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Note on Optimum Labour Market Regulation in Developing Countries: A Law and Economics Perspective

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Abstract

In the history of labour economics, the regulation of labour market has been debated since its inception. Many scholars argued for desirability of regulation and its implication on economic and labour market outcomes. Thus, myriad labour laws, meant to protect labourers, may have actually hurt them. This paper attempt to construct plausible theoretical model, using India as the backdrop of stylized facts, to show that this may indeed be the case. In stylised facts, we have adopted a framework developed by Averch and Johnson (1962) of regulatory constraints in monopoly markets. Our result suggests that, if the level of regulatory constraint imposed by the state on a particular industry is greater than the cost associated with labour input from formal sector but is less than without any regulatory constraints, then industry would start substitution of a labour from formal sector with informal sector and operate it at the output where cost is minimised with low price input (labour from informal sector). Because, higher amount of regulation on labour market provides an incentive to the industry to substitute a labour from formal sector to informal sector.

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