment may improve, some groups, such as low-skilled female workers, may be more vulnerable to employment displacement.

(iv) **Level of the national floor wage:** The impact depends on how the floor wage is set relative to prevailing wages and productivity levels. If set too low, it may remain non-binding and have limited impact on both employment and productivity. If set too high relative to productivity in certain sectors or regions, it may lead to negative employment effects and also constrain the ability of firms to adjust through productivity improvements.

(v) **Role of state level heterogeneity in implementation of rules:** Additionally, state-level rules will be critical in determining how the Code operates in practice. States fix minimum wages while the national floor provides just the floor, they classify jobs into skill categories, decide the timing of revisions of minimum wage, and manage compliance, inspection, and enforcement systems. Thus, while states may not have full autonomy in design, differences in how they implement these provisions can lead to variation in outcomes the extent to which they translate into changes in wages, employment, and productivity.

Policy responses should be closely aligned with these constraints.

First, strengthening enforcement, particularly in informal sectors, is critical and requires improved compliance mechanisms through mandatory record-keeping, digital wage payments, and targeted inspections, especially in informal and household-based employment.

Second, minimum wage policy should be complemented with skill development and productivity-enhancing interventions that allows higher wages to be sustained.

Third, the national floor wage should be carefully calibrated and periodically revised based on regional cost of living to ensure it is binding without being too high to affect employment and productivity adversely.

Finally, to reduce differences in outcomes across states, the Centre should provide clear guidelines on how minimum wages are set and revised. This could be supported by setting up national and state-level bodies to estimate benchmarks such as a revised poverty line. The Centre should also help states improve their ability to implement these laws. One way to do this is by supporting the adoption of digital systems through financial and technical assistance to States and investing in a nationally integrated digital stack.

## Chapter 3: The Code on Social Security

### 3.1 Introduction

India's labour regulatory system evolved over decades through numerous statutes enacted at different historical moments, many originating in the colonial period and designed for a far simpler industrial economy. As employment structures changed - with the rapid expansion of the services sector, the persistence of informal work, increasing contractualisation, and the rise of digital platforms - the existing legal framework became progressively fragmented and ill-suited to contemporary labour market realities.

Responding to these challenges, the Government of India undertook a comprehensive reform initiative to rationalise labour legislation by consolidating 29 central laws into four overarching Labour Codes, brought into force on 21 November 2025. The intellectual foundation for this reform can be traced to the Second National Commission on Labour (2002), which recommended simplification, harmonisation, and modernisation of labour laws.

Within this broader reform agenda, the Code on Social Security, 2020 represents a pivotal shift toward a unified and more inclusive system of social protection. By integrating multiple social security statutes and recognising previously excluded categories of workers — including those in informal, gig, and platform employment — the Code seeks to expand coverage, reduce regulatory complexity, and improve the portability of benefits across employment transitions.

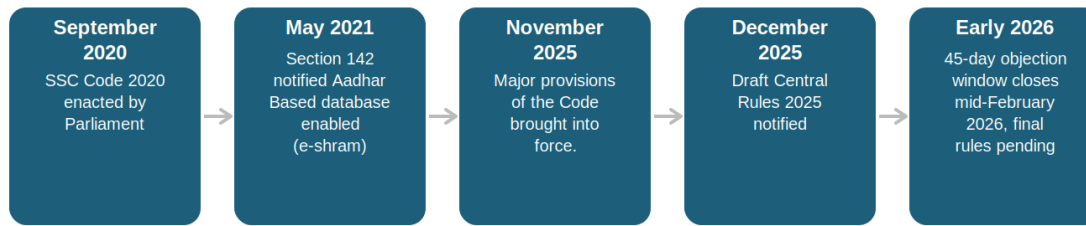
### 3.2 Chronology of the reform process

#### 3.2.1 Legislative timeline

The Code on Social Security 2020 was enacted with the design of repealing the previous nine Acts at the central level — namely the Employees' Provident Funds and Miscellaneous Provisions Act (1952), the Employees' State Insurance Act (1948), the Employees' Compensation Act (1923), the Maternity Benefit Act (1961), the Payment of Gratuity Act (1972), the Building and Other Construction Workers' Welfare Cess Act (1996), the Unorganised Workers' Social Security Act (2008), the Cine Workers' Welfare Fund Act (1981), and the Employment Exchanges (Compulsory Notification of Vacancies) Act (1959). However, a savings clause ensures that the schemes, rules, notifications, and administrative mechanisms operating under those repealed laws continue in force for a transitional period of one year. This preserves legal and administrative continuity rather than triggering an immediate structural overhaul. Since most substantive provisions and operational rules remain effectively unchanged during this period, the near-term impact of the Code on employment dynamics and labour costs — particularly in the domain of social security — is likely to be modest.

Following the Code's enforcement, states are required to publish their own rules in alignment with the central legislation. A majority of states have already done so through their respective State Gazettes.

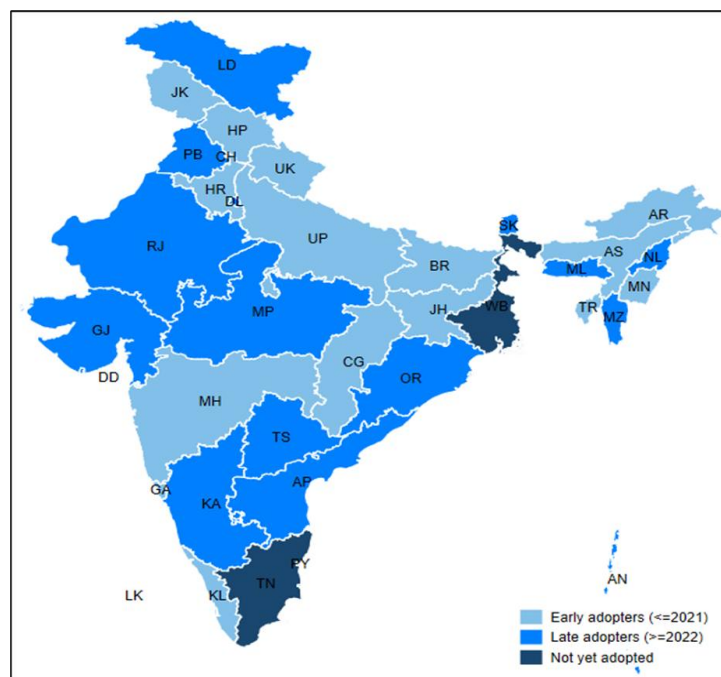
**Figure 3.1: Chronology of the Social security Code**



### 3.2.2 State-level Developments

The distribution of states (**Figure 3.2**) by their stage of preparedness in drafting these rules — with the 2020 Code acting as the baseline legislative reference year — reveals a striking degree of variation across the country, as illustrated in the map above. Early adopters, those that released draft rules by 2021, include states such as Uttar Pradesh, Bihar, Jharkhand, Odisha, Maharashtra, Telangana, Himachal Pradesh, Uttarakhand, and several northeastern states including Assam, Manipur, Meghalaya, Mizoram, Tripura, Nagaland, and Arunachal Pradesh. Late adopters, having released draft rules in 2022 or later, include Punjab, Haryana, Rajasthan, Gujarat, Madhya Pradesh, Karnataka, Kerala, Andhra Pradesh, and Goa, among others. West Bengal and Tamil Nadu had not yet published draft rules as of the reference period. The complete state-wise timeline of draft rule notifications is presented in the [Online Appendix](#). This uneven pattern of adoption reflects the broader federal dynamic in labour law implementation in India, where state capacity, political economy considerations, and administrative priorities shape the pace at which central legislative frameworks are translated into operative state-level rules.

**Figure 3.2: State-wise Timing of Adoption of Rules under the Social Security Code**



**Source:** Authors’ compilation based on state government gazette notifications on the Code on Social Security issued by state labour departments (2020–2025).

**Notes:** The map shows the year in which states and union territories issued draft or final rules under the Code on Social Security, 2020. Where both draft and final rules were notified, the year of the first notification is reported.

### 3.3 Key Changes in the Code on Social Security, 2020

India's social security architecture has historically rested on four structural pillars — the Employees' Provident Fund (EPF), the Employees' State Insurance Corporation (ESIC), the Payment of Gratuity, and Maternity Benefit. Each pillar was governed by a separate statute with its own administrative machinery, definitions, coverage thresholds, and enforcement mechanism. This section tracks, pillar by pillar, the specific changes made by the Code. A detailed table showing changes in each of these aspects is provided in the [Online Appendix](#).

#### 3.3.1 Employees' Provident Fund

- The 50% Wage Rule is the most consequential change for EPF. Under the earlier regime, employers routinely structured salary packages to inflate allowances, thereby minimising the basic wages component and narrowing the EPF contribution base. Under the revised definition, if excluded components exceed 50 per cent of total remuneration, the excess is added back and treated as wages. The practical financial impact is moderated by the statutory wage ceiling of Rs.15,000 for mandatory EPF contributions, which currently remains unchanged.
- Coverage threshold (20+ persons) and contribution rates (12 per cent each) are unchanged, but opt-in/opt-out is now symmetrical and platform-linked enterprises are explicitly brought within scope.
- The Rs.15,000 wage ceiling is retained, but the government can now revise it — and contribution rates — by notification rather than full legislative amendment.
- Gig and platform workers are recognised for the first time, with the Central Government empowered to frame PF-like schemes for them.
- Fixed-term employees get full EPF parity with permanent employees from day one, closing the contract-structuring loophole that was routinely used to deny coverage.
- Portability becomes genuinely automatic through Aadhaar-seeded UAN, replacing a largely manual and leaky transfer system that caused migrant workers to frequently lose accumulations.
- Penalties are significantly stiffened — fines rise from Rs. 10,000 to Rs.1 lakh, imprisonment extended to up to 3 years, with compounding introduced for defaults.

#### 3.3.2 Employees' State Insurance Corporation (ESIC)

- The ESIC framework currently maintains a monthly wage ceiling of Rs. 21,000 for employee coverage, a limit that has remained unchanged since January 1, 2017. Although the Code on Social Security has preserved this provision, the intervening years of wage growth and inflation have rendered the threshold outdated. Consequently, an increasing number of workers are being pushed beyond this limit, losing access to vital health and income protections exactly when they are most needed.

- Coverage threshold (10+ workers) is retained but extended pan-India, removing the notified-area restriction — any unit with hazardous processes is now mandatorily covered regardless of location.
- Contribution rates are unchanged (employer 3.25 per cent, employee 0.75 per cent), but the wage base they apply to may effectively increase due to the new unified wage definition and the 50% allowance cap.
- The Rs. 21,000 wage ceiling is retained under the new wage definition, with a proposal under consideration to revise it to Rs. 30,000 by notification.
- Gig and platform workers are brought within ESIC coverage scope for the first time, consistent with the broader recognition of non-traditional employment under the Code.
- Employee protection on default is significantly strengthened — ESIC can now pay benefits to employees directly and recover the capitalised value from the defaulting employer, rather than denying benefits pending recovery.
- An exit mechanism is introduced for the first time — establishments can exit ESIC coverage after a minimum 5-year lock-in, ending the previous "once covered, always covered" rigidity.
- Compliance is unified — standardised reporting across EPF and ESIC platforms, with compounding introduced for penalty defaults and portal-based filing replacing paper-based processes.

### **3.3.3 Gratuity**

- Gratuity has historically been calculated only on Basic Salary plus Dearness Allowance, leaving employers considerable scope to suppress the calculation base by inflating allowances. The Code's 50% Wage Rule directly addresses this. For companies with heavily suppressed basic pay structures, actuarial valuations under Ind AS 19 / AS 15 will reflect an immediate Past Service Cost on implementation, with expected gratuity liabilities increasing by 25–50% for the most affected employers.
- Coverage threshold (10+ employees) is unchanged, but the wage base is now significantly broadened — the unified wage definition with the 50% allowance cap closes the long-standing practice of suppressing basic pay to minimise gratuity liability
- The gratuity formula (Last Drawn Wages  $\times$  15/26  $\times$  Years of Service) and the Rs.20 lakh ceiling are both retained, but the ceiling can now be revised upward by notification without fresh legislation.
- The most consequential change for employers is the accounting impact — companies that have structured CTCs with suppressed basic pay should expect a 25–50 per cent increase in actuarial gratuity liabilities, recognised immediately as Past Service Cost under Ind AS 19 / AS 15.

- Fixed-term employees gain gratuity entitlement on a pro-rata basis after just 1 year of service, replacing the previous complete exclusion unless 5 full years were completed — a major expansion of the contract workforce's social security coverage.
- Principal employer liability is introduced for contractor workforce gratuity — if a contractor defaults, the principal employer is jointly liable, removing a significant gap in the earlier framework.
- The 5-year continuous service requirement for regular employees is unchanged
- Enforcement shifts to the Inspector-cum-Facilitator advisory-first model, and compliance moves to a unified portal covering EPF, ESIC, and Gratuity on a single platform.

### **3.3.4 Maternity Benefit**

- The Maternity Benefit provisions largely carry forward the significant changes introduced by the 2017 amendment to the standalone Act. The Code adds to this by enhancing penalties substantially, removing the ceiling on the medical bonus, and introducing shared creche facilities as a flexible compliance option for smaller establishments.
- The core entitlements — 26 weeks leave for the first two children, 12 weeks for the third child onwards, and 12 weeks for adoptive and commissioning mothers — are fully retained
- The wage base is strengthened through the unified wage definition with the 50 per cent allowance cap, ensuring more consistent and generally higher maternity benefit payouts across employers who previously varied in interpretation
- Gig and platform workers are brought within scope for the first time through new Central Government schemes, extending coverage beyond the traditional organised sector
- The medical bonus base of Rs. 3,500 is retained but the statutory upper cap is removed, giving the government flexibility to revise the ceiling upward by notification
- The creche facility requirement (mandatory at 50+ employees, 4 visits per day) is retained but enhanced with a resource-pooling provision — establishments can now share a common creche with other companies, reducing compliance costs for smaller employers
- Work from home after the 26-week leave period is reaffirmed by statute as a flexible option by mutual consent, giving it clearer legal standing
- Penalties are substantially increased — fines rise from Rs. 5,000 to Rs. 50,000 for a first offence, and repeat offenders face up to 3 years imprisonment and fines up to Rs.3 lakh, replacing the earlier 1-year imprisonment ceiling.

### 3.3.5 Coverage of Gig, Platform, and Unorganised Workers

One of the most significant innovations of the Code is the extension of social protection to categories of workers previously outside the formal labour welfare framework. The Code formally recognises three major groups: unorganised workers, gig workers, and platform workers.

#### 1. Unorganised Workers

Section 109 provides for social security schemes for unorganised workers who traditionally lacked access to formal employment benefits. Schemes may cover life and disability insurance, health and maternity benefits, and old-age protection. Both central and state governments are empowered to design and implement targeted welfare schemes tailored to the needs of these workers.

#### 2. Gig and Platform Workers

Section 114 marks the first-time gig and platform workers are brought within the ambit of social security legislation in India. Their inclusion reflects an acknowledgement of the growing importance of the platform economy and the structural inadequacy of traditional employer-employee frameworks for capturing emerging forms of work.

#### 3. The Aggregator Contribution Model

To finance welfare measures for gig and platform workers, the Code establishes a dedicated Social Security Fund. Digital platform companies are required to contribute between 1% and 2% of their annual turnover to this fund, subject to a ceiling ensuring the contribution does not exceed 5% of the total amount payable to gig and platform workers. This model represents a structural shift toward shared responsibility in the financing of social protection — involving governments, beneficiaries, and digital aggregators.

## 3.4 Key Implications of the Code on Social Security

### 3.4.1 Structural Improvements

#### i. Unified Compliance Architecture

The replacement of nine separate statutes with a single Code significantly reduces the compliance burden on employers. A single registration now covers all applicable social security obligations. A single Inspector-cum-Facilitator replaces multiple overlapping inspectorates. A unified return replaces multiple annual filings with different authorities. This rationalisation directly reduces the administrative cost of formal employment.

#### ii. The 50% Wage Rule — Closing the Structuring Loophole

The introduction of the 50% Wage Rule is the single most consequential substantive change across all four pillars. For decades, salary structuring — the practice of inflating allowances to minimise the contribution base — was the dominant mechanism through which employers legally reduced EPF contributions, gratuity liabilities, and maternity benefit payouts. The 50% cap ensures that at least half of total remuneration must form the calculation base for all social security contributions and benefits.

#### iii. Expansion of Coverage — Fixed-Term Workers and Gig Economy

The formal definition of fixed-term employment and the extension of all statutory benefits to fixed-term workers from day one closes a long-standing loophole widely

exploited through rolling short-term contracts. For the gig and platform economy, the Code provides the first legislative recognition in Indian social security law of workers outside the employer-employee relationship.

**iv. Portability and Digital Infrastructure**

The mandating of Aadhaar-seeded, UAN-based automatic portability for EPF — combined with the national database for unorganised, migrant, and gig workers — addresses one of the most persistent failures of the earlier regime, under which mobile workers routinely lost accumulated social security benefits when changing employers or migrating across state lines.

**v. Enhanced Accountability for Default**

The shift from the earlier model — where employer failure to pay contributions could result in denial of benefits to workers — to the new model where ESIC pays benefits to workers and recovers the capitalised value from the defaulting employer represents a fundamental rebalancing of risk. Workers are no longer penalised for their employer's non-compliance.

**vi. Inclusivity and New Worker Categories**

The recognition of gig workers, platform workers, and unorganised workers; the extension of maternity benefit to commissioning and adoptive mothers; pro-rata gratuity for fixed-term workers after one year; and shared creche arrangements all represent genuine expansions in the scope of formal social protection.

### **3.4.2 Potential Areas of Concern**

**1. The Wage Ceiling Problem - EPF and ESIC**

Both the EPF mandatory contribution ceiling (Rs.15,000 per month, unchanged since 2014) and the ESIC eligibility threshold (Rs.21,000 per month) have been retained without revision in the initial implementation. Given inflation and rising nominal wages, these stagnant ceilings progressively exclude workers who would otherwise benefit from formal social security coverage. The absence of an automatic indexation mechanism means the ceilings will again fall behind over time unless actively revised. The proposal to raise the ESIC ceiling to Rs.30,000 per month, if implemented, would be a meaningful step.

**2. Implementation Deficit - Gig and Platform Workers**

The provisions for gig and platform workers represent the most ambitious innovation of the Code — and also the most vulnerable to implementation failure. The Code creates a framework and empowers the Central Government to design schemes; it does not itself prescribe the content or funding levels of those schemes. The aggregator contribution rates have not yet been notified. The Social Security Fund has not been operationalised. Without specific, time-bound scheme notifications, the gig and platform worker provisions remain largely aspirational.

**3. Actuarial and Financial Shock - Gratuity**

The 50% Wage Rule, while structurally sound, creates an immediate balance sheet impact for employers who have maintained low basic pay structures. Companies that have relied on allowance-heavy salary structures will face a step-change increase in their actuarial

gratuity liability - estimated at 25–50% for the most affected employers - upon Code implementation. This Past Service Cost must be recognised immediately under Ind AS 19 / AS 15, affecting financial statements, leverage ratios, and in some cases, loan covenants.

#### **4. The Inspector-cum-Facilitator: Reform or Relabelling?**

The conceptually sound replacement of the Inspector with the Inspector-cum-Facilitator depends entirely on implementation: whether the facilitation mandate is genuinely internalised by enforcement officers, whether the randomisation mechanism is robust against manipulation, and whether the 30-day rectification notice is consistently observed. Relabelling without genuine institutional culture change would deliver administrative inconvenience without the promised predictability or protection.

#### **5. State Government Role and Fragmentation Risk**

Many provisions of the Code — particularly those relating to unorganised workers and gig and platform worker schemes — depend heavily on state government action. India's states differ significantly in their labour administration capacity, political will, and fiscal space. There is a real risk of implementation fragmentation, where coverage and benefit levels vary substantially across states, replicating at a different level the inter-jurisdictional inconsistency that the Code was designed to eliminate.

#### **6. Unresolved Questions in the Gig Economy Legal Framework**

The Code carefully avoids classifying gig and platform workers as employees, which preserves flexibility for aggregators but leaves fundamental questions unresolved. The rights of gig workers to organise, to contest algorithmic management, to access dispute resolution mechanisms, and to receive income continuity during periods of low platform demand are not addressed. As the platform economy grows, the legislative gap between the Code's social security provisions and the broader employment law framework is likely to become increasingly visible.

### **3.4.3 Cost Implications**

The economic effects of the Code on Social Security are mediated largely through contribution obligations, coverage expansion, and administrative reorganisation. The Q3 FY2026 earnings cycle, following the notification of all four labour codes on 21 November 2025, provides the first substantive empirical window into how these obligations translate into firm-level costs.

The financial disclosures of large listed employers leave little ambiguity about the near-term cost direction. Tata Consultancy Services booked a statutory charge of Rs. 2,128 crore in the December 2025 quarter, arising from a recalculation of gratuity and unearned leave liabilities under the revised wage definition. Infosys recognised an exceptional item of Rs. 1,289 crore for the same period, reflecting increases in both past service gratuity costs and leave liability. HCL Technologies disclosed a provision of approximately Rs. 956 crore, while Wipro absorbed a charge of Rs. 303 crore. Collectively, the top six IT services firms reported a combined one-time impact of approximately Rs. 5,400 crore in a single quarter. Across 41 Nifty 50 companies that had reported by early February 2026, aggregate provisions exceeded Rs. 13,161 crore.

These figures require careful interpretation. The charges are not operational cost increases in the conventional sense; they are balance-sheet-driven actuarial adjustments reflecting the recognition of accumulated past-service liabilities under a revised statutory framework. The immediate cash outflow is limited. What the numbers do reveal, however,

is the scale of under-provisioning that had built up under the prior regime — a function of allowance-heavy compensation structures that systematically understated the wage base for benefit calculations. The new 50% rule, which requires basic wages to constitute at least half of an employee's total cost-to-company, closes this gap and forces a one-time reckoning with liabilities that had been deferred for years.

The recurring cost effect, once the one-time provisions are absorbed, is considerably more modest. TCS management estimated an ongoing margin impact of approximately 15 basis points annually, while Infosys leadership characterised the continuing increase as between 10 and 20 basis points. These forward-looking assessments suggest that the structural cost shift, while real and permanent, is unlikely to materially alter competitive or operational dynamics for large, formally compliant employers. The adjustment burden is expected to fall more heavily on firms with historically flexible or allowance-laden compensation architectures, and on sectors beyond IT where workforce formalisation levels are lower and the gap between declared and effective wages is wider.

On the cost-reducing side, the Code's administrative consolidation — unified registration, standardised return-filing, and a single digital compliance portal — is expected to lower the transactional burden of compliance, particularly for multi-state employers previously navigating parallel obligations under separate EPF, ESI, and gratuity frameworks. The principal channels through which the Code is likely to affect employer costs are summarised below.

**Table 3.1: Channels affecting employer costs under the Code on Social Security, 2020**

<b>Cost-Increasing Factors</b>	<b>Cost-Reducing Factors</b>
Coverage of gig and platform workers	Unified registration mechanism
Aggregator contribution obligations	Consolidated return-filing
Pro-rata gratuity for fixed-term workers	Rationalised inspection scheme
Expanded contractor obligations	Single digital compliance portal
Broader wage base for benefit calculations	Reduced multiplicity of authorities

**Source:** Author's compilation based on the Code on Social Security, 2020; company quarterly disclosures (Q3 FY2026)

### 3.5 Literature review: Impact on employment

#### 3.5.1 Theory

The theoretical impact of social security on employment can be positive, negative, neutral, or ambiguous depending on which mechanism dominates. Where contributions act as a tax wedge on formal hiring, the effect is negative. And where firms respond by shifting workers into informal arrangements rather than reducing headcount outright, the

aggregate employment level may be unchanged even as its composition deteriorates. The net outcome is therefore an empirical question rather than a theoretical certainty.

**Table 3.2: Theoretical impact of social security on employment predicted by micro theories**

Predicted Effect	Theoretical Model	Key Assumption	Mechanism
Negative	Neoclassical Labour Demand (Marshall, 1890; Hicks, 1932)	Labour and capital are substitutable; firms are profit maximisers	Social security acts as a tax wedge, raising the marginal cost of hiring; firms reduce headcount or substitute toward capital/automation
Positive	Human Capital Theory (Gary Becker, 1964)	Skills and health are assets that depreciate without investment	ESIC preserves physical capacity; gratuity rewards tenure — both increase firm incentives to retain trained workers, improving employment quality
Ambiguous	Labour Market Dualism (Harris & Todaro, 1970)	The labour market is segmented into a regulated formal and an unregulated informal sector	High compliance costs create a regulatory barrier for small firms, compressing formal employment while expanding low-productivity informal work
Neutral	Implicit Contract Theory (Azariadis, 1975)	Workers are risk-averse and prefer stability over high, volatile wages	Social Security function as an insurance premium workers implicitly pay via lower current cash wages; employment level is unaffected if full wage-benefit substitution occurs

**Source:** Synthesized from the foundational theories of Neoclassical Labour Demand.

### 3.5.2 Empirical Evidence

Social security systems encompass a broad range of employer and employee mandated contributions including provident funds, health insurance schemes, maternity benefits, and gratuity payments. While these instruments are designed to provide workers with financial protection against life cycle risks such as illness, unemployment, old age, and

maternity, their implications for labour market outcomes — particularly employment — have been the subject of extensive empirical scrutiny.

### **Key factors that determine the empirical impact of social security on employment:**

- **Tax Wedge Channel:** Contributions raise the gap between what employers pay and what workers take home. Where wages are rigid, firms respond by shifting towards casual and informal arrangements rather than cutting headcount outright. Where wages can adjust, workers absorb the cost through lower take-home pay and the threat to employment diminishes.
- **Capital Substitution Channel:** Higher formal labour costs incentivise firms to reorganise production around more capital-intensive techniques — a pressure compounded when trade liberalisation or technological change simultaneously lowers the cost of capital. The workers who bear the heaviest cost are low-skill workers in labour-intensive industries — precisely those whom social security is designed to protect.
- **Productivity Channel:** Benefits raise the cost of job loss, inducing greater effort and reducing absenteeism and turnover. Health cover preserves workforce capacity and tenure-linked benefits reduce recruitment costs — mechanisms that partially or fully offset the cost wedge at the firm level.
- **Demand Channel:** Without social protection, low-income workers save excessively as a precaution, suppressing consumption. Coverage releases this spending power into basic goods and local services, generating a broad employment stimulus that may more than compensate for the hiring restraint of individual firms.
  - **Formalisation Channel:** This channel is distributional rather than aggregate — shifting workers between formal and informal arrangements without necessarily altering the overall level of employment in the economy.
  - **Labour Supply Channel:** Improved benefits draw previously discouraged workers into the labour force. However, the same mandated benefits can simultaneously give employers reason to avoid or reclassify certain workers — producing opposing effects on the same population.

## **A. India**

### **1. Employment Protection Legislation and Informalisation**

In the case of India, direct empirical evidence on the employment effects of specific social security components such as EPF, ESIC, maternity benefits, and gratuity is sparse. However, a substantial and well-identified body of work examines closely related mechanisms through the lens of Employment Protection Legislation (EPL) and labour market regulation. This literature constitutes the most relevant adjacent evidence available — not as direct evidence on social security effects but as evidence on the same underlying mechanism operating through a parallel institutional channel. The conceptual link is straightforward: both EPL and social security mandates raise the total cost of formal employment, and both therefore create incentives for firms to adjust along margins that minimise or avoid formal employment obligations.

The foundational paper in the Indian context is Besley and Burgess (2004), who exploited state-level variation in Industrial Disputes Act amendments across Indian states between 1958 and 1992. They found that pro-worker amendments were associated with lower

formal manufacturing output, employment, and investment, and with higher urban poverty and a larger informal sector. This establishes the fundamental mechanism central to the social security literature as well — that any increase in the cost of formal employment leads to informalisation as firms substitute towards workers and arrangements that fall outside the regulatory perimeter. This mechanism reflects a general feature of India's dual labour market in which a large and accessible informal sector provides firms with a readily available margin of adjustment when formal employment costs rise.

Ahsan and Pages (2009) examined the differential employment effects of three types of labour regulation using state-level variation in regulatory stringency. They found that the dominant firm-level response to any increase in formal labour costs is a shift towards contract and casual labour arrangements rather than outright employment reduction. This casualisation response is the same mechanism through which social security mandates are expected to operate, suggesting that the employment effects of specific social security components should be understood as partial effects within a broader regulatory burden that shapes firm behaviour comprehensively.

## **2. Direct Evidence from Maternity Benefit Amendment Act**

The most direct evidence on a specific social security component comes from studies examining the Maternity Benefit Amendment Act of 2017, which extended mandated paid maternity leave from 12 to 26 weeks for establishments employing 10 or more persons. Banerjee, Biswas and Mazumder (2025) provide the causal estimate of the reform's employment effects, finding a measurable decline in the probability of employment for women in the treated age group and an adverse effect on their earnings — establishing that the reform imposed a real cost on the very women it was designed to protect.

Bose and Chatterjee (2024) examine what happens to the nature of employment for those who remain in work following the reform. Using a difference-in-differences strategy exploiting the institutional feature that the mandate applies only to establishments with 10 or more employees, they find that women in treated establishments were 4.3 percentage points less likely to be employed as regular salaried workers and simultaneously 5.3 percentage points more likely to be employed as casual or unpaid workers. The effects are concentrated among younger and married women and are most pronounced in private sector firms and the services sector. Since the cost of paid maternity leave in India falls entirely on employers rather than being shared through a social insurance fund, firms face a direct financial incentive to reclassify women workers into contractual arrangements that technically exclude them from eligibility. Taken together, these two studies establish that the 2017 reform generated labour market responses that worked against the interests of the women it intended to protect.

## **B. Other Developing Countries**

### **1. Wage Flexibility and the Incidence of Contributions**

The relationship between social security contributions and employment in developing economies depends critically on firm size, wage flexibility, enforcement context, and the direction of policy change. Evidence from Chile's privatisation reform (Gruber, 1997) offers a clear illustration: when wages are flexible payroll taxes are fully shifted onto workers rather than absorbed by employers. When Chile reduced payroll taxes from around 30% to 5%, workers' wages rose correspondingly, leaving employers' total labour

costs unchanged and producing no significant effect on employment levels. Social security contributions therefore only threaten employment when wages cannot adjust downward — most notably when workers are already at the minimum wage and firms have no room to shift the burden.

## **2. Rigid Wages, Low-Skill Workers, and Informal Substitution**

This wage-floor constraint helps explain the dynamics observed in China (Liu et al., 2023), where higher contribution rates dampen demand for low-skilled labour and, in regions with stricter enforcement, push firms toward labour dispatching arrangements as a way of bypassing formal obligations. The response is not simply fewer jobs but a reorganisation of work away from formal employment altogether. Evidence from Brazil and Mexico further shows that during recessions, the high fixed cost of social security makes it nearly impossible for new or informal workers to transition into formal employment, trapping a large portion of the workforce in the unregulated sector (Bosch & Maloney, 2008).

## **3. Formalisation versus Net Job Creation**

A critical distinction that emerges from this evidence is between formalisation and net job creation. Evidence from Turkey shows that a geographically targeted subsidy that fully covered employer social security contributions for small firms with fewer than ten employees produced a significant increase in registered formal employment — but this rise was driven primarily by the formalisation of workers already employed informally rather than the creation of new jobs (Asik et al. 2022). The effect was especially pronounced among small firms operating on thin margins, for whom contributions represent a major barrier to entering the formal sector. This suggests that contribution costs matter less for employment levels overall than for the split between formal and informal work.

### **C. Developed Countries**

Social security contributions occupy a contradictory position in developed economies: they are the financial backbone of the welfare state, yet the labour tax wedge they create can simultaneously dampen both the incentive to work and the willingness to hire. In these countries, social security is broadly conceived as a publicly mandated system of income protection, funded chiefly through payroll levies on employers and employees alike. The prevailing financing model is pay-as-you-go, under which the current working population underwrites the benefits of retirees and other vulnerable groups — an intergenerational arrangement whose sustainability depends on a broadly stable age structure and a large base of formal employment. In contrast, the situation in India is fundamentally different. Social security remains limited in scope and largely restricted to the formal sector through institutions like the Employees' Provident Fund Organisation and Employees' State Insurance Corporation. A large share of the workforce, engaged in informal and unorganised activities, remains outside these systems. As a result, social protection in India relies more on targeted welfare programmes than comprehensive social insurance, making coverage—rather than contribution rates—the central issue for analysis

In the developed economies, country-level architectures differ considerably, though they share this common foundation. The United States channels dedicated payroll taxes into Social Security and Medicare. Germany's Bismarckian tradition ties entitlements directly to an individual's lifetime contribution record. The United Kingdom's National Insurance

system conditions access to pensions, jobseeker's support, and healthcare on a history of qualifying contributions. The Nordic states take the most expansive approach, funding near-universal social protection through general taxation rather than individual contribution accounts, effectively severing the link between what a worker pays in and what they are entitled to receive. Despite these design differences, all of these systems share three preconditions that make them viable: high rates of formal employment, strong tax administration capacity, and ageing populations that generate both the political demand for social protection and the fiscal imperative to sustain it.

### **1. The Tax Wedge and Aggregate Employment**

In developed economies, the tax wedge — the difference between what employers pay in total labour costs and what workers take home in net wages — is the primary channel through which social security contributions affect employment. Layard and Nickell (1999) find that a 10-percentage point reduction in the tax wedge increases employment by approximately 3.7 percentage points, and that active labour market policies can offset the negative effects of high social security benefits. Nickell (2003) confirms that higher tax wedges raise labour costs and reduce labour input, with tax differences explaining a significant share of employment gaps between Europe and the United States. Daveri and Tabellini (2000) show that these effects are strongest in Continental Europe, where wage-setting institutions limit adjustment, but weaker in Scandinavian and Anglo-Saxon systems.

### **2. Tax-Benefit Linkage and Employment**

A key finding in the developed country literature is that the employment effect of contributions is strongly influenced by the degree of tax-benefit linkage — how clearly workers perceive the connection between contributions paid and benefits received. Bozio et al. (2019), studying the French system, show that when linkage is strong and salient, workers accept lower current wages in exchange for future benefits, preventing an increase in total labour costs. In such cases, contributions function like deferred wages and do not distort employment. When linkage is weak, workers do not adjust wage demands, leading to higher labour costs for firms and reduced labour demand. Contributions tied to pensions are found to have smaller employment effects than those funding general benefits such as family allowances or health spending — a finding with direct relevance for the design of India's social security architecture.

### **3. Targeted Payroll Tax Cuts and Active Labour Market Policies**

Evidence on targeted payroll tax cuts reinforces the importance of the cost wedge for specific worker groups. Sáez, Schoefer & Seim (2019) show that Sweden's age-targeted payroll tax cut for workers aged 19–26 increased youth employment by 2–3 percentage points, mainly by drawing inactive individuals into the workforce. Similarly, Crépon & Desplatz (2003) find that targeted payroll tax reductions for low-wage workers in France increased employment by 2–3 per cent, particularly among low-skilled workers. A key complementary insight from Layard & Nickell (1999) is that the negative employment effects of generous social security systems can be substantially mitigated by active labour market policies that maintain labour market attachment, improve job matching, and reduce unemployment duration — a complementarity best illustrated by the Nordic flexicurity model.

### 3.6 Literature review: Impact on labour productivity

#### 3.6.1 Theory

The theoretical impact of social security on labour productivity operates through competing mechanisms. Where contributions fund health cover and tenure-linked benefits, they preserve the physical capacity of the workforce and reduce costly turnover, generating productivity gains that can exceed the compliance burden. Where they crowd out firm investment in technology and training — particularly for small and financially constrained enterprises — productivity may suffer. Where contributions induce capital substitution, measured output per worker may appear to rise, but this is a statistical artefact of employing fewer workers rather than evidence of genuine technological progress, and comes at the direct cost of employment. As with employment, the net productivity effect is therefore an empirical question whose answer depends on firm size, benefit design, and the institutional environment in which mandates operate

**Table 3.3: Theoretical impact of social security on productivity predicted by micro theories**

Predicted Effect	Theoretical Model	Key Assumption	Mechanism
Negative	Financial Constraints and Investment Theory (Fazzari, Hubbard and Petersen, 1988)	Small and credit-constrained firms face competing claims on limited internal funds	Mandatory contributions reduce resources available for investment in technology, R&D, and worker training; for firms already operating on thin margins, compliance obligations crowd out productivity-enhancing expenditure
Positive	Learning by Doing and Tenure Theory (Arrow, 1962)	Productivity rises with cumulative experience and firm-specific skill accumulation	Tenure-linked benefits such as gratuity and EPF raise the cost of voluntary separation, extending average job tenure; longer-tenured workers accumulate tacit knowledge and firm-specific skills, raising output per worker over time
	Aggregate Demand Stabilisation (Keynes, 1936)	Social security transfers sustain household consumption during downturns	By maintaining consumer spending during recessions, social security prevents the destruction of productive organisational capacity; firms that would otherwise contract are kept viable, preserving long-run productivity

Ambiguous	Solow Growth Model (Solow, 1956)	Output per worker rises with the capital-labour ratio	Where contributions raise formal labour costs without a compensating productivity gain, firms substitute capital for labour, increasing measured output per worker; however, if this substitution is policy-induced rather than technology-driven, the gain reflects allocative inefficiency rather than genuine productivity growth
	Efficiency of Social Spending Theory (Esping-Andersen, 1990)	The productivity return to social security depends on institutional design rather than contribution levels	The same level of contributions can generate high productivity returns where tax-benefit linkage is transparent and benefits are genuinely valued, or negligible returns where pooled systems weaken the perceived connection between contributions and entitlements

**Source:** Authors' compilation

### 3.6.2 Empirical Evidence

#### A. India

##### 1. Capital Deepening and Allocative Inefficiency

The relationship between social security mandates and productivity in India operates primarily through the capital deepening channel. Hasan, Mitra and Sundaram (2013) establish that India employs techniques of production that are significantly more capital-intensive than other countries at comparable stages of development — more so even than China across a range of industries. The authors identify policy distortions, particularly stringent labour regulation, as a primary explanation: regulation raises the effective cost of formal employment to the point where firms rationally substitute capital for labour even when the underlying factor endowment would suggest the opposite. While higher capital intensity can increase measured labour productivity, such gains may reflect allocative inefficiency driven by policy distortions rather than genuine technological progress.

##### 2. Trade Reform, Relative Prices, and Labour Displacement

Hasan, Mitra and Ramaswamy (2007) find that in states with more restrictive labour regulations, labour demand became significantly less responsive to wage changes — firms adjusted to competitive pressure through capital substitution rather than employment flexibility. Sen and Das (2015) add an important nuance: trade reforms made capital goods cheaper relative to labour over time, inducing firms to substitute machines for workers as a response to shifting relative prices. The two explanations are not mutually exclusive — regulation raising the cost of labour and trade reform lowering the cost of capital push in the same direction, and their combined effect on productivity and employment exceeds what either would produce alone.

### **3. Structural Rigidity and Demand Responsiveness**

Adhvaryu, Chari and Sharma (2013) show the downstream consequence of this structural substitution: industrial employment in states with stricter labour regulations is less sensitive to local demand shocks, consistent with firms having already reorganised production around a capital-intensive model that minimises dependence on formal labour. The employment margin has effectively ceased to function as a buffer — firms no longer expand or contract workforces in response to demand because the underlying production structure no longer requires them to do so.

## **B. Other Developing Countries**

### **1. Social Security as an Efficiency Wage**

In developing labour markets, the most important productivity channel is the efficiency wage mechanism. A robust benefits package increases the cost of job loss, creating a self-disciplining mechanism where the penalty for dismissal — forfeiting future security — incentivises higher individual productivity. Evidence from Vietnam shows that social security coverage reduces labour turnover and encourages longer worker tenures, enabling the mastery of firm-specific machinery and internal workflows. A 10 per cent increase in coverage is estimated to raise per-worker productivity by 1.1 per cent to 2.6 per cent (Lee & Torm, 2017).

### **2. The Tax Wedge as a Barrier to Productivity Gains**

The path to these productivity gains is often obstructed by the tax wedge. In Pakistan, high regulatory overhead and social contribution costs have driven a significant rise in temporary labour. When firms bypass formal contracts to avoid immediate costs, they sacrifice long-term productivity — temporary workers have less incentive to master specialised tasks, generating a cycle of low-skill, low-productivity output. Location-based tax incentives in India, such as those implemented in Uttarakhand and Himachal Pradesh, illustrate the mirror image: by reducing the cost wedge for entering the formal economy, these incentives triggered growth in new factories and expansion of existing ones, with particular benefit for smaller, credit-constrained firms (Chaurey, 2017).

### **3. Economic Shocks and the Informality-Productivity Trap**

Evidence from Brazil and Mexico shows that during recessions, the high fixed cost of social security makes it nearly impossible for informal workers to transition into formal, higher-productivity roles (Bosch & Maloney, 2008). Because the cost of the social mandate exceeds the marginal productivity of workers during a downturn, the economy experiences an informalisation response that traps a large portion of the workforce in the unregulated sector, where they lack access to the organisational structures, capital, and learning-by-doing opportunities that drive productivity growth over time.

## **C. Developed Countries**

### **1. Social Security as a Productive Investment**

In developed economies, a significant strand of literature views social security as a productive investment rather than a cost. Health insurance improves worker capacity; income security enhances job matching efficiency; and social protection facilitates adjustment to technological change. Social security also functions as an automatic stabiliser, sustaining aggregate demand during downturns and thereby protecting the investment and organisational capacity of firms. Auerbach and Feenberg (2000) find that

payroll and income taxes can offset up to 8 per cent of GDP shocks, helping stabilise investment and labour markets. Evidence from OECD countries shows that more efficient social security systems are associated with better healthcare outcomes and a more productive workforce.

## **2. Crowding Out and Capital-Labour Substitution**

Running against this are the investment crowding-out and capital substitution effects. Higher contributions reduce resources available for technology, research and development, and training — particularly for small and financially constrained firms. Daveri and Tabellini (2000) argue that rising contributions in Europe contributed to long-run capital deepening, explaining both higher labour productivity and persistently higher unemployment — a combination that illustrates the ambiguity of productivity gains achieved through policy-induced capital substitution rather than genuine technological progress.

## **3. Institutional Context and the Productivity-Employment Trade-off**

The resolution of this ambiguity depends heavily on institutional context. In Nordic economies, high contributions coexist with strong productivity and employment because of effective tax-benefit linkage, active labour market policies, and flexible labour markets. In Continental Europe, rigid wages amplify distortions and productivity gains from capital deepening are offset by persistently high unemployment (Daveri & Tabellini, 2000). In Anglo-Saxon economies, lower contributions and flexible labour markets allow greater wage adjustment, reducing the distortionary effect on both productivity and employment. The overarching lesson is that the productivity effect of social security is shaped less by its level than by the institutional architecture within which it operates — a lesson that carries direct analytical weight for the Indian case, where institutional design rather than contribution rates is the binding constraint on both coverage and efficiency.

## **3.7 Summary of expected impacts in India**

The Code on Social Security, 2020 represents the most significant restructuring of India's social security architecture since the EPF and ESI Acts were enacted in the early post-independence period. Its employment and productivity effects, however, cannot be read off the statute alone. The theoretical frameworks reviewed earlier establish that the direction and magnitude of these effects depend critically on how the mandate interacts with the structure of the labour market, the size distribution of firms, and the degree to which workers perceive contributions as deferred wages rather than a pure tax. The specific design features of the Code — its tiered threshold architecture, its administrative fragmentation, and its novel provisions for gig and platform workers — each generate distinct predictions that can be assessed against the empirical record.

### **3.7.1 Impact on employment**

#### **1. Effect on Formal Employment**

The Code does not apply a single uniform threshold. EPF obligations attach at twenty workers, ESI at ten, and gratuity and maternity benefit at ten for shops and establishments. This tiered structure creates a graduated compliance burden that rises sharply as an establishment crosses successive thresholds. The neoclassical prediction is unambiguous: establishments operating just below these thresholds have a strong

incentive to remain sub-threshold, either by limiting hiring, by fragmenting operations across multiple legal entities, or by substituting contract and casual labour for regular workers. The extension of social security benefits to contract workers under the Code partially reduce this incentive, as principal employer liability now formally attaches to contractor-mediated employment relationships. However, given persistent enforcement asymmetries between regular and contract arrangements, and the lower administrative burden associated with indirect employment, contractualisation is likely to remain an attractive margin of adjustment for establishments seeking to manage regulatory thresholds. The incentive has been weakened in design but not eliminated in practice.

The removal of the scheduled employment restriction for EPF is the one structural change that unambiguously widens coverage. Under the predecessor regime, industries not listed in the EPF schedule were exempt regardless of size. The Code removes this exemption, bringing previously excluded sectors into the EPF net. For firms in these newly covered sectors that were already paying above the EPF wage threshold, the effect on employment is likely to be modest — the cost was already being partially borne. For smaller firms in newly covered sectors operating close to the twenty-worker threshold, however, the extension of EPF obligation adds significantly to the cost of crossing the threshold, potentially intensifying the bunching behaviour already documented in the adjacent literature.

## **2. Effect on Informal Employment**

A substantial share of India's workforce is employed in enterprises operating below the ten-worker ESI threshold and the twenty-worker EPF threshold. The Code does not extend mandatory coverage to sub-threshold establishments, and the appropriate instruments for doing so — contributory schemes, state-funded floors, or simplified compliance regimes — remain outside the Code's current architecture. The theoretical prediction here follows directly from the dualism model: as long as a large and accessible informal sector sits outside the regulatory perimeter, any tightening of compliance within the formal sector will produce informalisation rather than net employment reduction. Workers displaced from formal arrangements, or workers who would have entered formal employment, are absorbed into the sub-threshold informal economy rather than leaving the labour market altogether.

## **3. Gig and Platform Worker**

The employment implications for the gig economy are inherently complex, as platform aggregators—facing new contribution obligations tied to their turnover—may seek to neutralise these costs by suppressing piece rates or capping total work volume. The ultimate net effect on gig employment remains a critical empirical unknown, contingent upon the price elasticity of labour supply and the extent to which workers equate the utility of statutory benefits with a reduction in immediate take-home earnings. Consequently, whether this legislative shift leads to enhanced worker security or an unintended contraction in available gig opportunities is a dynamic that the current Code's design cannot resolve in advance.

### **3.7.2 Impact on productivity**

The predicted impact of social security on productivity in India is mixed and highly dependent on firm size and institutional context.

For larger formal firms, the efficiency wage channel generates modest positive gains — coverage reduces turnover, extends tenure, and allows workers to accumulate firm-

specific skills that raise output over time. However, where contribution obligations raise the cost of formal labour, firms substitute capital for labour, inflating measured productivity without reflecting genuine technological progress.

For small and micro enterprises, the prediction is broadly neutral in the short run. Since the Code preserves the same worker thresholds as previous provisions — 20 workers for EPF and 10 for ESIC — no new category of small firm is drawn into compliance, and the crowding out argument loses much of its force. For firms already above the threshold, legislative consolidation may even reduce administrative friction marginally. The more significant distortion is the threshold effect itself: the longstanding incentive for firms to artificially cap their workforce below the trigger point to avoid compliance obligations. This threshold-hugging behaviour suppresses firm growth and forecloses the scale economies that drive long-run productivity gains — a structural constraint the Code does nothing to correct.

At the formal-informal boundary, high contribution costs trap workers in the informal sector, where they are excluded from the organisational structures and learning opportunities that drive long-run productivity growth, consistent with Brazilian and Mexican evidence showing that social security costs prevent upward transitions into formal, higher-productivity employment during downturns.

For gig workers, the revenue-linked contribution model could in principle reduce turnover and sustain consumption, but the net effect depends on whether aggregators absorb the cost or pass it through to workers via lower piece rates — an empirical question the Code cannot resolve by design.

The overarching prediction is therefore one of divergence: modest productivity gains in the large formal sector, a growth-suppressing threshold distortion in the small firm segment, and the informal majority left structurally excluded from any benefit. The binding constraint is not the level of contributions but the institutional design of the thresholds and delivery architecture within which they operate.

### **3.8 Policy Implications**

The Code represents a genuine structural advance over the fragmented regime it replaces, but its effectiveness depends on how well the remaining gaps are addressed through administrative action.

The unification of nine statutes into a single compliance architecture meaningfully lowers the fixed cost of formal employment. Realising this potential, however, requires closing the delivery fragmentation that persists behind the unified interface. The Central Board, ESIC, the National Social Security Board, and State Welfare Boards remain operationally separate; a roadmap toward genuine single-window delivery would convert front-end consolidation into a substantive reduction in compliance overhead.

The Code's empowerment of the Central Government to revise EPF and ESIC wage ceilings by notification is a well-designed flexibility mechanism, but its value depends entirely on its use. With ceilings frozen since 2014 and 2017 respectively, a formal indexation mechanism would ensure this flexibility is exercised systematically rather than episodically.

The recognition of gig and platform workers is the Code's most institutionally significant innovation. The aggregator contribution model is structurally sound, but translating it

into operative social protection requires time-bound notification of contribution rates, scheme design, and fund governance — the legislative foundation is complete; the administrative superstructure is not.

The threshold architecture remains the binding constraint on coverage expansion. A contribution structure that scales proportionally with firm size, rather than activating as a step function at the threshold, would reduce the bunching incentive that the literature consistently identifies as a primary driver of informalisation.

Beyond these structural issues, the Code's actual impact will be shaped significantly by state-level implementation. Two channels are particularly consequential. First, the mandatory obligation on states to frame welfare schemes for unorganised workers across seven domains — including provident fund, employment injury, housing, and old age protection — is real, but the statute specifies neither the content nor the timeline of these schemes. A fiscally constrained state may frame schemes on paper without the capacity to operationalise them, while better-resourced states translate the same mandate into substantive coverage. Unorganised worker protection will therefore reflect the preexisting administrative and fiscal hierarchy among states as much as the Code's architecture. Second, ESIC medical benefit delivery is subject to negotiated agreement between the Corporation and each state government on the nature, scale, and cost-sharing of treatment. This makes the quality of medical care a function of state health infrastructure and bargaining capacity — producing a quality gradient in ESIC benefits that broadly mirrors the quality gradient in state health systems. The uneven pace of state rule adoption compounds both risks; central support through capacity-building and performance-linked fiscal transfers would raise the floor for states that have not yet moved.

## Chapter 4: The Industrial Relation Code

### 4.1. Introduction

The International Labour Organization (ILO) proposes that effective industrial relations, based on collective bargaining, dispute resolution, and workers' protection, should be ensured for industrial stability and productivity (ILO Convention 1976). This framework has been extended across economies to create laws and regulations in their unique contexts.

In India, the industrial relation framework that existed between early 1900's till 2020 is broadly captured through three key laws: The Trade Unions Act, 1926, which provided legal recognition to trade unions; the Industrial Employment (Standing Orders) Act, 1946, which required employers to define conditions of employment formally; and the Industrial Disputes Act, 1947, which established procedures for dispute resolution, layoffs, retrenchment, and closure. Together, these legislations reflect a long-standing attempt to balance worker protection alongside industrial growth in the organized sector.

During the 1970's and 1980's, the direction in which amendments were being made increasingly strengthened worker protection, including conditions for retrenchment and closure, and expanded safeguards for union activity. However, post-1991 liberalization and increasing globalization, greater flexibility was needed in the labour market.

By the early 1990s, India's labour law architecture had become highly fragmented and had substantial variation in state-level enforcement. Firms were required to comply with overlapping reporting requirements and navigate parallel procedural systems. This increased compliance costs and regulatory uncertainty, particularly for medium-sized enterprises (100 to 300 workers) seeking to expand, restructure, or adjust employment levels.

These conditions bolstered the requirement for reform with a focus on simplifying the legislative process while delicately balancing worker protection and enabling firm flexibility. The Industrial Relation Code 2020 is one of the cornerstone reforms in the overhauling of the labour laws and an attempt to uniformize industrial relations legislation under a single overarching legal framework.

#### **Observations of the Second National Labour Commission (2002)**

The Second National Commission on Labour highlighted the issue of lack of coherence, which weakened both industrial harmony and regulatory clarity. It noted that labour legislation had evolved in a piecemeal manner, increasing the overall complexity for compliance and effective negotiations.

**a. Trade Union Regulation:** Under the Trade Unions Act, the Commission highlighted several structural weaknesses, including low registration thresholds that led to a proliferation of small and competing unions. The existing fragmentation weakened the collective bargaining power. The absence of a clear statutory framework for recognizing a single negotiating agent further complicated industrial negotiation.

**b. Retrenchment and Closure Provisions:** Under the Industrial Disputes Act, firms with 100 workers (or at amended state-level thresholds) required prior government permission for layoffs, retrenchment, or closure in larger establishments. The Commission observed that this requirement often led to administrative delays and

uncertainty. In several cases, closure applications remained pending for extended periods, increasing financial strain on firms. The expansion of the judicial definition of “retrenchment” further increased litigation and compliance risks, while the mandated prior notice for changes in service conditions reduced the firms’ ability to respond quickly to technological and market demand shifts.

**c. Standing Orders Framework:** The Standing Orders Act mandated formal certification of employment conditions for establishments having 100 workers or more. The commission noted that the certification process was cumbersome, particularly for enterprises near the threshold. Moreover, the existing model standing orders were outdated and misaligned with evolving workplace practices. It also highlighted that the smaller units were without standardized employment conditions, making workers more vulnerable.

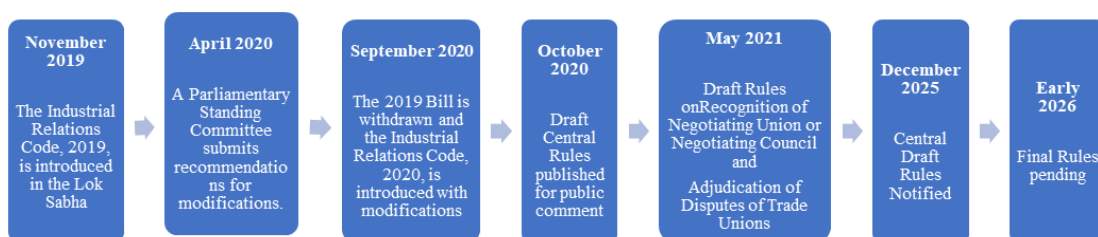
**d. Systemic Shortcomings:** At a broader level, the Commission emphasized two key issues: prolonged dispute resolution and a lack of coherence across labour laws. This imposed high costs on workers while reducing predictability for firms. The overall framework was seen as insufficient in fostering a productive and cooperative work environment.

## 4.2. Chronology of Industrial Relations Code

### 4.2.1. Legislative Timeline

The above-mentioned observations of the Second National Commission on Labour formed the basis for debate around the reforms, which led to the drafting of the Industrial Relations Code, 2020, consolidating the three major statutes into a unified framework. The objective of the consolidation by theme was to reduce regulatory fragmentation, lower compliance costs, and improve clarity for both employers and employees. The substantive effort was to retain core worker protections and enable greater flexibility for firms. This required a series of deliberations as shown in **Figure 4.1**.

**Figure 4.1: Chronology of the Reform Process:**



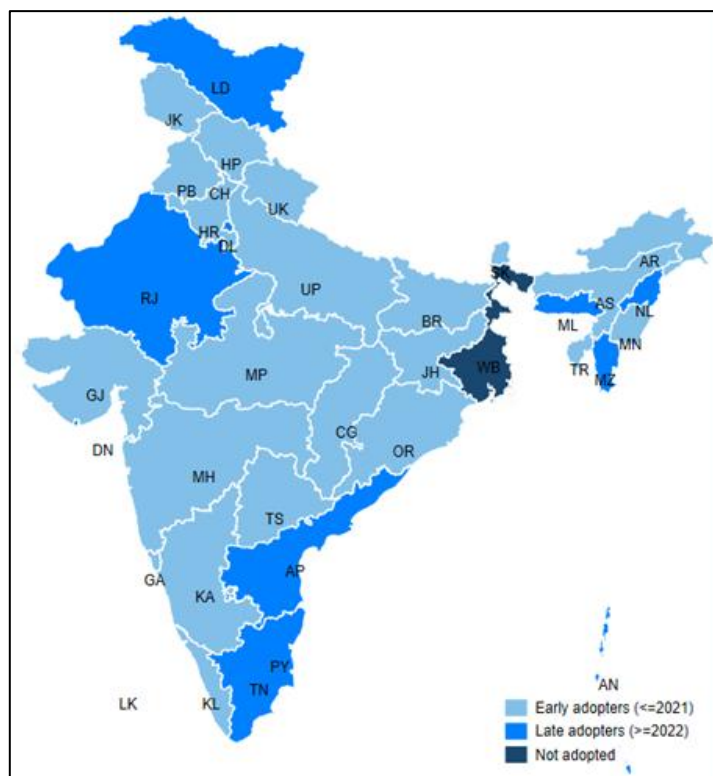
**Source:** Authors’ compilation based on Central gazette notifications

### 4.2.2. State-level Development in Industrial Relations Legislation

Following the passing of the IR Code 2020 bill, states initiated the process of operationalizing the framework through the publication of draft rules. Many states moved relatively quickly, issuing draft rules during 2020–2021, following the enactment of the Code at the Central government level.

**Figure 4.2** presents the early and late adopters across states, while [Online Appendix](#) provides detailed information on the timing of publication of initial rules.

**Figure 4.2: State-wise Timing of Adoption of Rules under the Industrial Relations Code**



**Source:** Authors' compilation using States and UT gazette notification of the draft rule for industrial relations code.

**Note:** The map above shows the year the industrial relations draft rules for a State or Union Territory have been given a gazette notification

A smaller group of states adopted the framework later, including Andhra Pradesh, Mizoram, Tamil Nadu, Rajasthan, and Ladakh in 2022; Meghalaya and Andaman and Nicobar Islands in 2024; and Nagaland, Delhi, Lakshadweep, and Nagar Haveli & Daman and Diu in 2025. West Bengal remains the only state that has not issued draft rules.

### 4.3. Key Changes in the Industrial Relations Code, 2020

The Industrial Relations Code, 2020 (IR Code), consolidated and retained many of the legal definitions from the three repealed Codes. While many other terms have been updated and expanded, their core legal essence and structure are carried forward. Some new terms have also been added to expand the coverage of the law. A summarized table of the core changes in the definition and structure that impact the overall implications for industrial relations can be found in the [Online Appendix](#).

#### Structural and definitional changes in the Industrial Relations Code

- a. Reduction in regulatory complexity, with rules reduced from **105 to 51**, forms from **37 to 18**, and returns have been consolidated, easing compliance for employers.

- b. The threshold for the size of the firm that requires government permission before retrenchment has been expanded from 100 or more workers to 300 or more workers.
- c. Introduction of a Worker **Re-skilling Fund** to provide support for retrenched workers, requiring employers to contribute 15 days' wages for retraining workers. The Central draft rules specify that it functions as a one-time top-up to the retrenchment payment.
- d. Statutory recognition of **Fixed-Term Employment** with defined benefits and protections, similar to permanent contracts, facilitating temporary hiring by the firms.
- e. Threshold for mandatory standing orders increased from 100 to 300 workers. Deemed certification applies if model standing orders are adopted without modification. Explicit inclusion of “Work from Home” and remote work under the services sector standing orders.
- f. Establishment of a **unified Industrial Tribunal** to replace multiple adjudicating bodies, streamlining dispute resolution. Workers can now directly approach the Tribunal after failed conciliation, enabling faster access to justice.
- g. Formal recognition of negotiating unions/councils as **sole bargaining agents** strengthens collective bargaining. Government recognition of Central and State Trade Unions enhances legitimacy. Introduction of minimum worker thresholds ensures representativeness.
- h. The range of authorities to which a 14-day strike notice must be submitted has been expanded.
- i. Introduction of a statutory compounding mechanism for first-time offences simplifies resolution; mandatory electronic filing and registration enhance transparency and reduce paperwork.

## 4.4. Consolidation of Changes in the law and their Possible Implications

### 4.4.1. Implication of Structural Changes

#### a. Retrenchment Threshold and Fixed-Term Employment

The IR Code raises the retrenchment threshold that does not require prior government permission from 100 to 300 workers and gives legal recognition to Fixed Term Employment (FTE). This reduces the implicit regulatory cost associated with hiring. This change is expected to increase a firm’s sensitivity to market conditions, particularly among the firms where the previous retrenchment threshold, as stated by the Act, was binding. According to ASI 2023-24 data, about 42.4 percent of factories have an employment size of 0-19, 35.2 percent of the factories have an employment size of 20-99, 16.4 percent of the factories have an employment size of 100-499, and 6.0 percent have an employment size of more than 500 workers. Given the bundling of firms just below 100 workers, an increase in scale of firms and number of workers employed may happen, since future downsizing becomes less procedurally uncertain.

However, the legal recognition of short-term hiring may, in the short run, impact the composition of the workers within a firm or industry. There may also be a decrease in contract durations to ease the job destruction by non-renewal of contracts. However, this would make employment and contract tenure decisions relatively more dependent on the demand faced by the firm.

#### **b. Parity for Fixed-Term Workers**

The Code mandates equal wages, statutory benefits, and pro-rata gratuity (after 1 year) for fixed-term workers, aligning them closely with permanent employees. This statute attempts to equate basic provisions between permanent and temporary workers. The intent is to ensure that flexibility does not translate into lower labour standards. However, the actual changes may depend on enforcement dependent on whether the firm is present in a state with pro-worker or pro-employer. The direct impact of this and the presence of other factors impacting bargaining power may dictate the composition of workers employed.

#### **c. Productivity and Firm Restructuring**

An easier adjustment of workforce size lowers the implicit cost of reorganising production. The decrease in adjustment costs allows enterprises to close less productive activities and respond more quickly to technological or demand shifts. This may improve efficiency and hence productivity, particularly in sectors that were previously constrained by rigid labour thresholds. This may be done by either having changes in the composition between contract and permanent workers (short run) or by becoming more capital-intensive (long run). The compositional change may depend on the overall cost, depending on contract type, but the relative cost of labour and capital may pose a longer horizon change to the total requirement of labour itself. Thus, these gains may coincide with a reduction in labour intensity in certain industries, especially where firms substitute toward capital-intensive processes or reduce high-turnover manual employment. Consequently, productivity improvements may be accompanied by sector-specific contractions in labour use, reflecting a rebalancing rather than an expansion.

#### **d. Collective Bargaining Reforms**

The Code introduces structured mechanisms such as a recognized Negotiating Union or Negotiating Council. The objective is to reduce inter-union rivalry and create clearer bargaining channels. For firms, this may reduce negotiation uncertainty and coordination costs. However, higher recognition thresholds may weaken unions' bargaining power due to imperfect consolidation of the previously fragmented union representation. The overall effect on bargaining power and wage dynamics will depend on the implementation and structure or composition of an industrial unit.

#### **e. Unionization in the unorganized sector**

The Code normatively extends recognition to trade unions in the unorganized sector, enabling a wider set of workers to organize and strengthen their bargaining power collectively. It also establishes a formal framework for identifying, registering, and tracking these segments, thereby improving their visibility within the labour system.

This gives policy legroom for extension into recognizing these establishments under legal systems and institutional legitimacy. This, in turn, can support improved access to formal channels, including finance, and create conditions for more stable and structured economic participation.

## **f. Strike Regulations**

The Code requires advance notice for strikes across all industrial establishments and broadens the definition of industrial action. This makes operations more continuous by reducing the likelihood of sudden work stoppages. This, from a firm's perspective, ensures the timely completion of work, enhances predictability, and reduces output volatility. However, the tightening of the strike regulations leads to more compliance requirements from the union's side. This may reduce the labourer's ability to have higher bargaining power in negotiations. The reform, therefore, reflects a trade-off between industrial stability and worker leverage.

In the context of the unorganised sector, the stricter strike provisions may constrain the effectiveness of that bargaining power. This creates a counterbalancing dynamic, where gains in formal bargaining power may be partially offset by limits on the ability to exercise it.

## **g. Compliance Simplification**

The consolidation of multiple laws into a single framework reduces procedural duplication, encourages digitized filings, and introduces monetary penalties for minor offences. This, in effect, is expected to reduce compliance complexity and cost. These may have a particularly pronounced effect for small and growing firms. An easier structure may also allow firms that were remaining in the informal sector due to regulatory costs to formalize.

## **h. Worker Re-Skilling Fund**

The introduction of a Worker Re-Skilling Fund signals recognition that greater exit flexibility requires transitional safeguards. Employers must contribute toward retraining support for retrenched workers. However, its effectiveness is currently under uncertainty as draft rules at present treat this as an additional retrenchment payment rather than an actual avenue to reskill retrenched workers and allow easier transition.

### **4.4.2. Potential Area of Concerns**

The policy has certain concerns and principal strengths in view of its impact on labour employment and productivity:

#### **a. Increased firm flexibility but potential loss for workers:**

- Raising the retrenchment and certification threshold from 100 to 300 workers, along with streamlined certified employment conditions, allows firms to adjust workforce size more efficiently.
- This flexibility can enable firms to reorganize operations, optimize resource allocation, and respond faster to market changes, potentially leading to higher productivity.
- The impact on employment is ambiguous; while lower separation costs may encourage job creation, there may simultaneously be job destruction. The net effect will depend on the relative pace of job creation versus destruction and will be particularly sensitive to market demand. Over the long run, there may also be a shift toward more capital-intensive production.

**b. Minor Improvement in normative Worker Protections:**

- Fixed-Term Employment (FTE) workers are entitled to wages and benefits similar to permanent employees.
- However, FTE workers remain excluded from retrenchment protections if the contract expires, and the absence of limits on successive FTE contract renewals may increase reliance on temporary employment.
- These factors could lead to higher workforce turnover costs and reduced predictability in workforce composition, partially offsetting the protective measures intended for workers.

**c. Ambiguous effect on Collective Bargaining:**

- Formal recognition of negotiating unions and councils creates structured bargaining channels.
- Nonetheless, higher recognition thresholds, the Draft Rules' 30 per cent representation criterion for a sole negotiating agent, and exclusion of certain supervisory workers weaken bargaining power for smaller groups, leaving the net impact on wage negotiations and worker influence uncertain.

**d. Inadequate support to the unorganized sector:**

- While the Code extends recognition to trade unions in the unorganised sector, practical mechanisms to support participation, enforce compliance, and provide benefits remain underdeveloped.
- Consequently, informal workers may continue to face limited protection and representation despite increased visibility.

**e. Normative re-skilling efforts:**

- The Worker Re-skilling Fund acknowledges the need for transitional support for retrenched workers.
- However, its current implementation functions largely as a retrenchment top-up, leaving its effectiveness in improving employability and workforce skill development uncertain.

**f. Un-addressed concerns:**

- Without complementary policy measures, incentives for firms to fully utilize the re-skilling fund to upskill workers so they may be reabsorbed in the workforce may not be fully realized.
- Contract and fixed-term workers at contract expiry are not being counted for the retrenchment thresholds. This may overall decrease worker protection and enable a compositional shift in the workforce. This, at present, may lead to an increase in precarious jobs.
- There is a potential for employer manipulation of worker categories that may further limit the scope of protections.

A key consideration is the change in total costs faced by firms, which are subject to both lower compliance costs under the IR Code and increased costs arising from the other three Codes implemented alongside it. The net effect will depend on how these forces shape aggregate firm behaviour, potentially resulting in more nuanced distortions in hiring and firing decisions than a unidirectional framework would suggest.

#### 4.4.3. Cost Implications - Ease of Doing Business under the IR Code

The Industrial Relations Code introduces several structural and procedural reforms aimed at improving the ease of doing business by reducing regulatory uncertainty, simplifying compliance, and increasing operational flexibility for firms.

**Table 4.1: Principal Ease of Doing Business changes**

Parameter	Pre-code	New IR Code 2020
Deemed Certification for Adoption of Model Standard Order	The employment condition for firms having 100 or more workers needed to be certified in full by the relevant authorities	The employment conditions of firms with 300 or more workers need to be certified only for those aspects that deviate from the government-provided model.
Faster Industrial Dispute Resolution	<ol style="list-style-type: none"> <li>Any dispute hearings were handled by multiple adjudicating bodies.</li> <li>Workers require a government referral to go to the tribunal.</li> </ol>	<ol style="list-style-type: none"> <li>All disputes are handled by a unified tribunal</li> <li>Workers can directly take their cases in front of a tribunal.</li> </ol>
One-on-One bargaining	<ol style="list-style-type: none"> <li>Multiple small and competing trade unions present.</li> <li>Each union with at least 7 members</li> </ol>	<ol style="list-style-type: none"> <li>Only one recognized negotiating union</li> <li>The union needs at least 10% or 100 workers, whichever is less.</li> </ol>
Lower disruption in production activity	<ol style="list-style-type: none"> <li>Strike required notice to public utility services.</li> <li>Unanimous leave is not considered a strike.</li> </ol>	<ol style="list-style-type: none"> <li>Strike requires notice to all industrial establishments 14 days prior.</li> <li>Leave of more than 50% of the workforce together is considered a strike.</li> </ol>
Lower cost due to reduced number of regulatory compliances	High numbers of rules, forms, and returns	The number of rules and forms has been reduced. While the return requires a single consolidated periodic filing.

**Source:** Authors' compilation; Compliance handbook of employers under the Labour Code (2025); Industrial Relations Code (2020)

Given the above-mentioned changes, the relaxation of regulatory requirements, particularly the increase in the standing orders threshold to 300 workers, reduces the fixed cost of compliance for small and medium-sized firms. Firms below this threshold can now operate without the rigidities associated with formally certified employment conditions, enabling quicker adjustments in hiring, job roles, and workplace practices.

Additionally, the provision of deemed certification through model standing orders, with certification required only for deviations, lowers procedural delays and reduces administrative frictions. From a firm perspective, these changes operate primarily on the intensive margin of regulatory burden, reducing the time and resources spent on compliance. This can support hiring by lowering adjustment costs, particularly in firms with limited administrative capacity. However, these provisions do not directly alter core labour cost components, thus, the impact on employment is likely to be marginal.

Simultaneously, the loosening of formal terms of employment engenders heightened contractual uncertainty for employees, especially within companies that are no longer bound by established protocols. This could potentially elevate employee turnover rates and foster moral hazard in the development of human capital, given that both employers and employees encounter diminished motivations to invest in firm-specific skills. Consequently, the impact on productivity remains uncertain; although firms benefit from increased flexibility, diminished job security might impede skill acquisition and overall efficiency, especially in the long run.

Reforms to the dispute resolution framework, including the shift to a unified Industrial Tribunal system and the removal of government referral requirements, aim to reduce delays and improve the timeliness of adjudication. In principle, this enhances operational continuity and lowers regulatory uncertainty, contributing positively to productivity. However, these gains are contingent on institutional capacity. If tribunals become overburdened, delays may persist or even worsen, limiting the effectiveness of procedural simplification.

The formalisation and centralisation of collective bargaining through the introduction of a negotiating union or council reduces coordination failures and transaction costs associated with multi-union negotiations. Similarly, the rationalisation of trade union registration criteria improves representativeness and reduces fragmentation. While these changes enhance predictability in industrial relations, their impact on employment and productivity remains ambiguous, as they primarily affect bargaining structure rather than underlying labour demand conditions.

The generalization of the 14-day strike notice requirement further contributes to predictability by reducing the likelihood of sudden industrial disruptions. This allows firms to better plan production and manage labour relations, generating potential productivity gains. However, this also imposes procedural constraints on workers, potentially affecting the balance of bargaining power.

The Draft Rules (2025) reinforce ease of doing business through digitisation and compliance rationalisation. The consolidation of rules, returns, and forms, along with mandatory electronic filing, reduces administrative burdens, particularly for small and medium enterprises, and lowers the cost of regulatory compliance. This can facilitate hiring, especially for short-duration or flexible employment arrangements. However, the benefits of digitisation depend on the reliability of digital infrastructure and coordination across jurisdictions, without which gains may remain partial.

Finally, the introduction of a compounding mechanism for minor offences reduces litigation risk and allows firms to resolve non-serious violations through monetary penalties rather than prolonged legal processes. This eliminates a category of delay-induced compliance friction and improves the overall industry operation.

Overall, the ease of doing business provisions under the Industrial Relations Code are administratively coherent and directionally aligned with reducing regulatory frictions. They lower fixed and procedural costs, particularly for smaller firms, and improve predictability in industrial relations. However, their effects on employment and productivity are structurally bounded, limited on the one hand by the persistence of substantive labour cost obligations, and on the other by the relatively small share of administrative costs in total firm decision-making. The net impact is therefore likely to manifest through incremental adjustments in hiring and contract structures, rather than large-scale changes in employment levels or productivity.

#### 4.5. Literature Review: Impact on Employment

Under the Industrial Relations (IR) Code, 2020, provisions related to retrenchment, dismissal, severance pay, notice periods, trade unions, and conditions of employment are consolidated into a unified framework. By shaping dismissal procedures, severance obligations, and notice requirements, these laws influence how firms adjust employment in response to economic changes. A key reform is the increase in the threshold for prior government approval for retrenchment.

For compatibility, these retrenchment-related provisions fall within the broader framework of Employment Protection Legislation (EPL). While there is extensive literature on rigid EPL, evidence on its deregulation, particularly in developing countries, remains limited. To address this, the following section synthesizes existing research by identifying key mechanisms through which EPL affects firm behaviour, with a focus on employment and labour productivity. It first outlines the theoretical channels, followed by a review of empirical findings and key takeaways.

##### 4.5.1. Theoretical Impact of the IR Code on Employment

Indian industrial relations framework and the larger literature present in the EPL present several insights from theoretical literature that remain relevant and can be meaningfully applied. A selection of these key deductions for employment is summarized in the table below.

**Table 4.2: Theoretical Implications of the IR Code on Employment**

Predictive Employment Effect	Model	Key Assumption	Mechanism
Positive	Threshold Convergence and Principal-Agent Models (Jensen & Meckling, 1976)	Firms are heterogeneous in employment size and face high compliance costs above a threshold	Firms facing additional fixed compliance costs above the threshold of worker counts have a strong incentive to reduce headcount below the threshold. This causes bunching at the margin and can happen through contract worker substitution, increased capital usage, or firm splitting.

<b>Predictive Employment Effect</b>	<b>Model</b>	<b>Key Assumption</b>	<b>Mechanism</b>
	Insider-Outsider Problem (Blanchard & Giavazzi, 2003)	Strong bargaining power reduces hiring	Already employed (insiders) use their bargaining power to secure higher wages and job protection. Firms are discouraged from hiring outsiders due to anticipated future bargaining rents and firing costs.
	General Equilibrium (GE) Model (Helpman & Itskhoki, 2007)	Firing restrictions act as a labour wedge in regulated sectors	Strict EPL contract formal activity and induce a massive reallocation of labour toward unregulated, less productive sectors
Negative or Neutral	Institutional Mediation (Aghion et al., 2008)	Enforcement and institutional quality vary across regions	Effects of EPL depend heavily on enforcement, judicial interpretation, and state-level variation
	New Keynesian model with labour market frictions and endogenous producer entry (Cacciatore et al., 2015)	Firm entry and hiring are a gradual process, while layoffs are immediate	Firms adjust to regulatory changes cautiously, as hiring involves sunk costs and uncertainty, while layoffs can be implemented quickly. This asymmetry dampens immediate employment expansion despite deregulation.
	Zombie Firm Phenomenon (Exit Costs) (Hopenhayn, 1992)	Exit barriers trap resources in unproductive units	Costly exit traps labour and capital in unproductive firms. Even if hiring becomes more flexible, weak exit mechanisms limit reallocation and dampen aggregate employment gains.
	Dynamic Demand with Two-Tier Reform (Bouis et al., 2012)	Reforms apply unevenly across firm sizes or worker types	Partial deregulation shifts distortions to new margins. Initial employment gains may be offset as firms adjust strategically, recreating segmentation.

**Source:** Authors' compilation

While these theoretical predictions provide useful guidance, their translation into real-world outcomes is riddled with complex interactions between firm size, workforce composition, and market structure. The distribution of firm sizes shapes the magnitude of responses to regulatory threshold changes, while market power, like the presence of monopoly or oligopolistic structures, influences how changes in compliance costs are internalized. In addition, state-level variation in enforcement influences firm behaviour around regulatory tipping points. Hence, the effect of policy measures, such as raising thresholds, comes with caveats that need consideration.

The presence of thin literature on deregulation in general implies that analysis of these changes lack analytical rigor and may be irregular. More broadly, such changes do not eliminate distortions but shift the tentative equilibrium, simultaneously leaving some workers, previously within the coverage threshold, without formal protection. The ultimate impact is highly context-dependent, shaped by factors such as the prevalence of informality, existing capital intensity, and rigidity in wage adjustments. Even when theoretical channels remain consistent, their realized effects can differ across sectors and over time due to evolving institutional and economic conditions. A literature analysis with broad coverage allows us to examine these variations, and the following sections present empirical evidence to assess these dynamics.

#### 4.5.2. Empirical Evidence of the Impact of IR Code on Employment

- **Threshold-Induced Growth Barriers:** Firm-size thresholds encourage firms to stay small to avoid stricter rules, limiting expansion and reducing job creation. This distortion weakens at higher thresholds where firms have already absorbed compliance costs. Hence, expansion of these thresholds may reduce cost and stimulate employment, but the actual impacts may be limited
- **Asymmetric Deregulatory Shedding:** The relaxation of labour restrictions often leads to an immediate increase in job separations as firms utilize new flexibility to shed inefficient labour, which may not be immediately offset by new hiring. The net effect on employment is therefore often ambiguous or negative in the short run, as the pace of job destruction can potentially outstrip the pace of job creation depending on prevailing market demand.
- **Institutional and Judicial Mediation of Outcomes:** The impact of labour laws depends heavily on how strictly they are enforced and interpreted. Strong enforcement can reduce hiring, while weak enforcement can dilute worker protections.
- **Synergistic Effects of Complementary Reforms:** Labour reforms are more effective when combined with broader economic reforms, such as easing business entry or increasing trade, which create conditions for job growth.

##### 4.5.2.a. Empirical Evidence from India

Most empirical literature present in India focuses on the institutional framework created by the Industrial Disputes Act (IDA), along with state-level amendments that altered the degree of job security protection. Very little literature is present on the Industrial Relations Code introduced in 2020.

Before the introduction of labour codes the general debate was around rigid EPL in the discourse of industrial relation legislation which had two opposing ideas which Goswami

and Paul (2021) have very aptly summarised – one strand of literature argues that restrictive labour laws constraint firms by incentivizing them to remain small and encourage reliance on contractual workers or capital-intensive technologies (Hasan, Kapoor, Mehta, and Sundaram 2017; Ahluwalia, Hasan, Kapoor, and Panagariya 2018; Amirapu and Gechter 2020; Hasan, Mehta, and Sundaram 2020, as cited in Goswami and Paul, 2021). While the opposing view contends that labour laws could not solely be blamed for India’s sluggish growth (D’Souza 2010; Roychowdhury 2014; Chatterjee and Kanbur 2015; Deakin and Haldar 2015; Roy, Dubey, and Ramaiah 2020 as cited in Goswami and Paul, 2021). This debate has now been extended and is being analysed in the new frame of the Industrial Relations Code, though the heterogeneous impact in the empirical literature remains.

Negative employment effects are widely documented in the Indian context, particularly in relation to the tightening under the Industrial Disputes Act. Using a district–industry panel covering the period 1974–1990, Kotia et al. (2025) show that the 1982 IDA amendment, which tightened firing restrictions for factories employing between 100 and 300 workers, led to a 27 per cent decline in manufacturing employment in the affected units. Similarly, Sofi et al. (2022) exploit variation in high-court verdicts to demonstrate that firms located in states with pro-worker judicial regimes employ approximately 9 per cent fewer workers than firms in pro-employer states. This is specifically linked to the increase in bargaining power of the permanent employees (insiders) in pro-worker judicial regimes. Further evidence on the relationship between labour regulation and economic outcomes is found in Besley & Burges (2004). Using data on Indian firms, they found that high labour market rigidities adversely affect employment. Hopenhayn & Rogerson (1993, as cited in Chaudhary and Sharma (2022), also demonstrate that highly restrictive labour laws can affect firm creation as well as employment creation. Goswami and Paul (2021), applying a difference-in-differences framework to the 2014 Rajasthan deregulation, also document an unintended decline of around 3 per cent in total employment within existing plants, as firms used the increased regulatory flexibility primarily to shed workers rather than expand hiring.

Positive employment effects, while less frequently documented, emerge in contexts where complementary reforms improve firm entry and expansion opportunities. For example, Aghion, Burgess, Redding, and Zilibotti (2005) find that industrial delicensing increased the number of factories by lowering entry barriers, which in turn created opportunities for employment expansion, although the magnitude of these gains varied across States depending on their labour regulatory environment. This suggests that employment protection policies may generate more favourable employment outcomes when combined with broader market reforms that stimulate investment and firm growth. Another recent study by Ahluwalia, Hasan, Kapoor, and Panagariya (2018) analyses the impact of labour regulations on employment and wages. They use the 2005 abolition of the quota restrictions on the export of apparel and textile products from developing to developed countries and the variation in the labour regulations across the Indian state as a natural experiment to find the effect of labour regulation. They find significant benefits in employment and wages post 2005 in the apparel and textile industries in states with flexible labour laws. This is further supported by Kaplan (2009), as cited by Gwatidzo and Moyo (2014), who found that flexible labour markets, through job reallocation, tend to increase employment creation. The gains of labour market flexibility are more pronounced in those environments or countries with highly regulated labour markets.

Ambiguous or mixed employment effects often arise when firms adjust along margins other than total employment. Chaudhary and Sharma (2022) show that while Rajasthan's reforms reduced the cost (through lower firing cost) on labour, they had no measurable effect on overall state-level manufacturing employment because firms responded primarily by substituting permanent workers with contractual labour. Similarly, Chaurey et al. (2023) demonstrate that penalizing the use of contract labour in Andhra Pradesh reduced its use by 42–47 percent on the intensive margin but simultaneously increased informality on the extensive margin as firms that would have formalized instead chose to remain unregistered. In addition, Chatterjee et al. (2025) use a dynamic model to show that reducing firing costs alone can lower employment by approximately 14 percent, whereas relaxing direct exit barriers, such as bankruptcy restrictions, can simultaneously increase both productivity and employment. Together, these findings highlight that the employment effects of EPL in India are often mediated by structural adjustments in firm behaviour, labour composition, and sectoral allocation rather than by simple changes in the total number of jobs.

#### **4.5.2.b. Empirical Evidence from Other Developing Economies**

Negative employment effects have been documented across Latin America and Africa. Jaramillo (2019), using a difference-in-differences approach in Peru, shows that a 2001 reform strengthening dismissal protections led to a 70 percent drop in the probability of obtaining permanent contracts. In Africa, Gwatidzo and Moyo (2014), using a pooled cross-country regression across Botswana, Kenya, Nigeria, Swaziland, Tanzania, and Uganda, find that restrictive regulations reduce total employment and stifle labour market fluidity. A survey by Djankov and Ramalho (2009) corroborates that developing countries with rigid labour laws tend to experience higher unemployment, particularly among youth.

Ambiguous or mixed effects often arise when other factors, like interactions with public sector policies, are present. For example, Yassin and Langot (2017) show that in Egypt, while labour market liberalization reduced firing taxes, the potential gains were offset by rising public sector wages, which increased reservation wages and job separations without generating commensurate new hires. Similarly, Betcherman's (2014) meta-reviews suggest that interaction effects are more widespread, finding that in developing countries, employment outcomes are highly sensitive to model specifications and institutional context, and generally show more modest effects than the debate often implies.

#### **4.5.2.c. Empirical Evidence from Developed Economies**

Negative effects on employment arise when strict employment protection legislation (EPL) raises dismissal costs and discourages firms from hiring. Bassanini, Nunziata, and Venn (2008) also find that stringent dismissal regulations act as a tax on job separations, discouraging new hiring and extending unemployment durations in OECD countries. Bornhäll et al. (2016) highlight that the last-in-first-out (LIFO) principle in Sweden makes firing costly, leading small firms to avoid expanding to maintain flexibility. Similarly, Garicano, Lelarge, and Van Reenen (2016) show that regulatory thresholds in France and other European countries create distortions in firm size, lowering large-firm employment and raising the number of inefficient small firms.

Positive employment effects are observed when labour reforms reduce firing costs or increase labour market flexibility. Bouis et al. (2012) find that active labour market policies and product market deregulations can increase hiring even in the short term,

though reductions in job protection may temporarily increase layoffs. Ciminelli and Franco (2025) document that in Italy, lower firing costs facilitated firm entry and exit, increasing headcount growth, while Bertoni, Chinetti, and Nisticò (2023) show that replacing reinstatement requirements with fixed financial compensation in Italy increased job separations and mobility, allowing workers to transition to more efficient firms. Lee and Cheon (2004) provide evidence from South Korea that reforms enabling collective dismissals and the hiring of irregular workers increased labour turnover and flexibility, which facilitated better allocation of workers across firms. Dräger and Marx (2012) demonstrate that in rigid European labour markets, temporary contracts act as a buffer, allowing firms to adjust staffing in response to demand fluctuations, thereby increasing employment in flexible arrangements.

Mixed or neutral employment effects appear when reforms create trade-offs between flexibility and worker protection. Bouis et al. (2012) show that two-tier reforms, which ease regulations for temporary workers while maintaining protections for permanent employees, can theoretically be associated with a short-term hiring effect that stabilizes over time. Bjuggren (2018) finds that removing LIFO constraints in Sweden increased job flows but did not significantly change net employment levels, as increased hiring was offset by higher separations. Esposito (2022) shows that in Italy, policy uncertainty around EPL reforms encouraged firms to shed labour but discouraged new hiring, resulting in mixed employment effects. Moreover, studies for the United Kingdom by Henry & Nixon (2000) conclude that the time-series evidence suggests that the deregulation of the UK labour market does not account for much of the observed changes in unemployment since the 1970s as cited in Gwatidzo and Moyo (2014). Similarly, Hunt (1994) finds that West German reforms had little impact on employment adjustment speed, as firms substituted hours adjustments for headcount changes.

## **4.6. Literature review: Impact on labour productivity**

The impact of IR Code on labour productivity is primarily mediated through changes in allocative efficiency, the ease with which labour can be reallocated from less productive to more productive uses, and the incentives for human capital investment. By raising the retrenchment threshold and formalising fixed-term employment, the Code seeks to reduce compliance cost of firing that historically trapped capital and labour in unproductive units.

### **4.6.1. Theoretical Impact of the IR Code on Productivity**

Theory suggests that industrial relations regulation can have opposing effects on productivity depending on whether it fosters stable employment relationships or creates rigidities that prevent resource reallocation. These mechanisms are summarised in the table below.

**Table 4.3: Theoretical Implications of the IR Code on Productivity**

<b>Predictive Productivity Effect</b>	<b>Model</b>	<b>Key Assumption</b>	<b>Mechanism</b>
Positive	Worker Effort and Signaling Theory (Engellandt & Riphahn, 2003)	Temporary workers are more productive, driven by the desire to secure a permanent role.	Temporary workers exert higher effort to improve their chances of retention or contract renewal, leading to productivity gains at the firm level. However, effects may not persist if turnover rate is high.
	Moral Hazard (Insurance Models) (Shapiro & Stiglitz, 1984)	Employment protection acts as implicit insurance	Strong protection reduces worker incentives to exert effort or invest in productivity (reduced dismissal risk).
Negative or Neutral	Labour composition adjustments (Ramaswamy, 2013)	Firms can substitute across contract types	Firms substitute away from more productive permanent workers toward relatively less productive contract, temporary, or informal labour to avoid EPL constraints.
	Human Capital Theory (Becker, 1964)	There is a distinction between general human capital, which is transferable across firms, and specific human capital, which is tied to a particular firm	If turnover is high, firms will not invest in general training because employees can leave and take that value elsewhere. Consequently, firms only invest in firm-specific training, and high turnover discourages even that, leading to an overall reduction in training investment
	Job Polarisation and Task-Based Models (Acemoglu & Autor, 2011)	Tasks differ in routineness and susceptibility to substitution	Firms may reorganise production toward easily replaceable tasks under flexible contracts, potentially reducing overall skill intensity and long-term productivity growth.

**Source:** Authors' compilation.

#### 4.6.2. Empirical Evidence of Impact of IR Code on Labour Productivity

1. **Allocative Efficiency through Labour Fluidity:** When firms can adjust their workforce without excessive administrative friction, labour flows toward more efficient uses, thereby raising the total factor productivity (TFP) of the economy.
2. **The Skill-Formation and Technical Efficiency Trade-off:** High turnover rates may discourage both employers and employees from investing in training, potentially weakening technical efficiency and long-term productivity growth.
3. **Selection Effects and the Pruning of Inefficient Firms:** Creative destruction allows resources to be absorbed by more efficient competitors, though the immediate result may be a sector-specific contraction in labour use.
4. **Threshold-Induced Scale Distortions:** Regulatory thresholds often trap firms in an inefficiently small size, preventing them from achieving the economies of scale necessary for high productivity. This distortion prevents labour and capital from flowing to firms that have the potential to grow, effectively capping the productivity potential of the entire industrial landscape. Deregulating these is expected to have a positive impact on productivity in the medium term.

##### 4.6.2.a. Empirical Evidence from India

Positive productivity effects in India are frequently associated with improved firm selection, better worker–firm matching, and stronger incentives for skill investment. For instance, Goswami and Paul (2021) find that Rajasthan’s deregulatory reforms increased Total Factor Productivity (TFP) and value added by approximately 3 per cent, suggesting that greater labour market flexibility can enhance allocative efficiency. Similarly, Sofi et al. (2022) argue that pro-worker regimes may raise labour productivity by fostering stable employment relationships that encourage firms to invest in firm-specific training and human capital. Chatterjee et al. (2025) further show that reducing firing costs and lowering exit barriers can increase average productivity by forcing the exit of unproductive firms and allowing more efficient firms to expand. Dougherty (2009), Mitra and Ural (2008) and Hasan and Jandoc (2012) as cited in Goswami and Paul (2021), support that reforms improving labour market flexibility can also raise aggregate productivity. Mitra and Ural (2008) highlight that the positive impact of trade liberalization on productivity is more pronounced in states with flexible labour markets, and Hasan and Jandoc (2012) show that the prevalence of large-sized firms in such states is particularly noticeable as well.

Negative or mixed productivity effects, however, often arise from distortions in resource allocation and shifts toward lower-productivity activities. Kotia et al. (2025) find that the 1982 firing restrictions under the Industrial Disputes Act induced structural labour reallocation toward less productive, unregulated sectors, causing an estimated 7.5 per cent loss in aggregate output. Chaurey et al. (2023) similarly estimate that penalizing contract labour in Andhra Pradesh reduced aggregate TFP by approximately 1–2 percent, as resources shifted toward informal enterprises with lower productivity. These findings underscore that the productivity consequences of employment protection legislation (EPL) in India depend not only on the direct costs of labour adjustment but also on the broader institutional environment, including complementary market reforms and state-level labour market flexibility.

Another aspect discussed by Goswami and Paul (2021) using several studies is that labour regulations also shape firm practices and capital allocation. Evidence from Hasan,

Mitra, and Sundaram (2013b) finds that India's firms exhibit higher capital intensity than peer countries with similar levels of development or factor endowments, largely attributed to rigid labour laws. Additionally, firms frequently rely on contractual or fixed-term workers to reduce labour costs. In particular, Ramaswamy (2013) finds that strict labour laws drive higher contract worker intensity among firms in the 55–99 worker range and in labour-intensive, inflexible states.

#### **4.6.2.b. Empirical Evidence from Other Developing Economies**

Negative productivity effects are often linked to reduced reallocation and underinvestment in skills. For instance, Jaramillo (2019) shows that Peru's reforms discouraged investment in worker training due to the high turnover of temporary staff. Similarly, Caballero et al. (2004) estimate that stricter employment protection reduces annual TFP growth by approximately 1 per cent in countries with strong enforcement.

Ambiguous or mixed effects arise when potential gains from stable employment relationships are offset by efficiency losses from constrained labour reallocation. Betcherman (2014) argues that while EPL can encourage training and long-term investment, these benefits are frequently reduced by reductions in labour mobility, resulting in productivity outcomes that are contingent on market conditions and firm-level implementation, with an increased sensitivity to enforcement.

#### **4.6.2.c. Empirical Evidence from Developed Economies**

Negative productivity effects occur when EPL restricts labour reallocation or limits firm restructuring. Boeri and Jimeno (2003) show that in Italy, rigid EPL reduces layoffs of inefficient workers but simultaneously lowers overall worker turnover, effectively decreasing labour market dynamism without significantly changing employment growth. Bassanini, Nunziata, and Venn (2008) show that strict dismissal regulations prevent the reallocation of labour from low- to high-productivity firms, reducing TFP growth in OECD countries. Garicano, Lelarge, and Van Reenen (2016) find that thresholds in France trap labour and capital in smaller, less productive firms, depressing aggregate productivity. Highly restrictive employment laws can adversely affect not only domestic productivity but also trade, particularly a firm's decision to export. Labour market flexibility reduces adjustment costs and increases productivity, thereby serving as a source of comparative advantage (Helpmann & Itskhoki, 2010). Greater flexibility can lead to higher profits, facilitating a firm's entry into foreign markets, especially since future exporters often need to grow in size and productivity before sustainably participating in international product markets (Helpmann & Itskhoki, 2010; Seker, 2012). Highly restrictive labour laws, by contrast, tend to reduce firm size, productivity, and competitiveness, making such expansion difficult. The variation in court judgments on dismissals for economic reasons in Japan further illustrates how legal uncertainty can influence firms' labour and productivity decisions (Okudaira, Takizawa, and Tsuru, 2013).

Positive productivity effects emerge when reforms encourage skill investment, capital deepening, or efficient labour reallocation. Bouis et al. (2012) demonstrate that product market deregulation and active labour market policies improve allocative efficiency and raise labour productivity. Ciminelli and Franco (2025) show that lower firing costs in Italy encouraged the adoption of more efficient production technologies, increased capital per worker, and improved workforce composition through permanent contracts that incentivize training. Bertoni, Chinetti, and Nisticò (2023) highlight that increased separations and mobility enhance productivity via improved worker effort and allocation to high-quality firms. Lee and Cheon (2004) show that restructuring under reduced

protection in South Korea increased technical efficiency through performance-based pay systems and targeted hiring, lowering training costs while maintaining output quality. Bjuggren (2018) also documents productivity gains through improved personnel selection and capital deepening after LIFO exemptions were relaxed.

Mixed or neutral productivity effects are observed when labour flexibility reforms are offset by other constraints or uncertainties. Esposito (2022) notes that policy uncertainty in Italy limited the productivity gains from reduced firing costs, as firms delayed investment until reforms were credible. Dräger and Marx (2012) discuss that temporary workers can stabilize employment in rigid markets but leave long-term productivity effects ambiguous. Hunt (1994) highlights that West German reforms aimed at increasing flexibility by reducing firing costs did not measurably increase the speed of employment adjustment, as firms substituted adjustments in hours per worker for layoffs to manage production shocks

#### **4.7. Summary of Expected Impacts in India**

The Industrial Relations (IR) Code, 2020 provides a modernised framework for India's labour market, but its ability to boost employment and productivity depends on complementary policies, institutional credibility, and effective enforcement. Evidence suggests that deregulation acts more as a catalyst than a primary driver: productivity gains and job creation are most likely when labour reforms are combined with market-friendly measures such as industrial delicensing and trade liberalization, which create the demand and growth opportunities necessary for firm expansion. Without these synergies, deregulation may lead to asymmetric labour shedding, where jobs are lost faster than they are created.

Raising retrenchment and standing order thresholds from 100 to 300 workers reduces compliance costs, allowing labour to move from less productive activities to higher-growth firms and raising overall productivity. Removing the 100-worker "growth barrier" encourages mid-sized firms to expand their permanent workforce without fear of regulatory entrapment, supporting sustainable scaling. Greater flexibility also enables firms to adopt more efficient technologies and production processes that require frequent workforce adjustments, further enhancing long-term productivity.

Despite these potential gains, several frictions can prevent deregulation from translating into robust employment growth. Firms may substitute permanent roles with fixed-term or contract positions instead of increasing overall headcount, limiting net job creation. High turnover in temporary roles reduces incentives for both firms and workers to invest in firm-specific skills, weakening long-term technical efficiency. Enforcement and institutional capacity play a critical role: state-level judicial differences and the efficiency of industrial tribunals can amplify or suppress the intended effects of deregulation. Perceived policy instability may also lead firms to delay productivity-enhancing investments, while some may shift operations to informal or unregulated sectors to avoid compliance costs, bypassing potential gains.

##### **4.7.1. Analysis of Firm Size Distribution – Where is the Threshold Binding?**

A key takeaway from the changes under the Industrial Relations Code, 2020, is the impact of the increase in the retrenchment threshold from 100 to 300 workers. This change potentially benefits mid-sized firms that were previously subject to stricter retrenchment

approval, while also creating incentives for smaller firms to expand employment. According to the Annual Survey of Industries (ASI) Summary Statistics, 2023–24, most Indian factories are small: over 50 per cent employ fewer than 50 workers, and an additional 12.4 per cent fall in the 50–99 worker band. This distribution indicates that the majority of firms face minimal regulatory constraints and could expand along the extensive margin, particularly in the smaller size segments.

**Table 4.4: Distribution of Factories in Operation by Size of Employment**

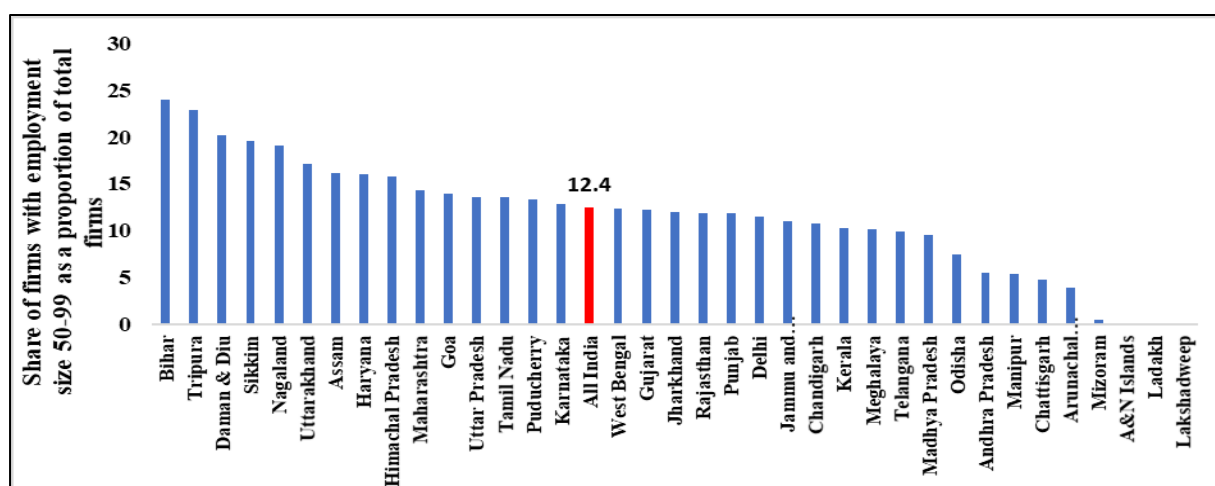
Employment Size	Number of Factories	Percentage Distribution of Factories
0-14	72144	33.87
15-19	18173	8.53
20-29	23307	10.94
30-49	25098	11.78
50-99	26505	12.44
100-199	19623	9.21
200-299	5150	2.42
300-499	10149	4.76
500-999	6552	3.08
1000-1999	3269	1.53
2000-4999	2120	1.00
5000 & More	899	0.42
Total	212990	100.00

**Source:** ASI 2023-24, Summary Statistics

**Note:** The raw data was available for the employment size 200-499 category, which has been bifurcated assuming a uniform distribution within the bin.

State-level heterogeneity is present. For instance, Bihar, Tripura, and Daman & Diu have the highest shares of firms in the 50–99 worker range (20–24%), suggesting that a larger proportion of factories in these states could potentially grow now, crossing the 100-worker threshold. In contrast, Andhra Pradesh, Telangana, and Chhattisgarh have below-average shares (4–6%), implying fewer mid-sized firms are likely to benefit from immediate threshold effects.

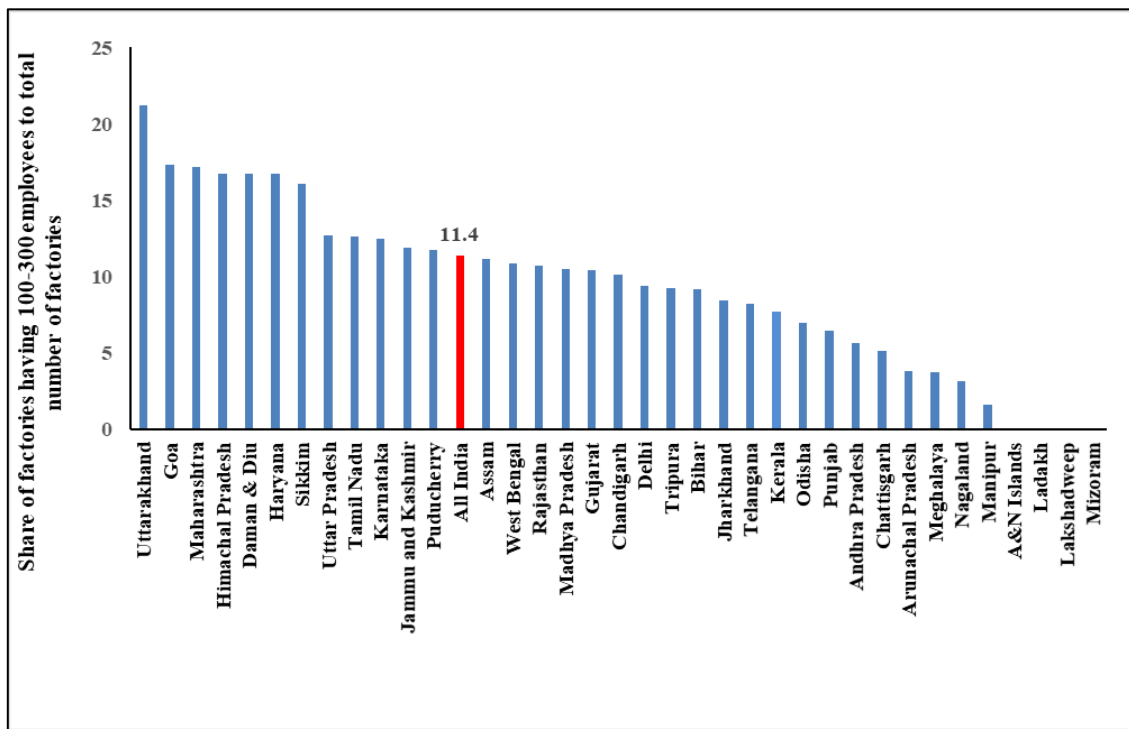
**Figure 4.3: Factories in Operation with 50 to 99 workers for each State/UT**



**Source:** ASI 2023-24, Summary Statistics.

Firms in the 100–300 worker range, which previously faced stricter retrenchment regulations, are expected to gain from reduced compliance costs and greater operational flexibility. States such as Himachal Pradesh, Maharashtra, Haryana, Goa, Uttarakhand, and Sikkim have the largest shares of firms in this band (20–24 per cent), while states including Manipur, Nagaland, Arunachal Pradesh, and Kerala fall below the national figure (14–19 per cent), suggesting a smaller pool of mid-sized firms benefiting from threshold relaxation.

**Figure 4.4: State-wise distribution of factories with employment size 100-300**



**Source:** ASI 2023-24, Summary Statistics.

**Note:** The 100–300 worker band is constructed by combining the 100–199 category with a proportion of the 200–499 category. Assuming a uniform distribution within the 200–499 bin, one-third ( $\approx 33\%$ ) of firms are allocated to the 200–299 range to approximate the 100–300 segment.

Overall, the reform may generate positive effects on both employment and productivity, though these effects will vary across states and firm sizes. Smaller firms under 100 workers may expand, creating additional jobs, while mid-sized firms in the 100–300 worker band may achieve efficiency gains due to lower regulatory burdens. The overall impact will depend not only on the state-level distribution of firm sizes but also on firm behaviour, sectoral composition, and broader economic conditions. For example, the impact of deregulation is likely to vary; not all mid-sized firms may choose to expand employment, and smaller firms may face other constraints, such as capital availability or market demand. Additionally, the Factories Act (OSHC Code, Chapter 5) has also been reformed; establishments which were covered if they employed 10 or more workers with power, or 20 or more without power, now have thresholds of 20 and 40 workers, respectively. This change reduces the regulatory burden for many smaller factories, lowering costs independent of the IR Code, enabling an increase in firm scale at the lower end.

#### **4.7.2. An Analysis of Contract Type – Introduction of Fixed Term Employment**

Labour productivity is impacted through three main channels: effort incentives, skill accumulation, and allocative efficiency, which depends on how well workers are matched to tasks. The introduction of fixed-term employment under the Industrial Relations Code, 2020 (IRC 2020) affects these channels by redistributing labour across contract types. If firms replace permanent workers with fixed-term workers, long-term labour productivity may decline due to weaker skill accumulation. Conversely, if firms shift from informal contract labour to fixed-term employees, labour productivity can increase because of formalisation and improved worker quality. Additionally, if fixed-term contracts enhance matching efficiency without substantial substitution for permanent workers, overall productivity may rise. Each contract type involves a trade-off between flexibility, cost, and worker protection, influencing both firm-level decisions and aggregate labour market outcomes. Understanding these effects is critical not only under the IRC 2020 but also in light of complementary regulations under other Labour Codes.

Permanent employment supports long-term labour productivity by incentivising firms to invest in training and firm-specific human capital. Workers in permanent roles accumulate institutional knowledge, and stable employer-employee relationships improve coordination and efficiency. High job security, however, can reduce short-term effort incentives, consistent with efficiency wage and moral hazard models. Historically, strict EPL has created rigidity that may misallocate labour across sectors, as over-protection results in lower permanent workers, relegating workers to agriculture and other informal sectors – according to only 3 per cent of workers have permanent jobs in India. The Code on Wages, 2019, and the Social Security Code, 2020, reinforce the importance of minimum wages, skill-linked pay, and statutory benefits in maintaining labour productivity through effort incentives and skill accumulation.

Contract labour maximises flexibility and minimises compliance costs, but often constrains labour productivity. Workers hired through intermediaries typically receive minimal trainings, and as a result, task efficiency, product quality, and innovation are limited. Threshold-based regulations, such as the OSHWC Code’s licensing increase from 20 to 50 workers, may incentivise firms to cluster below thresholds, maintaining reliance on low-productivity contract arrangements. To counterbalance this, the Code on Wages and Social Security Code hold principal employers jointly liable for wages and gratuity if contractors default, increasing the effective cost of contract labour and narrowing the gap with fixed-term roles (for more, see OSHWC Code Chapter 5; Code on Wages, Chapter 2; SS Code Chapter 3). Despite these reforms, contract labour remains suitable primarily for routine or short-term tasks, limiting long-term productivity growth.

Fixed-term employment (FTE) provides a hybrid solution balancing flexibility and worker protection. FTE workers are entitled to wages and benefits on par with permanent employees, including statutory benefits such as EPF and ESI from day one and pro-rata gratuity after just one year of service (for more, see SS Code Chapter 3). By offering formalisation and better security than traditional contract labour, FTE reduces turnover, encourages firm-specific skill accumulation, and improves workforce quality. Short-term labour productivity gains also arise from higher worker effort due to contract renewal incentives and improved matching to project-based tasks. However, the semi-permanent nature of these contracts may limit firms from investing in long-term skill development compared with permanent employment.

In summary, the IRC 2020, supported by complementary labour regulations, reshapes labour productivity through the interaction of contract types. Permanent employment continues to build skills but carries rigidity costs, contract labour offers flexibility but limits labour productivity, and fixed-term employment provides a hybrid mechanism that encourages formalisation while preserving flexibility. Threshold-based rules and formalisation incentives under the amalgamation of all four Codes influence firm hiring behaviour, effort, and skill accumulation, further shaping labour productivity outcomes. While trade-offs at the firm level remain, aggregate evidence suggests that diversifying contract types and formalising employment relationships under the Codes can reconcile worker protection with economic efficiency, enabling higher total factor productivity and better matching of labour to firm needs.

#### 4.8. Policy Implication:

- **Synergy of Policies:** The effectiveness of the IR code in terms of both productivity and employment has depended on its integration with complementary policies such as trade liberalization, industrial delicensing, and investment facilitation. Without these synergies, flexibility alone may allow firms to shed labour asymmetrically, and downsizing may potentially outpace the creation of jobs through expansion. Furthermore, coordination between the centre and the states is also crucial to avoid jurisdictional fragmentation and maintain a consistent regulatory framework.
- **Implementation of Reskilling Fund for Human Capital Development:** To help efficient labour reallocation, the reskilling fund must be transformed from an additional payment to workers into a functional avenue for vocational training and skill upgrading, ensuring that displaced workers can be reabsorbed into the formal economy
- **Closing the Gap for Institutional Friction and Policy Translation:** Regulatory thresholds, insider–outsider dynamics, and enforcement inconsistencies (such as constraints associated with the renewed Factories Act and Contract Labour Act) can distort labour and capital allocation. While deregulation is theoretically expected to facilitate job destruction for better resource allocation, these frictions may delay firm scaling, limit employment absorption, and generate sectoral imbalances. A secondary concern is the translation of labour productivity gain from these efficiency gains into job creation, which requires closing policy translation gaps. Short-term layoffs, informalization, higher turnover rates, and uneven enforcement can weaken the transmission from efficiency improvements to employment outcomes. This makes credible enforcement necessary. One way to strengthen this is through alignment with global standards and established best practices, which can enhance regulatory credibility and help ensure that efficiency gains are more effectively converted into broad-based employment growth.
- **Addressing Uneven State-Level Impacts:** State-level variation in firm size distribution and regulatory environments creates the risk of uneven gains from the policy change, with some states benefiting from firm scaling while others see limited effects. Differences in enforcement and regulatory stringency may further distort firm entry and exit patterns, potentially widening interstate disparities as more flexible states have the incentive to attract greater industrial activity. In

addition, the prevailing investment environment will condition how strongly firms respond to these incentives. There is a need to align the reforms with the investment climate, ensuring enforcement is consistent and predictable. Further, states with fewer mid-sized firms should implement policies complementing labour reforms to support firm growth, such as improving access to finance, infrastructure, and market linkages.

## Chapter 5: The Occupational Safety, Health and Working Conditions Code

### 5.1 Introduction

The International Labour Organization (ILO) and the World Health Organization (WHO) uphold the principle that workers must be protected from sickness, disease, and injury arising from their employment (ILO Convention, 1981). However, for millions of workers worldwide, the reality is very different. According to the most recent ILO global estimates, 27.8 lakh (2.78 million) work-related deaths are recorded every year, of which **24 lakhs** (2.4 million) are **related to occupational diseases** (WHO & ILO, 2021). In addition to the suffering caused to workers and their families, the associated economic costs are substantial for enterprises, countries and entire economies. The **losses** in terms of compensation, workdays, interrupted production and training, as well as health-care expenditure, represent around **3.94 per cent of the world's annual GDP**. Employers face costly early retirements, loss of skilled staff, absenteeism, and high insurance premiums. Much of this misfortune can be averted through implementation of sound prevention, reporting, and inspection practices.

The ILO has an extensive framework on occupational safety and health (OSH), comprising more than forty conventions and recommendations specifically addressing workplace safety, alongside over **forty non-binding codes of practice** that provide technical guidance on implementation ([Link](#)). These instruments span general OSH governance (such as national policy frameworks and employer obligations) as well as sector- and hazard-specific risks, including chemical exposure, shipping work, construction safety, and major industrial accidents.

India has ratified **four OSH conventions** till date ([Link](#)). These include sector- or hazard-specific instruments such as Convention No. 32 (Protection against Accidents, Dockers), Convention No. 127 (Maximum Weight), Convention No. 136 (Benzene), and Convention No. 174 (Prevention of Major Industrial Accidents). However, India is yet to ratify Conventions No. 155 (Occupational Safety and Health Convention) and No. 187 (Promotional Framework for Occupational Safety and Health Convention), which have carried fundamental status within the ILO system since 2022.<sup>3</sup> India's broader national OSH framework, as consolidated under the Occupational Safety, Health and Working Conditions (OSHC) Code, operates without formal ratification of the principal global governance conventions that articulate national OSH policy architecture.

The Occupational Safety, Health and Working Conditions Code, 2020 aims to regulate the safety, health, working conditions, and welfare provisions for workers of various establishments. It **subsumes 13 existing labour legislations** within itself to bring uniformity and streamline the labour law regime. These include the Factories Act, 1948; the Mines Act, 1952; the Dock Workers (Safety, Health and Welfare) Act, 1986; the Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996; the Plantations Labour Act, 1951; the Contract Labour (Regulation and Abolition) Act, 1970; the Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979; the Working Journalist and other Newspaper Employees (Conditions of Service and Miscellaneous Provisions) Act, 1955; the Working

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<sup>3</sup> National Occupational Safety and Health Profiles ([Link](#))

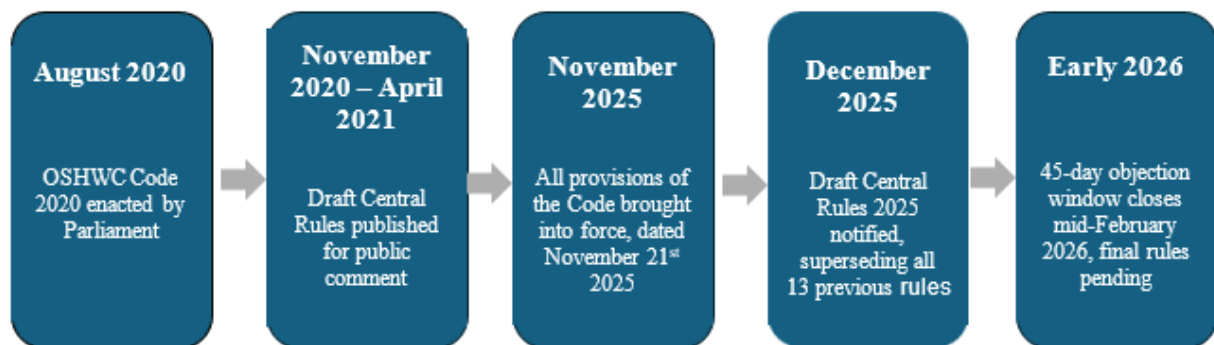
Journalist (Fixation of Rates of Wages) Act, 1958; the Motor Transport Workers Act, 1961; the Sales Promotion Employees (Condition of Service) Act, 1976; the Beedi and Cigar Workers (Conditions of Employment) Act, 1966; and, the Cine-workers and Cinema Theatre Workers (Regulation of Employment) Act, 1981.<sup>4</sup>

## 5.2 Chronology of Reforms

### 5.2.1 Legislative Timeline

In this chapter, we analyse the OSHWC Code 2020 as the last component of the Government of India's rationalisation of 29 Central Labour Acts into four Labour Codes. The Code consolidates these 13 predecessor Acts into a single legislation, with stated objectives of improving **transparency**, **reducing compliance** burden, and **enhancing worker welfare**.<sup>5</sup> We map the changes introduced by the new rules against the pre-Code regime, focusing on Acts most relevant to industrial and commercial establishments. A timeline of the Code's implementation is first presented below.

**Figure 5.1: Chronology of the OSHWC Reform Process**



This reflects a phased transition from subordinate rules to operationalisation, with state-level rulemaking marking the final stage of the Code's rollout.

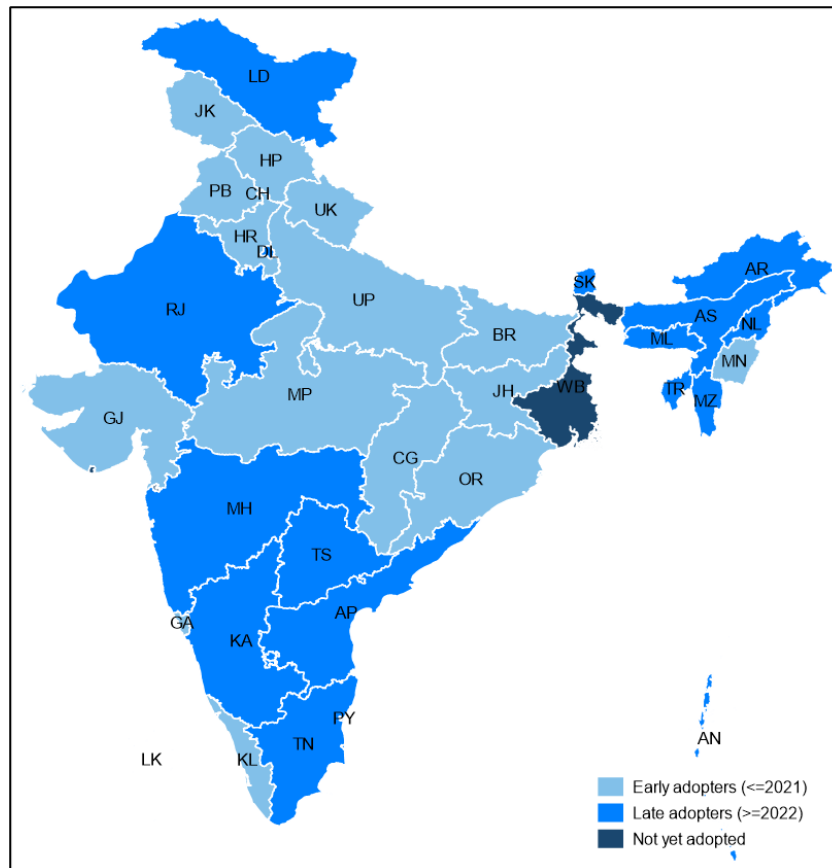
### 5.2.2 State-level Developments

When the OSHWC Code, 2020 repealed the previous 13 Acts at the Central level, their legislation necessarily ceased for all states. The states' responsibility thereafter was to replace their own state-level rules made under those Acts. Each state's corresponding **OSHWC Gazetted Notification** released after December 2020 lays down their state rules scrapped in favour of the new OSHWC Code. This is usually a subset of the 13 Acts, while the remaining Acts followed the Central rules. The distribution below represents states by their stage of adoption, with the 2020 Code acting as the baseline enactment year.

<sup>4</sup> Given the breadth of legislations subsumed under the OSHWC Code, this chapter restricts its analysis to implications arising from the Factories Act, 1948; the Contract Labour Act, 1970; the Building and Other Construction Workers Act, 1996; and the Inter-State Migrant Workmen Act, 1979.

<sup>5</sup> Occupational Safety, Health and Working Conditions (OSH) Code, 2020 ([PIB](#))

**Figure 5.2: State-wise Timing of Adoption of Rules under the OSH&WC Code**



**Source:** Authors' compilation based on state government gazette notifications on the OSHWC Rules issued by state labour departments (2020–2025).

**Note:** The map shows the variation in which states and union territories issued their draft or final rules. Where both draft and final rules were notified, the year of the first notification is reported.

With the exception of West Bengal, all states and union territories of India have drafted their respective OSHWC rules, as of March 2026. Sixteen states released their first notifications in 2021, with final rules published in some cases since then, while ten states published their rules in 2022 and three states each brought out their notifications in 2023, 2024 and 2025. The complete state-wise timeline of rule notifications is provided in the [Online Appendix](#).

### 5.3 Key Changes in the OSHWC Code, 2020

A detailed comparison of the OSHWC Rules, 2025 and some of the Acts subsumed under it can be found in the [Online Appendix](#). A general itemization is presented below. We focus our attention on the Factories Act, 1948, Building and Other Construction Workers (BOCW) Act, 1996, the Contract Labour Act (CLA), 1970 and the Inter-State Migrant Workmen (ISMW) Act, 1979.

#### a. Common Changes Across Predecessor Acts

*i. Legislative Consolidation:* Thirteen standalone Acts have been replaced by a single OSHWC Code with unified Central Rules, 2025. Employers across factory, construction,

contract labour, and migrant worker categories now operate under one registration, one inspection scheme, and one compliance architecture.

*ii. Working Hours Liberalisation:* Daily working hour limit has been raised from nine to twelve hours across factories, construction, and contract labour establishments, with the forty-eight-hour weekly cap retained. Quarterly overtime cap has been standardised at 144 hours, replacing variable state-prescribed limits. Overtime pay at twice the ordinary rate is triggered beyond 12 hours/day or 48 hours/week.

*iii. Single Digital Registration:* Separate Act-specific registrations have been replaced by a single electronic registration on the Shram Suvidha Portal, with a seven-day deemed approval if unprocessed. Factory plan pre-approval by state Chief Inspectors has been abolished.

*iv. Centralised Inspection:* State inspectorates have been replaced by centrally appointed Inspector-cum-Facilitators with cross-designation across all four Codes. Risk-based inspection replaces reactive complaint-driven inspections. Electronic recording of all findings is mandatory.

*v. Digitised Accident and Disease Reporting:* Immediate electronic notification to Inspector-cum-Facilitator, District Magistrate, nearest police station, and deceased's family for fatal accidents is now mandatory. Bodily injury and dangerous occurrence notices have to be provided within twelve hours. Occupational disease notifications are required simultaneously from employer and attending medical practitioner.

*vi. Universal Health and Documentation Entitlements:* Free annual health examination mandated for all workers above forty at employer cost, extending beyond previously limited hazardous-process coverage. Mandatory appointment letters are now also required for all workers in covered establishments, standardising documentation that was absent for construction, contract, and migrant workers.

## **b. Factories Act, 1948**

A few key takeaways from the amalgamation of the Factories Act, 1948 into the new OSHWC Code, 2025 are analysed below:

*i. Factory Definition Thresholds:* For premises to be defined as a factory, the definitional threshold has been increased from 10 (with power)/20 (without power) workers to 20 (with power)/40 (without power) workers. Previous seasonal factory distinctions have now been absorbed into the general definition. The weekly holiday frequency has also been improved from rest to be taken after ten consecutive workdays to rest to be taken after six consecutive workdays.

*ii. Women's Employment:* Blanket prohibition on women working before 6am and after 7pm has been replaced by conditional permission requiring written consent, free transport, CCTV surveillance, dedicated emergency contacts, and compliance with the Sexual Harassment of Women at Workplace Act.

*iii. Mandatory Safety Committee:* Mandatory safety committees have been introduced for all factories employing 500 or more workers, construction sites with 250 or more, and mines with 100 or more workers, with equal representation between workers and employers. This replaces the previous safety officer requirement applicable only at 1,000 workers. Mandatory women's representation and quarterly meetings are required, with employer response to recommendations within fifteen days.

*iv. Jurisdictional Centralization:* Factory registration has been moved from state Chief Inspectors to Central registration officers, with inspection shifted from state factory inspectorates to Central Inspector-cum-Facilitators under Chief Labour Commissioner (Central). These uniform central rules thereby replace state-specific Factory Rules, eliminating state-level variation. Such loss of regulatory autonomy by state governments may reduce contextual enforcement in industrial safety but is expected to improve consistency and bring efficiency gains.

*v. Child and Adolescent Protection:* The absolute prohibition on child labour (below 14 years) has been strengthened. Adolescent (14-18) protections continue with medical certification, limited hours (6 hours), night work exclusion, and hazardous process prohibition.

*vi. Penalties:* The general penalty structure (2 years imprisonment or Rs. 1 lakh fine) has been retained but repeat offense penalty has been enhanced significantly with imprisonment up to 5 years (from 2 years) for violations within 5 years of previous conviction. This is expected to serve as a stronger deterrent for habitual violators.

### **c. Building and Other Construction Workers (BOCW) Act, 1996**

The BOCW Act, 1996 previously applied to establishments employing ten or more building workers on any day during the preceding twelve months. Under the new OSHWC Code, this sector-specific threshold is dissolved. Building workers are subsumed within the unified establishment definition, bringing construction employment under the general Code architecture rather than a standalone sectoral instrument.

### **d. Contract Labour Act (CLA), 1970**

With respect to the Contract Labour Act, the OSHWC Code, 2020 and 2025 Rules represent substantial deregulation and simplification of contract labour regulation compared to the 1970 specifications. Some key threshold-based changes are listed below:

*i. The contractor licensing threshold* has been increased from 20 to 50 workers. Licenses are to be auto-generated if the relevant authority fails to deliver within 45 days of application.

*ii. The license validity* has been increased from 1 to 5 years. Licenses are no longer establishment-specific but are pan-India or multi-state licenses.

*iii. License fees* have increased four- to twenty-fold but are now to be paid once in 5 years instead of being paid annually.<sup>6</sup> A 25 per cent additional fee has been instituted for late renewals.

*iv. Security deposit* is Rs. 1,000/worker but capped at Rs. 10-20 crore for mega-contractors. Payments can now be made through bank guarantees only.

*v. Grievance redressal:* A new three-tier internal mechanism has been introduced to replace the previous system where disputes were resolved only through external mechanisms with No statutory obligation on the principal employer to address contract worker grievances directly. However, the new grievance committee is permissive, not mandatory, with no worker or union representation.

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<sup>6</sup> The fee structure is: up to 49 workers: nil (exempt); 50–100 workers: Rs. 1,000; 101–300: Rs. 2,000; 301–500: Rs. 3,000; 501–1,000: Rs. 5,000; 1,001–5,000: Rs. 10,000; 5,001–10,000: Rs. 20,000; 10,001–20,000: Rs. 30,000; and, above 20,001 workers: Rs. 40,000.

Additional changes applicable to contract workers in the domain of wage payments, joint liability for wages, annual increments and fixed term employment have been examined in detail in Chapters 2, 3, and 4.

#### **e. Inter-State Migrant Workmen (ISMW) Act, 1979**

For the Inter-State Migrant Workmen Act, migrants who previously had no statutory coverage now have definitional inclusion, journey allowances, online portability, registration systems and, in principle, access to social security. Further, the uniform wage definitions, under the Code on Wages, 2019 (Chapter 2) are expected to raise the benefit base for all workers, including migrants. Migrant workers coming from other states are also now admissible for all benefits as provided to direct employees as long as they earn less than Rs. 18,000 per month

However, the increase in the contract worker licensing threshold from 20 to 50 workers can potentially omit some migrants from this purview when they are employed as contract workers. Migrants in this band of employment can lose protection that previously applied to them. Further, under the ambit of contractors, a section of migrant workers will not be eligible for gratuity. Given their short engagements in construction and seasonal manufacturing, a migrant worker employed through a contractor for less than a year will receive no gratuity entitlement under the new framework. These gaps, unless addressed in future amendments, prevent the new rules from serving as a clean Pareto improvement for migrant workers.

In **summary**, core entitlements such as annual leave, equal pay, displacement and journey allowances for migrant workers, hazardous process protections, and joint wage liability for contract labour are retained. New provisions have been introduced, such as a statutory annual wage increment for regular contract workers, a three-tier grievance redressal mechanism for contract labour, and a national toll-free helpline for migrant workers. The shift from prohibition to regulated inclusion for women's night work, and the reduction of the consecutive working days limit from ten to six, represent notable changes with the same protective intent. While there are no large sweeping changes across safety and hazard protection measures and states are expected to bring out their own industry-specific health regulations, the mandatory safety committee provision, targeted at hazardous process industries, is expected to increase safety compliance and reduce injury rates in the most risk-prone workplaces, subject to credible enforcement.

## **5.4 Key Implications in the OSH&WC Code, 2020**

Beyond the provisions catalogued above (and in the [Online Appendix](#)), the Code's broader economic implications are discussed below in terms of what the new architecture is likely to deliver in practice, potential shortcomings and the cost landscape it entails for applicable establishments.

### **5.4.1 Structural Improvements**

The changes to the **employment thresholds** are the most consequential features of the OSH&WC Code. It does not apply a single uniform threshold but uses different tiers by worker-counts. Of these, the contractor licensing threshold represents the most significant upward revision, moving from twenty under the Contract Labour Act, 1970 to fifty workers under the new Code.

Several provisions represent genuine advances over the predecessor regime. The **universal appointment letter requirement**, written documentation of employment terms to all workers in covered establishments regardless of sector, creates an evidentiary basis for enforcement of other rights that did not exist for workers in construction, transport, and migrant labour before. The absence of such had effectively barred workers from availing of the implicit benefits of legalities and formalisation (Hasan and Jandoc, 2021). The **annual health examination** obligation for workers aged forty and above extends health surveillance beyond the hazardous sectors previously covered under the Factories Act. The **gender-inclusive welfare facility** requirements represent a notable update to predated equality frameworks. The removal of the blanket prohibition on **women's night work** by a consent-and-safety-conditions framework expands formal labour force participation options for women in export manufacturing and services, an outcome consistent with both efficiency and equity objectives.

While the Code does not specify exact **workplace protection metrics**, states are expected to bring their own enactments and amendments to the Central rules (several of which have already been finalised as of March 2026). Reductions in workplace injuries, occupational disease, and work-related absenteeism improve effective labour supply and reduce turnover costs (Rajagopalan and Shah, 2024). In sectors with historically elevated injury rates, such as construction, mining, and manufacturing, cumulative productivity effects can be substantial over medium-term horizons, supporting employment through competitiveness and output effects rather than cost reduction alone (Islam, Lorient and Rahman, 2025). The short-run adjustment path may involve some formal employment contraction in sectors where OSH compliance was previously minimal, as establishments take time to absorb compliance costs. The medium-term and long-term trajectory though is more likely to be shaped by these formalisation and productivity gains than by compliance cost pressures.

Electronic registration and return systems can create **new centralized administrative data** at the national level (vs. dispersed state-level data previously). However, new factory thresholds (20/40 workers) may mean 10 to 19 and 20 to 39 worker-size establishment data disappear from formal factory statistics. The mandatory annual health examination can create new occupational health databases if systematically maintained. Digital recording of accidents as specified in the Act can also be expected to create new novel data sources.

The Code's consolidation reforms reinforce the structural logic of threshold-based compliance. Fifty-five forms are reduced to twenty, six registrations to one, and twenty-one physical returns consolidated into a single annual electronic return, lowering the fixed cost of compliance for establishments within scope. For multi-state and multi-sector employers, this procedural reduction is quantitatively meaningful.

#### **5.4.2 Potential Areas of Concern**

The rationale for **threshold-based compliance** is well-established in the economics of regulation. Administrative costs of compliance are relatively fixed, making per-worker compliance costs disproportionately high for small establishments (Viscusi, 1986). A threshold system concentrates regulatory obligations where they are most efficiently administered and where non-compliance is most observable.

The **contractor licensing threshold increase** from twenty to fifty workers removes the twenty to forty-nine worker band from licensing oversight entirely. Whilst this is presented as regulatory rationalisation, it withdraws a layer of statutory protection from

contractors and workers in precisely the band where contract labour is most prevalent and most vulnerable to non-compliance. Firms near the new threshold will rationally evaluate whether to keep contractual workers below fifty rather than formalise them further, recreating the same avoidance incentive at a higher margin.

The **coverage gap for sub-threshold establishments** merits separate attention. A substantial share of India's non-agricultural workforce is employed in micro and small enterprises operating below the ten-worker general threshold (ASUSE Reports). Specific OSHWC obligations in the form of safety infrastructure, safety committees, canteens, crèches, and health check-ups do not apply to this segment. This is not a feature unique to the OSHWC Code but characterises the entire threshold-based compliance model inherited from the predecessor Acts. The Code does not widen this gap materially, but neither does it narrow it. The appropriate policy instrument for sub-threshold establishments, whether simplified compliance regimes, social insurance mechanisms, or sector-specific rules, lies outside the Code's current architecture and provides an area for which complementary measures can be more efficiently built in by subsequent legislative cycles.

Lastly, a binary characterisation of the OSHWC Code as pro-worker or anti-worker is not analytically defensible. The Code contains provisions that advance worker interests in measurable ways and others whose net effect on workers depends on implementation by their principle employers. A disaggregated assessment can be more instructive than an aggregate verdict, until further empirical evaluation.

A prudent juxtaposition is that it can create conditions under which both positive and negative outcomes for workers are possible. The determinative variable is not the text of the Code itself but the **quality of implementation**, the pace of rule notifications, investment in inspectorate capacity, and the effectiveness of the unified Inspector-cum-Facilitator framework in maintaining technical depth across sectors as different as chemical manufacturing and deep-sea dock work. The Code establishes the architecture, the operative protections are in the rules, and the rules' effectiveness will lie in their enforcement.

### 5.4.3 Cost Implications

The OSHWC compliance on safety and welfare mandates imposes a few new perfunctory capital and operating costs on applicable establishments. Standard labour theories predict higher compliance costs reduce labour demand at the margin, particularly for employers near the threshold cut-offs who face a discrete cost increase upon crossing that threshold. However, the Code's procedural consolidation can work in the opposite direction, as multiple separate registrations, sector-specific licences, and return-filing costs are now replaced by one of each. An employer who previously avoided registration because of the complexity and cost of maintaining compliance across multiple sectoral Acts now faces a substantially lower barrier under a single-window architecture. If this effect materialises at scale, it can increase total employment. The **net compliance cost effect** on employment is therefore likely to be **positive** for larger organised-sector employers and ambiguous for smaller establishments near threshold boundaries. The realisation of this channel depends, however, on enforcement. If non-compliance continues to carry low detection risk, the formalisation incentive may remain limited regardless of how low transaction costs fall.

Beyond procedural costs, the Code introduces **new obligations** that employers in the formal sector may not have previously borne. For example, the mandatory safety

committee at five hundred workers requires worker representation, quarterly meetings, and documented employer responses within fifteen days of committee recommendations. The digitisation of employee details, accident reporting, and annual returns through the Shram Suvidha Portal imposes technology adoption costs that may be non-trivial for small and medium establishments with limited administrative capacity. Employer-funded annual health examinations, while a genuine welfare advance, represent a recurring operational cost with no offsetting fiscal instrument currently provided under the Code. For establishments crossing the factory threshold for the first time under the new architecture, the combined fixed cost of formalisation, safety infrastructure, welfare facilities, and digital compliance may still exceed the expected productivity and market access gains in the short run, particularly where product markets are informal and buyers do not differentially reward formal supplier status.

### **Box: Ease of Doing Business under the OSHWC Code**

The OSHWC Code's Ease of Doing Business (EoDB) provisions operate horizontally across the 13 consolidated Acts, reducing procedural multiplicity rather than altering labour standards substantively.

Based on the changes stated officially<sup>7</sup>, **lower compliance costs** are expected to reduce the fixed cost of formalisation, shifting the extensive margin of formal employment outward. Establishments that previously triggered CLA obligations at 20 workers now operate outside the licensing net up to 50, lowering the marginal cost of expanding contractual engagement. At the lower bound, this can generate a modest but plausible **positive employment effect** among small contractors.

Moreover, compliance cost reduction operates on the intensive margin of regulatory burden and not on wage costs, output expectations, and product market conditions. Since firms avoid formalisation to primarily circumvent statutory wage floors, provident fund contributions, and retrenchment costs, none of which the EoDB provisions touch, the upper bound on employment is less likely to be affected.

Compliance cost reduction can also be seen through a **productivity channel**, operating through reallocation. Managerial time and administrative resources previously absorbed by multi-Act compliance can, in principle, be redeployed toward productive activities. For small and medium establishments with thin administrative capacity, the shift to deemed approvals, for example, eliminates some bureaucratic hold-up that previously allowed rent extraction at the registration and licensing stage. This can reduce the cost of entry and potentially improve allocative efficiency at the extensive margin. For large establishments, compliance costs constitute a small share of total operating costs, and dedicated compliance functions already exist. Here, the reforms are unlikely to move productivity on a sufficient scale.

The **digitisation** of compliance, anchored to the Shram Suvidha Portal, can be a double-edged sword. The productivity gains from single-window registration are contingent on portal reliability, inter-operability with state-level systems, and the continued accuracy of the employer database. If digital infrastructure is thin or state coordination incomplete, the gains can remain partial.

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<sup>7</sup> Occupational Safety, Health and Working Conditions Code, Central gazette notification, Government of India, 2020; PIB release ([link](#)).

Thus, the OSHWC Code's EoDB provisions are administratively coherent and directionally correct. They can reduce procedural redundancy, lower entry costs for contractors, and eliminate a category of delay-induced compliance friction. However, the employment and productivity effects are bounded below by the persistence of substantive labour cost obligations and by the limited weight of administrative costs at firm-level formalisation decisions. Credible identification of employment effects from these specific provisions, isolated from concurrent reforms under the Wages and IR Codes, will require firm-level panel data exploiting variation in pre-reform compliance burden across industries and firm sizes.

## 5.5 Literature Review: Impact on Employment

Under the Occupational Safety, Health and Working Conditions Rules, 2025, the provisions on worker thresholds, firm sizes, registration and licensing constitute the regulatory architectural reforms that determine the scope of coverage of the Act. Once applied, the OSHWC Rules determine how the corresponding safety, health and working conditions are to be regulated. Further, the rationalisation mandate of the Second National Commission on Labour (NCL), 2002 led to some thematic overlap with the IR Code (Chapter 4) and the Code on Wages (Chapter 2), which also restructures applicability thresholds and compliance mechanisms. These **threshold changes** attract most academic and policy criticism as they determine collective bargaining, job security and dispute resolutions. Such analytical discourse which studies labour relations are functionally inseparable from safety regulations and hazard provisions as they determine who receives these statutory health provisions and how they are regulated thereafter.

Given this premise, we now attempt a clear division among the amalgamation of the new Labour Codes, by aligning the literature on occupational safety, health and working conditions on **coverage gaps, enforcement architecture, welfare and working condition** provisions, and **hazard and risk** frameworks. This leads with a theoretical background and associated empirical evidence each split into perceived employment and productivity impacts, highlighted with key takeaways that have swayed academic opinion over the last few decades.

### 5.5.1 Theory

Given the new OSHWC framework and the larger universe of occupational safety, health and hazard protocols stemming from the ILO and WHO Conventions, there are several tractable **theoretical deductions** from legacy literature that receive renewed validity. A few are tabulated below:

**Table 5.1: Theoretical Implications of the OSHWC Code on Employment**

<b>Predicted Effect</b>	<b>Theoretical Model</b>	<b>Key Assumption</b>	<b>Mechanism</b>
<p><b>Negative (direct) employment effect at the margin.</b> Threshold increases shift congestion points upward, releasing firms from the bunched bands, but potentially recreate the same incentive at the new margin.</p>	<p><b>Threshold Convergence and Principal-Agent Models</b></p>	<p>Heterogenous firm size and high compliance costs above the margin. Principal employers can shift compliance risk by hiring more contractors.</p>	<p>Firms facing additional fixed compliance costs above thresholds have strong incentive to reduce headcount. This causes bunching at the margin and can happen through contract worker substitution, increased capital usage, or firm splitting.</p>
<p><b>Welfare gains are ambiguous,</b> depending on the redistribution between wage premiums and safety improvements. If markets are competitive, the wage-risk premia should decrease post-OSH regulation.</p>	<p><b>Compensating Wage Differentials and Efficiency Wages (Hedonic labour market models; Thaler and Rosen, 1976; Shapiro and Stiglitz, 1984)</b></p>	<p>Workers have preferences over job safety and wages. Competitive labour markets produce wage-risk trade-offs. Firms pay above-market wages to elicit worker effort.</p>	<p>Workers in hazardous jobs receive a wage premium for higher injury or mortality risk. When safety regulation reduces workplace hazard, workers receive lower compensation. Where labour markets are monopsonistic or have imperfect information about hazard levels, the compensating differential is unbalanced and workers bear uncompensated risk.</p>
<p><b>Potential welfare gain:</b> Safety regulations can have net welfare gains if moral hazard is adjusted externally (e.g. employers do not bear the insurance costs directly), leading to injury reductions post-regulation</p>	<p><b>Moral Hazard (Insurance Models)</b></p>	<p>Employers bear liability for workplace injuries. Workers may reduce precautionary effort if insured.</p>	<p>If workers perceive themselves as insured against injury through workmen’s compensation, moral hazard on the worker side may partially offset safety gains.</p>
<p><b>Net efficiency gain:</b> Statutory regulations correct information failure, workers gain leverage; employers</p>	<p><b>Adverse Selection Models (Akerlof, 1970)</b></p>	<p>Workers have imperfect information about workplace hazard levels. Employers have</p>	<p>Mandatory hazard disclosure requirements (as in OSHWC provisions) correct this asymmetry allowing workers to make informed decisions and</p>

Predicted Effect	Theoretical Model	Key Assumption	Mechanism
invest in hazard reduction or compensation arrangements.		additional withheld information.	bargain appropriate compensating differentials.
<b>Net welfare gain:</b> Collective action produces higher gains than voluntary action. Effect is stronger where worker bargaining power is low (for new safety committee provisions in OSHWC Code 2020).	<b>Public Goods and Collective Action</b>	Working conditions have public good characteristics: one worker's improved safety environment benefits all workers	Safety benefits are non-excludable. Workers can free-ride on others' advocacy efforts. Mandatory safety committees can correct this market failure by institutionalising safety protocols, thereby lowering cost of collective bargaining.

**Source:** Authors' compilation.

Where labour markets are competitive and information complete, regulations can introduce distortions with ambiguous net effects. On the other hand, where market are monopsonistic, asymmetric or immobile, institutionalized safety, health and working condition standards can **correct market imperfections** and produce **unambiguous welfare gains**, especially for migrant, contract and informal workers.<sup>8</sup> Thus, the welfare effects of the new OSHWC provisions will likely be heterogenous across firm size, market structure and worker characteristics. Changes such as raising thresholds will not eliminate all distortions but rather shift the tentative equilibrium outward, while withdrawing protection for some workers who were previously within the threshold. It remains to be seen if the relative change between the old and new rules regime outweighs the costs of abidance across establishment types and worker categories.

The significance of these observations varies across global labour markets. Some models are more applicable to India and other developing nations, while others are more measurable in developed economies, where mandatory correction systems have been in place for longer periods. The literature examining India in this context, for state amendments made to particular Acts over the last two decades or studied across major events, such as the post-1991 liberalisation era, is particularly informative. Our takeaways thus stem from a combination of India-centric changes with respect to the previous labour regime as well as labour regulations enforced in the US or European nations, and now applicable to the new Indian labour codes.

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<sup>8</sup> The argument here is that in monopsonistic markets, where employers have wage-setting power and pay workers below the marginal product of labour (MPL), mandatory safety regulations and welfare provisions can correct the under-provision without distorting the otherwise stable equilibrium. With asymmetric or incomplete information, workers cannot know the full extent of their work-related risks and hence rely on statutory disclosures to set wages to risk-considered levels. This is particularly effective for vulnerable worker populations who have even less wage-setting power.

## 5.4.2 Empirical Evidence

The theoretical frameworks surveyed above generate testable predictions about the direction and distribution of employment effects under the new OSHWC architecture. The empirical literature drawn from quasi-experimental evaluations of previous legislation and state-level amendments, broadly validates these predictions. Four key takeaways are presented below, highlighting direct implications for how the OSHWC Code's provisions are likely to affect employment outcomes on the extensive margin.

- **Direction of state regulation:** One of the main determinants of the purported effects of the reforms on output, employment and firm size is the direction of state legislation. The same nationwide reforms can often produce diverse outcomes based on the extent of institutional heterogeneity across states. Pro-worker industries or states are found to behave differently under regime changes compared to pro-employer states, often at the expense of the former.<sup>9</sup> Consequently, policies such as delicensing or registration amendments, as highlighted in the OSHWC Code, can exacerbate inter-state inequality that directly impacts the hiring and firing, or entry and exit of firms.
- **Increase in total employment with suppression at the threshold:** The Factories Act, 1948 and the BOCW Act, 1996 maintained a 10-worker threshold to be defined as a 'factory' or a production-based establishment.<sup>10</sup> Crossing that threshold triggers the entire Act's obligatory safety and welfare mechanisms, often progressively more stringent as the headcount rises further.<sup>11</sup> Thereby, firms and inspectors can under-report employment at the margin, creating a win-win situation for both parties, as the inspector extracts rent while the employer reduces additional compliance and unit labour costs.

Thus, while the new labour reforms are likely to **shift the bounds of employment outward**, generating a net positive effect on total employment, it can also incentivize informalisation below the thresholds of compliance, and restart the debate on whether reforms should focus on deregulation or threshold redesigns. It is also worth noting that this suppression will be weaker at higher thresholds as firms have already borne some of the compliance costs and cannot recover certain sunk costs.

**Figure 5.3** below simulates a distributional consequence of the Code's revision of the factory definition threshold from 10 to 20 workers (for manufacturing processes using power). The base figures from the ASI 2023-24 Annual Report show 33.9 per cent of registered factories employing less than 15 workers, and 2.2 per cent of total factory workers. Given this left-tailed bunching, if we assume a 50 percent shift in factories and workers from the 0-14 band to the 15-19 band, plus an additional conservative 25 per cent increase in new factory registration and total employment as a result of the new Labour Codes, the distribution repositions itself slightly from the previous regime's threshold to the new one (shown by shaded lines).

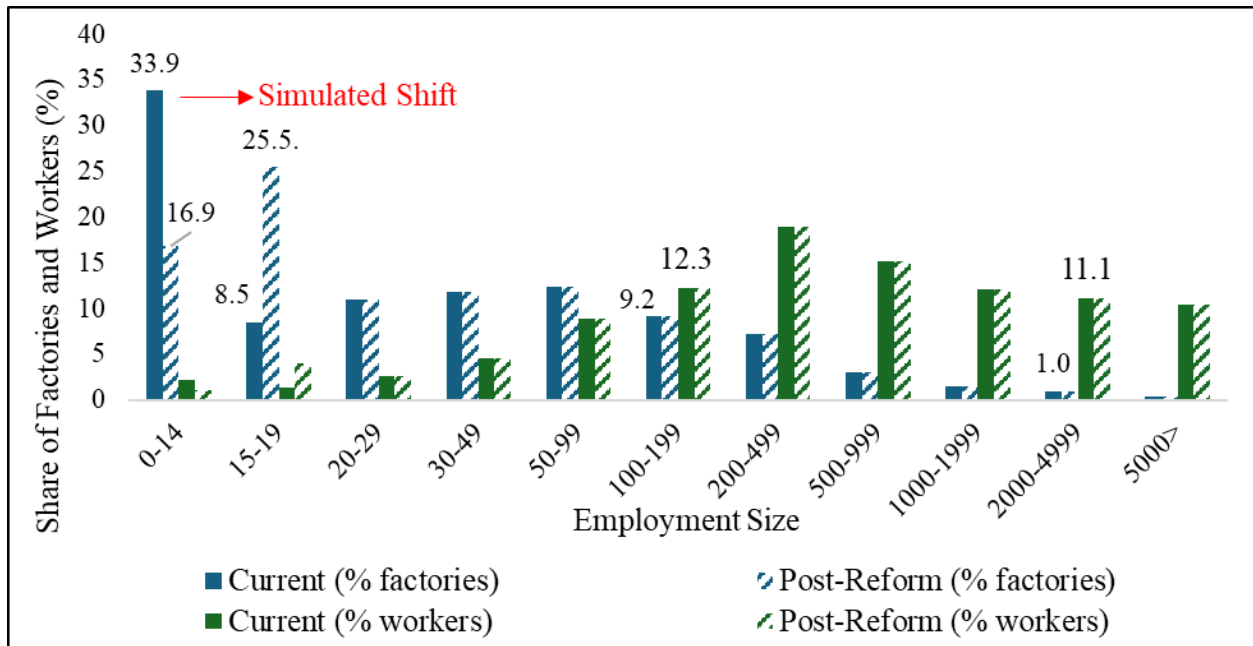
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<sup>9</sup> The categorisation of states as pro-worker or pro-employer follows from the literature after Besley and Burgess (2004).

<sup>10</sup> For premises using power equipment and employing so many on any day in the preceding 12 months.

<sup>11</sup> These obligations under the OSHWC/Factories Act involve, at minimum, registration and licensing of the factory, structural safety compliance, working condition standards, and maintenance and submission of returns.

**Figure 5.3: Simulated Effect of Threshold Redesign on Factory and Worker Distribution**



**Source:** Annual Survey of Industries 2023-24; Authors' calculations.

**Note:** Factory employment bands above the new threshold (employing more than 20 workers using power) are assumed to not increase in this simplistic scenario, as the new threshold does not affect them directly.

This shows how the **net employment effect of the threshold redesign is positive but narrow** in aggregate. The formalisation gains come from releasing factories that previously suppressed headcount just under 10 workers, while the worker distribution, even under optimistic assumptions, would still be affected for only a small fraction of total factory employment (<5 per cent). The distributional asymmetry is thus the central concern.<sup>12</sup>

- The productivity-employment trade-off via increased contractualisation:** Threshold architecture also incentivizes firms to hire workers that do not fall under the entire regulatory ambit of worker-centric laws. The CLA, 1970 required contractors to obtain a license if they hired 20 or more workers leading them to often substitute permanent workers with contractual workers, who were counted separately. This reduced direct employment, while potentially keeping productivity up, and hence the trade-off.

The OSHWC Rules, 2025 move this threshold to 40 or more workers, allowing firms to hire more workers across all industries, but also likely triggering the same contractualisation incentives as a rational avoidance strategy. However, the Code on Social Security, 2020 extends new benefits to contract workers in terms of provident funds while the OSHWC Code also extends its safety and health obligations to this population. It remains to be seen if the conditions on principal

<sup>12</sup> The same distributional effect can be expected at the factory definitional shift in terms of employment size from 20 to 40 workers for manufacturing processes not using power.

employer liability<sup>13</sup>, implementation for gig and platform workers, and the extent of employer-borne compliance costs to move hiring from contract to direct workers is sufficient to eliminate this phenomenon completely.

- **Vulnerable worker populations:** The Inter-State Migrant Workmen Act, 1979 did not extend the same coverage to migrant workers as it did for non-migrant workers. It excluded workers outside licensed contractors, migrants numbering less than five and self-employed migrants. The 2020 migrant crisis exposed the lack of enforcement of rules mandated on paper. Similarly, the Factories Act, 1948 prevented women night-shifts, severely restricting women's participation in the night-shift economy.<sup>14</sup>

Putting migrant workers under extended protection frameworks and validating women's participation in night-shift employment can bring about a Pareto improvement in terms of migrant and female hiring in particular industries, expanding the extensive margins of their employment.

#### **a. India**

- **Firm Size Thresholds and Employment Suppression**

The most consistent finding across the India-specific literature is where threshold-based regulations create strong incentives for firms to remain sub-threshold, producing a bimodal firm size distribution with excess mass below activation points and a conspicuous missing middle above them (similar to **Figure 5.3** above). Rajagopalan and Shah (2024) report over 95 per cent of Indian firms remain below 10 workers to avoid compliance costs and recommend raising the threshold even higher than what the new Code mandates. Hasan and Jandoc (2012) show labour-intensive industries in states with flexible regulations have less employment in micro firms and more in large firms relative to inflexible states, a gap that widened after the 1982 tightening of the Industrial Disputes Act. Cai and Pandey (2013) extend this to a general equilibrium framework and find size-dependent regulations impede labour reallocation from agriculture into manufacturing and services.<sup>15</sup> Hasan et al. (2017) show the same mechanism operating in apparel sectors, where regulatory-induced contraction constrains scale economies and is a proximate cause of India's export underperformance.

- **Compliance cost of regulation**

Amirapu and Gechter (2019) calibrate distortions in firm size around the 10-worker threshold, and correct for strategic misreporting by firms and enumerators. They find labour regulations raise unit labour costs by 35 per cent on average. The cost is highest in high-corruption states and firms owned by disadvantaged social groups, identifying an extortionary mechanism in which inspectors extract rents under the cover of regulatory enforcement. This finding is material to the OSHWC Code's single registration and unified return architecture, which simplifies the statutory compliance burden, but does not, by

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<sup>13</sup> OSHWC provisions apply if contract work is carried out on the principal employer's premises, potentially excluding coverage for off-site contract work, home-based work or gig and platform-based work.

<sup>14</sup> A third crucial vulnerable population, namely gig and platform workers, is covered under the Code on Social Security (Chapter 3).

<sup>15</sup> However, such estimated aggregate output loss is often modest, implying such employment suppression consequences of threshold design are more policy-relevant than the headline welfare cost.

itself, reduce de facto costs where inspector-level rent extraction can reconstitute again. Sapkal (2016) corroborates this by noting that enforcement intensity has a stronger effect on contractualisation than statutory stringency, with firms in inflexible states under active inspection showing higher contract worker ratios than those in flexible, low-enforcement states.<sup>16</sup>

- **Labour Substitution and Contractualisation**

The substitution of contract for direct workers is the dominant margin through which Indian firms adjust to regulatory pressure. Bertrand, Hsieh, and Tsivanidis (2021) show how liberalisation drove contract worker share at large firms from 20 to 38 per cent between 2000 and 2015. Chaurey (2015) shows firms in pro-worker states hire approximately three additional contract workers per positive demand shock relative to firms in neutral states, while permanent worker hiring remains unresponsive across all labour regimes. It can be inferred that firms facing rigid permanent hiring rules do not reduce employment volatility but shift it onto a more precarious, lower-paid workforce outside the ambit of statutory protections.

The OSHWC Code raises the Contract Labour Act licensing threshold, potentially recreating the same incentive at a higher margin (from 19 to 49). Whether the Code on Social Security's extension of provident fund and other wage benefits to contract workers is sufficient to neutralise this incentive is an open empirical question, particularly given the implementation gap documented by Goswami and Kujur (2024).

- **The Productivity-Employment Trade-off**

Where quasi-experimental evidence exists on the employment effects of Indian labour law reform, the findings challenge the job-creation rationale. Goswami and Paul (2021) evaluate Rajasthan's 2014 simultaneous amendments to the Industrial Disputes Act, Factories Act, Contract Labour Act, and Apprentices Act. Reforms reduced total employment by approximately 3 per cent and directly employed workers by approximately 2 per cent, with no new plant entry in the post-reform period. The employment decline was concentrated among directly hired workers, while contractual ratios rose in export-oriented industries. This productivity-employment trade-off, with no compensating entry effect, is in tension with the extensive margin employment gains anticipated from the new Labour Codes.

Aghion et al. (2008) have found India's industrial delicensing produced heterogeneous outcomes, with pro-employer states seeing output rise approximately 10 per cent above the counterfactual and pro-worker states approximately 18 per cent below. This showcases the direction of state-level labour mediations and whether nationwide reforms produce gains or losses at the establishment level. The same institutional heterogeneity will likely condition the employment effects of the OSHWC (and IR) Code across Indian states.

- **Restrictions on vulnerable worker populations (female participation)**

Gupta et al. (2025) provide a causal analogue to the OSHWC Code's night shift liberalisation for women. Exploiting staggered state-level removal of night shift bans between 2014 and 2017, they find large firms increased female worker share by 3.5 per

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<sup>16</sup> The argument here is that firms prefer to employ an excessive number of contract workers to circumvent firing (allowing seasonal workers to exit their contracts naturally) and overall compliance costs of regular workers.

cent and total female workers by 13 per cent, with no significant effect on male parameters, confirming firms expanded their workforce rather than substituting across genders. However, effects are absent among smaller firms, reflecting fixed costs of female-friendly infrastructure (separate sanitation, transport, harassment redressal) that only large firms can absorb on a per-worker basis. This weakens the OSHWC Code's new provisions for vulnerable groups. The extensive margin gains will likely be concentrated among large, export-oriented firms, leaving smaller establishments and informal sector women and migrant workers unaffected. Sarkar and Samantroy (2023) and the World Bank (Shanker et al., 2025) corroborate the distributional concern, identifying specific omissions in maternity and safety provisions that disproportionately affect women in informal and home-based work, populations the OSHWC Code does not reach.

## **b. Other Developing Countries**

Evidence from other developing economies corroborates core India findings while showcasing contextual differences in the magnitude and distribution of purported employment effects as itemized below:

- **Firm Size Thresholds and Employment Suppression (Informal Sector)**

In addition to the India-centric literature on threshold distortions, firms are also likely to turn to the informal sector to navigate regulatory limits. This may not have the desired effect. Dabla-Norris et al. (2018) use an RDD around Peru's 20-employee regulatory threshold and find size-dependent regulations reduce aggregate wages by 0.4-1 per cent, profits by 3-4 per cent, and output by up to 1 per cent of GDP. Access to informal labour does not buffer these costs: increases in informal employment are largely offset by declines in formal employment, leaving aggregate labour market outcomes worse. This serves as a caution to India's unorganised sector which absorbs the majority of workers outside the OSHWC Code's reach.

- **Compliance cost of regulation**

Negative employment effects are most pronounced when regulations are set at high ratios relative to median wages, and are most adverse for youth, women, and low-skilled workers in small firms. Betcherman's (2015) cross-country review from Latin America, Asia, and Sub-Saharan Africa, finds workers and firms in large informal settings shift between sectors or simply do not comply when faced with high regulation costs. He identifies infrastructure deficits, taxation, and corruption as likely more binding constraints than statutory labour regulation itself, consistent with Amirapu and Gechter's (2019) India-specific finding that de facto compliance costs are driven by inspector-level rent extraction rather than statutory text.

- **Labour Substitution and Contractualisation**

Betcherman (2015) further finds that EPL across developing countries consistently generates substitution toward informal, temporary, and contractual employment arrangements, with effects concentrated among worker groups (migrants, women, low-skilled workers) the OSHWC Code seeks to protect. The distributional pattern is consistent across Latin American, Asian, and African contexts despite significant variation in statutory design, suggesting the contractualization response is a robust feature of threshold-based regulation rather than a country-specific effect.

- **Restrictions on vulnerable worker populations (low-skilled or informal workers)**

Where workers are discriminated against as a minority of the typical workforce demography, Boudreau (2020) finds mandating worker-manager safety committees across 84 Bangladeshi garment factories significantly improved compliance and safety indicators without imposing efficiency costs, but gains were entirely concentrated in factories with better baseline managerial practices. Poorly managed factories show no improvement and experience declining worker satisfaction. Islam et al. (2023) reinforce this from the informal sector where OSH information provision alone improved business practices and raised annual sales among informal Bangladeshi firms, but produced no measurable reduction in actual injury rates, pointing to a persistent gap between reported compliance and safety outcomes.

### **c. Developed Countries**

Evidence from developed economies offers a set of cautionary precedents applicable to the OSHWC Code.

- **Firm Size Thresholds and Employment Suppression**

The analysis on threshold bunching stems from Garicano et al (2016), where they found 12 per cent of firms at exactly 49 employees for 2 years versus 2 per cent at 52 employees, calculating losses up to 3.4 per cent of France's GDP. However, later studies (Askenazy et al, 2022) show such threshold spikes to be an artefact of under-reporting, matching India's experience. While this may highlight ambiguous differences in employment growth, firm size distributions can also reflect cost calibrations rather than genuine threshold avoidance.

- **Compliance Cost of Regulation (Inspector Regimes)**

Where regulations have been systematically implemented over a sufficient period of time, as in the case of several developed nations' industries, the effects of certain compliance metrics are more clearly quantifiable. The OSHA regulations, for instance, have inspection routines that can be randomly assigned to calculate their effectiveness in terms of reducing workplace injuries and the social equity it generates (Lafuente and Daza, 2020; Johnson, Levine and Toffel, 2023).<sup>17</sup> However, inspections can also have the opposite effect of increasing accident claim rates (McLeod et al., 2024), due to increased reporting.

The simplification of the Inspector-cum-Facilitator model in the OSHWC Code, 2020 will thus require credible deterrence implementation, risk-based industry targeting and sufficient inspection frequency to produce substantial safety gains. The new interplay between such inspectors and principal employers will be a key point of interest.

- **Labour Protection and Unionisation**

Workers are more likely to prefer employment in industries with better legal protection against firing practices, the preferences being higher with unionised worker populations than without (Johnson, Schwab and Koval, 2022). The employment effect is likely to be stronger for contract and informal workers who lack equivalent job security.

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<sup>17</sup> Lafuente and Daza (2020) find a particularly interesting pro-cyclicality between GDP (across 24 European countries from 2008 to 2015) and workplace accidents. They argue that during economic expansion, workers receive better protection, which increases injury reporting; while during recessions, workers under-report incidents in fear of getting laid off.

- **Restrictions on vulnerable worker populations (new migrant entrants)**

Given the long precedent of licensing statutes in the US, certain entrenched industries offer negative labour market participation effects for new entrants (Han and Kleiner, 2017). The effect is stronger on migrant workers who are more likely to get injured on the job than their native-born counterparts (Moyce and Schenker, 2018). They also highlight the documentation insecurity, language barriers and cultural roadblocks faced by contractual migrants in the US and several European countries, in the absence of comparable statutory protections for their population. These lessons apply for the Indian inter-state migrant under the OSHWC Code, where their new guardrails on coverage and portability can be expected to increase the upper bounds of their employment.

## 5.6. Literature Review: Impact on Labour Productivity

### 5.6.1 Theory

Parallely after Section 5.5.1, **Table 5.2** below merges the classic theoretical models with their purported effect on labour productivity under the regulations of the OSHWC Code, 2020.

**Table 5.2: Theoretical Implications of the OSHWC Code on Productivity**

<b>Predicted Effect</b>	<b>Theoretical Model</b>	<b>Key Assumption</b>	<b>Mechanism</b>
<b>Net efficiency gain:</b> statutory regulations correct information failure, workers gain leverage, employers invest in hazard reduction, raising allocative efficiency and output quality.	<b>Adverse Selection Models</b> (Akerlof, 1970)	Workers have imperfect information about workplace hazard levels. Employers withhold information.	Mandatory hazard disclosure requirements correct this asymmetry, allowing workers to make informed decisions and bargain appropriate wage differentials. Employers invest in hazard reduction to avoid wage demands or worker exits.
<b>Positive productivity effect,</b> especially in labour-intensive work, where occupational disease is prevalent and often undetected. Effect accumulates over medium-term horizons. Particularly relevant where occupational health surveillance was limited to	<b>Efficiency Wages and Health Capital</b> (Leibenstein, 1957; Strauss and Thomas, 1998)	Worker productivity is a function of their health and nutritional status. Employers in low-wage, high-hazard environments underinvest in worker health relative to the social optimum.	Mandatory annual health examinations and disease surveillance, as introduced for workers above 40, reduce the stock of undetected occupational illness. Healthier workers supply more effective labour hours, make fewer errors, and exhibit lower absenteeism, raising output per worker

<b>Predicted Effect</b>	<b>Theoretical Model</b>	<b>Key Assumption</b>	<b>Mechanism</b>
hazardous process industries only.			without a commensurate increase in labour input.
<b>Potential gain</b> conditional on external adjustment of moral hazard. Net productivity depend on whether employer liability is credibly enforced and workers internalise residual injury risk.	<b>Moral Hazard</b> (Insurance Models)	Employers bear liability for workplace injuries. Workers may reduce precautionary effort if insured.	If workers perceive themselves as insured against injury through compensation, moral hazard on the worker side may partially offset safety gains from mandatory investment in workplace safety infrastructure.
<b>Net productivity gain</b> through reduced accident expenditure, lower downtime, and improved worker effort. Effect is stronger in establishments where individual worker voice is weakest.	<b>Public Goods</b> and Collective Action	Working conditions have public good characteristics within the establishment.	Mandatory safety committees institutionalise hazard identification and remediation at the establishment level. By correcting collective action failure in safety advocacy, they generate firm-level safety investments that would not emerge from voluntary market equilibrium, reducing accident-related productivity losses.

**Source:** Authors' compilation.

These implications thus are **theoretically more unambiguous** than the employment effects, but equally contingent on implementation. Where safety regulation corrects information asymmetries, institutionalizes collective action on hazard governance, and enables systematic health surveillance, the models converge on a **positive productivity outcome**: lower accident-related downtime, reduced chronic illness burden, and improved worker effort per effective labour hour. The efficiency wage and health capital channel is particularly relevant for India, where occupational disease is widespread but underreported, and where the Code's annual health examination provision creates a systematic basis for detecting conditions outside hazardous process industries.

The caveat, as with employment, is that these gains are conditional. Moral hazard on the worker side, weak enforcement of employer liability, and thin managerial capacity to act on safety committee recommendations can each attenuate the productivity dividend. The short-run adjustment path may involve cost absorption without commensurate output

gains, particularly in sectors where OSH compliance was previously minimal. Over the medium term, however, a positive productivity trajectory is favoured, provided the Inspector-cum-Facilitator model maintains credible deterrence and the digitisation of workplace incident data is used actively for risk-based targeting rather than passive record-keeping.

### 5.6.2 Empirical Evidence

Several enactments and amendments under the new threshold and safety rules in 2025 have been targeted to increase not just employment and its distribution, but also to improve the working conditions of the average worker, in line with international standards. A few expected transitions in firm effort and labour productivity are discussed below:

- **Delicensing and entry-exit:** As a continuation of the analysis on employment, delicensing policies can also affect output and productivity both ways. The 1991 post-liberalisation era witnessed an increase in the number of factories, output per employee and total factor productivity. It also spurred innovation among incumbent firms and affected entry of new firms. The OSHWC Code change to single registration can similarly be expected to entice new entrants into the industry but face an uphill task against old incumbents. The net effect on sectoral productivity will need to be investigated on a case-by-case basis.
- **Threshold Productivity Gain or Loss:** The upward shift of the threshold limit on employee size can be expected to increase employment in sub-threshold establishments, where productivity was likely being suppressed. The corresponding structural transformation can move labour from agriculture to formal manufacturing, boosting output. However, such deregulation often has small general equilibrium gains, implying the aggregate welfare cost can also be substantial.
- **The safety-productivity trade-off:** Safety precautions and hazard protection measures can often have one of the strongest impacts on worker productivity. Ideally, implementation of a new mandatory safety committee as stipulated in the OSHWC Code, 2020, should increase marginal output per worker. However, this needs to take into account safety improvement costs by the principle employer, inspection targeting and frequency, as well as penalty credibility for deterrents.

Given these tendencies, we now attempt to similarly divide the literature symmetrically across these key components.

#### a. India

- **Delicensing, entry-exit and productivity**

In their seminal paper, Aghion et al, (2005) contend the dismantling of the License Raj era in Indian industry post 1991 increased new entrants and raised output per worker disproportionately among advanced and backward firms, pro-worker and pro-employee states. The current OSHWC Code's simplified entry architecture may reduce incumbent compliance costs as advertised, but the net effect on sectoral productivity will also depend on states' implementation capacities.

- **Threshold-driven productivity effects**

Where labour policies have stagnated and firms have suppressed employment at the margin of compliance for too long, the new Codes are expected to have the highest impact where output per worker is lowest. ASI and NSSO unit-level data over the last decade show up to 16 times productivity differentials between large firms and micro firms employing 1-9 workers (Biswas and Bandyopadhyay, 2021).

The OSHWC Code's doubling of the Factories Act threshold from 10/20 to 20/40 workers (for manufacturing with and without power) shifts the bunching point upward but does not alter the underlying incentive structure. For such firms clustered below 10 workers, the threshold increase release some distortion at the old margin. For firms near the new threshold, the same avoidance logic can continue. The overall impact on productivity may thus be positive, or neutral.

- **Safety, health, working conditions and productivity**

The safety-productivity linkage can operate through several channels such as climate-induced shocks, manager interventions, and hazardous working environments. Adhvaryu, Kala and Nyshadham (2022) show how managers mitigate productivity impacts from pollution-induced shocks by careful reallocation of affected workers. Among the vast literature on heat stress and productivity, Somanathan et al. (2021) estimate reduced worker productivity and higher absenteeism on hotter days, suggesting investment in low-cost technologies to safeguard workers. While the Code may not specify detailed contingencies for safety shocks, states can notify and enact sector-specific adaptations to account for such external or internal events.

## **b. Other Developing Countries**

- **Delicensing, entry-exit and productivity**

The relationship between competitive exposure and productivity in developing country manufacturing is well established but conditional on firm capabilities and market access. Verhoogen (2023) reviews an extensive causal literature across Asia, South America and African firms and argues that poor entrant performance is due to information and organisational failures rather than entrepreneurial capacity, a finding worth emulating in India post the new labour reforms.

- **Threshold-driven productivity effects**

Comparative studies in Peru (Dabla-Norris et al., 2018) find threshold rigidity increases informal employment but reduces formal employment, often leaving net productivity outcomes worse. A novel suggestion in this regard is firm splitting, which could partially mitigate such reallocation but create significant welfare costs for medium firms. Thus the broader enforcement environment and not threshold redesign alone will determine whether the new regulatory space in India translates into productive firm growth.

- **Safety, health, working conditions and productivity**

Several studies analyse the working conditions and productivity trade-off in the garment factories of Bangladesh. Bossavie, Cho and Heath (2023) exploit an exogenous disaster (the Rana Plaza building collapse) to find improvements in working conditions raised wages with no employment or output contraction. Avis, Ferraz and Finan (2018) review anti-corruption audits in Brazil and find reductions in future violations, helped by strong

disciplining and local media coverage. Both studies allude to improving output per worker from their findings.

### **c. Developed Countries**

Given study samples of advanced firms and seasoned industries, the inference from the developed-country literature on the effect of reforms on productivity is more nuanced and targeted as discussed below.

- **Delicensing, entry-exit and productivity**

Aghion et al. (2009) model the distance to technological frontiers between old and new firms and find foreign entry raises incumbent TFP growth the shorter this distance is.<sup>18</sup> If the distance is large, it can widen productivity gaps between advanced and laggard firms, a matter of concern for firms farther from the technological frontier in India, should the new single license registration enactment dilute market quality too much.

- **Threshold-driven productivity effects**

The French literature on threshold effects is most dominant here. Gourio and Roys (2014) find removing the threshold raises output per worker but the magnitude shrinks when entry is elastic. Further studies discount this effect citing deliberate under-reporting by firms to stay below the limit. For Indian industries, productivity estimates using ASI data for such thresholds may overestimate their impact if size misreporting is prevalent, an inference to be deduced from future studies of the new labour reforms.

- **Safety, health, working conditions and productivity**

The developed country causal evidence on safety and productivity contends that the two are not inherently in conflict but realising output per worker gains from improvements in working conditions require credible enforcement, adequate targeting and penalty strength. Gowrisankaran et al. (2015) study mine fatalities and find productivity declines can happen when addressing state-level safety measures, but that cost is small relative to post-accident expenditures. McManus and Schaur (2016) further show how import competition can reduce OSHA violations and boost worker productivity. The lesson therefore for the OSHWC Code 2020 is to avoid uneven implementation across establishment types, especially where contract and informal workers are involved.

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<sup>18</sup> This stems from increased competition from new entrants, forcing incumbents to continuously innovate and try to stay ahead of the curve.

## 5.7 Summary of Expected Impacts in India

The table below summarises key findings from the literature on parameters of interest.

**Table 5.3: Comparison of OSHWC-relevant effects on Employment and Productivity by region**

India	Other Developing Countries	Developed Countries	Parameter
<b>Employment Effects</b>			
<b>Negative.</b> Most firms cluster below threshold to avoid compliance.	<b>Ambiguous.</b> Threshold rigidity reduces formal but increases informal employment; the two effects largely offset each other.	<b>Negative to neutral.</b> True employment distortion may be smaller than what distributional data suggest.	<b>Firm Size Threshold and Employment Suppression</b>
<b>Negative</b> on formal employment. Regulatory costs at the threshold raise unit labour costs substantially.	<b>Negative.</b> Infrastructure deficits, taxation, and corruption are identified as more binding constraints than statutory labour regulation.	<b>Ambiguous.</b> If enforcement and penalty credibility is high, costs are offset by gains. If enforcement is poor, costs accumulate without benefits.	<b>Compliance Cost</b>
<b>Positive.</b> Contract worker substitution dominates, potentially increasing total employment.	<b>Positive and robust</b> across regions. EPL consistently generates substitution toward informal, temporary, and contractual arrangements.	<b>Positive but conditional.</b> Contractualisation can be an issue but the effect is moderate where worker voice, unions, and legal protection are strong.	<b>Labour Substitution and Contractualisation</b>
<b>Positive</b> on the extensive margin but concentrated among large firms; constrained by enforcement credibility and documentation infrastructure.	<b>Positive</b> where managerial quality is sufficient. Documentation and contractual dependence suppress migrant workers' ability to claim statutory	<b>Positive for incumbents, negative for new entrants.</b> Established licensing and protection regimes reduce participation for	<b>Vulnerable Worker Populations: Women and Migrants</b>

India	Other Developing Countries	Developed Countries	Parameter
	protections even where they nominally exist.	new entrants. Migrant workers more exposed.	
<b>Productivity Effects</b>			
<b>Heterogeneous.</b> Entry liberalisation raises output per worker on average but with pro-employer states disproportionately and pro-worker states falling.	<b>Conditional</b> on firm capabilities and market access. Poor entrant performance reflects informational barriers rather than regulatory friction alone.	<b>Heterogeneous</b> by frontier distance. Foreign entry raises incumbent TFP among near-frontier firms but reduces it among far-from-frontier firms.	<b>Delicensing, Entry-Exit and Productivity</b>
<b>Positive</b> subject to managerial response and awareness on possible threats to worker safety and productivity.	<b>Positive.</b> Working condition improve following external scrutiny in monopsonistic markets. Safety contingent on managerial quality.	<b>Positive.</b> Credible inspection regimes, legal protection, and penalty strength determine if safety investments translate into productivity-enhancing outcomes.	<b>Safety Regulations and the Safety-Productivity trade-off</b>

**Source:** Authors' compilation.

In conjunction, the cross-country evidence highlights how India's labour market outcomes are shaped less by the direction of the regulation itself, but more by how it interacts with weak enforcement, firm size patterns and a large informal sector. The findings reinforce the need for stronger compliance systems, credible enforcement and complementary conditions to allow firms to scale with the formal economy, lest the gains remain incremental and uneven.

## 5.8. Policy Implications

The OSHWC Code is designed to expand the bounds of formal employment at the extensive margin by lowering compliance costs and raising thresholds. However, these directorates also impose new obligations on employers in the form of safety committees (now at lower thresholds), health examinations, digitised reporting and compliance, to name a few. For small and micro establishments, such costs may exceed the productivity and profitability from formalisation, particularly in the short run. The Code makes it

easier to be formal and more expensive to be formal at the same time, with the two forces working in opposite directions for different firm sizes.

This predicament necessitates a few policy suggestions.

i. **Fiscal Complementarity:** The Code imposes new compliance costs but provides no offsetting fiscal instruments for small establishments making the transition. Where social security reforms are partly funded through aggregator contributions or employer-employee splits, OSHWC compliance on safety, infrastructure, health examinations, hazard buffers, fall entirely on the principal employer. These are fixed costs that do not scale with output.

One solution can be targeted employer compliance subsidy or tax credit instituted for first-time formal registrants. Such fiscal tools have been used by other East Asian economies during their transitions, and can reduce any disincentives in crossing the thresholds.

ii. **Demand-side Support:** Firms will formalise if the expected benefits of formalisation in terms of higher credit access, export markets and loan availability outweigh the compliance and additional hiring costs. However, if their markets were informal to begin with and buyers do not differentially reward formal supplier status, the formalisation incentive will remain weak. States can provide support through public procurement, plot allocations, and credit guarantee schemes for these new establishments. This can link the gap between the demand side of formalisation with the supply side nudge the Code provides.

iii. **Hazard Database:** The Rules enforcing digitisation of employment, notices, work intimations, etc. extend to accident, injury, disease and health examinations as well. A **national OSH data repository** can be established to publish annual sectoral injury rate benchmarks, compile detailed hazardous activity metrics from state classifications and make sure they align with the standard ILO conventions. This transparency will innovate new approaches in worker productivity, and more importantly increase accountability on industries with higher injury rates.

States with greater concentration in mining, chemical manufacturing, or plantations, such as Jharkhand, Rajasthan and Kerala, have the largest incentive to notify granular sector-specific rules that go beyond the central baseline. As the literature on efficiency wages and human capital suggests, these protocols can amplify labour productivity, hinting how the Centre can benefit by nationally benchmarking such expected front-runners in the state-level amendments to come.

iv. **State-differentiated Enforcement Targeting:** The empirical literature shows us that the direction of state regulation, whether pro-worker or pro-employer, determines the extent of employment and labour productivity gains or losses at the establishment level. States with historically weaker inspection capacity may recreate their inspector rent extraction practices in those industries, irrespective of the new centrally designated inspector-cum-facilitator model. The new mandate for digitising inspection and accident reporting data may be utilised in this respect to push for greater transparency and accountability in enforcement. This can put pressure on laggard states to comply, with national databases directing the best practices to be diffused across states.

In **conclusion**, the Occupational Safety, Health and Working Conditions Code, 2020 and its draft Central Rules, 2025 is a substantive procedural reform whose cost-benefit gains for organised-sector workers will be quantifiable and material, specifically with the

introduction of provisions that extend formal employment rights to categories previously outside sectoral coverage. These are strong advances, not just procedural. The net effect on total employment is expected to be positive, both in the short and in the long run.

The economic implications of the Code thus will be **directionally distinct** and **temporally separated**. Initial compliance cost absorption may produce some formal employment contraction in sectors where OSHWC compliance was minimal. In the medium term, lower barriers to registration for currently informal establishments can generate positive employment effects for workers who cross the formal-informal boundary. Over **longer horizons**, fewer workplace injuries, lower absenteeism, and reduced turnover can support employment and enhance productivity through competitiveness rather than cost effects. The bigger distributional concern may be the concentration of gains among larger organised-sector employers and workers in covered establishments relative to smaller employment units.

The final word on the Code's welfare impact will not be found in its text but in its implementation. A substantial share of the Code's operative protections, such as occupational safety standards, migrant portability, women's workforce participation and welfare officer qualifications **will depend on practices enforced and followed** at local, state and central levels. How enforcement capacity is maintained through this transition, and how quickly the outstanding rules are notified, will determine the extent of positive floor-level outcomes for workers. The Code creates the conditions for both advancement and regression; which materialises will be a question of political economy and administrative capacity rather than legislative design.

## Chapter 6: Conclusion and Policy Implications

The four new Labour Codes—Code on Wages (2019), Code on Social Security (2020), Industrial Relations Code (IRC), and Occupational Safety, Health and Working Conditions (OSHWC) Code—represent a major attempt to rationalise India’s complex labour regulatory framework. Their impact on employment and labour productivity is expected to be **incremental**, with outcomes that are **heterogeneous across sectors, firm sizes, and worker categories**. While the employment effects will be largely **compositional through shifts in type and quality of employment**, the productivity effects are likely to be **moderately positive** depending critically on implementation quality. Against this backdrop, the **policy implications become central** to realising the potential gains of these reforms.

From an **employment perspective**, the codes may not generate large net job creation or destruction. Instead, they will reshape the structure of employment through a net shift towards formalisation of the workforce. Specifically, the new Code on Wages may support more employment in imperfect labour markets by correcting wage suppression and reducing wage inequality at the lower end. However, its effectiveness depends on where the national floor wage is set, relative to the current market wage. On the other hand, the Code on Social Security would likely raise the cost of formal employment, leading firms to adjust along margins such as contractualisation or informalisation rather than reducing headcount. The Industrial Relations Code promotes labour market flexibility and may encourage firm expansion, but its impact on increasing employment will be constrained by the pervasive small size of the majority of firms in India. At the same time, the OSHWC Code would primarily encourage formalisation by reducing compliance barriers and improving working conditions, without significantly altering total employment levels.

In terms of labour productivity, the codes create enabling conditions for improvement through better worker protection, reduced compliance complexity, and more efficient labour allocation. Large firms are likely to benefit the most, as they can absorb compliance costs while gaining from reduced worker turnover, improved worker health outcomes, and better workforce stability. In contrast, small and medium enterprises may face disproportionate compliance burdens, which can offset any labour productivity gains. There is also a structural risk of capital–labour substitution, where rising labour costs due to the shift towards workforce formalisation, induce firms to adopt more capital-intensive production methods, increasing output per worker but reducing labour absorption, particularly for low-skilled workers.

Given these dynamics, the **policy implications are crucial** for ensuring that the labour codes translate into meaningful improvements in employment and productivity.

First, **strengthening enforcement mechanisms** is the most critical priority. A persistent challenge in India’s labour market is the weak enforcement of regulations, especially in the informal sector where the majority of workers are employed. Without credible enforcement, minimum wages remain non-binding, social security provisions fail to reach intended beneficiaries, and safety regulations are not adhered to. To address this, the government must invest in **digital compliance systems**, including mandatory digital wage payments, electronic maintenance of employment records, and data-driven inspection systems. Targeted inspections based on risk profiling can improve efficiency

while reducing opportunities for rent-seeking. Building administrative capacity at both central and state levels is essential to ensure consistent and credible enforcement.

Second, **careful calibration of wage policy** is necessary. The national floor wage should be set at a level that is **binding yet sustainable**, taking into account regional variations in cost of living and sectoral differences in productivity. Periodic revisions, ideally linked to inflation and productivity growth, can prevent the erosion of real wages while avoiding sudden shocks to employers. A poorly calibrated wage floor—either too low or too high—can undermine the objectives of the Code on Wages.

Third, there is a strong need to **support small and medium enterprises (SMEs)**, which form the backbone of India's employment structure but are also the most vulnerable to regulatory costs. Compliance subsidies, tax incentives, and simplified reporting requirements can help ease the transition to formalisation. Providing access to affordable credit and technology can further enable SMEs to improve productivity and absorb higher labour costs. Without such support, the labour codes risk having regressive effects, benefiting large firms while burdening smaller ones.

Fourth, **expanding and deepening social security coverage** is essential. Existing thresholds for schemes such as EPF and ESIC have eroded in real terms and exclude a large share of the workforce. These thresholds should be revised upward and indexed to inflation to maintain their relevance. Equally important is the **operationalisation of provisions for gig and platform workers**, including the establishment of a functional Social Security Fund, notification of contribution rates, and design of tangible benefit schemes. Bridging the coverage gap for informal workers requires proactive policy action rather than reliance on gradual formalisation.

Fifth, policymakers must address **threshold-based distortions** that discourage firms from scaling up. Even with reforms, regulatory thresholds continue to create incentives for firms to remain small or fragment operations to avoid compliance. Smoother, graduated regulatory frameworks can reduce these distortions and encourage firm growth, which is critical for both employment generation and productivity improvement.

Sixth, labour reforms should be complemented by **skill development and human capital investment**. Higher wages and better working conditions must be supported by corresponding improvements in worker productivity. This requires expanding access to vocational training, strengthening industry-academia linkages, and promoting continuous skill upgrading. Aligning skill development initiatives with industry needs can enhance employability and ensure that productivity gains are sustained.

Seventh, there is a need for **policy coordination across sectors**. Labour reforms alone cannot drive employment growth unless supported by broader economic policies, including industrial policy, trade liberalisation, infrastructure development, and investment promotion. Such coordination ensures that productivity improvements translate into expanded economic activity and job creation rather than merely cost savings for firms.

Eighth, improving **administrative coordination and institutional integration** is vital. Despite the consolidation of laws, the delivery of benefits remains fragmented across multiple agencies and levels of government. Moving toward a **true single-window system** for compliance and benefit delivery can reduce transaction costs and improve user experience. Greater coordination between central and state governments is also necessary to avoid regulatory fragmentation and ensure uniform implementation.

Finally, leveraging the **digital architecture of the labour codes** can create long-term gains. The development of integrated labour databases, real-time compliance monitoring systems, and publicly available data on workplace safety and employment conditions can enhance transparency, accountability, and evidence-based policymaking.

In conclusion, the labour codes represent an important step toward modernising India's labour regulatory framework, with the potential to improve efficiency, formalisation, and productivity at the margins. However, their success depends not on legislative design alone but on **effective enforcement, supportive policies, and institutional capacity**. Without these, the gains in employment and productivity may be limited and uneven, reinforcing existing structural challenges rather than resolving them.

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