



Wage Determination in Informal Labour Market: Thinking beyond the Minimum Wages Act

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ABSTRACT

The persistence of informal employment and wage inequality remains one of the most pressing challenges for achieving inclusive and sustainable development in India. Despite legislative frameworks such as the Minimum Wages Act and the Code on Wages (2019), a significant proportion of workers continue to earn below subsistence levels. This study examines the structural issues underlying wage disparities in India, focusing on the dominance of informal labour and weak institutional enforcement. The paper highlights the inadequacy of the current minimum wage system and proposes a novel framework linking statutory minimum wages with Pay Commission benchmarks. The study argues that such integration can reduce inequality, enhance labour welfare, and promote sustainable economic growth. The findings contribute to policy discourse on labour market reforms in developing economies.

Introduction:

The idea of *decent work* has gained global importance as a central component of sustainable development, particularly in developing economies where labour markets are highly fragmented and unequal. In India, the challenge of ensuring decent work is deeply rooted in the structural dominance of informal employment. A significant proportion of the workforce—estimated at around 85 percent—is engaged in informal activities characterized by low wages, lack of job security, and absence of social



protection. This structural reality raises serious concerns about income inequality, labour welfare, and the sustainability of economic growth.

The structure of employment in India clearly reflects a dualistic labour market. The majority of the workforce consists of self-employed individuals (around 50 percent) and casual labourers (about 24 percent), both of whom earn significantly lower incomes (GoI, 2019). Casual workers, in particular, face irregular employment opportunities and income instability, placing them at the bottom of the labour market hierarchy. This pyramidal structure of employment indicates that a large proportion of the workforce is trapped in low-productivity and low-income activities, limiting their ability to achieve a decent standard of living. The persistence of such wage disparities highlights the limitations of the existing minimum wage system in India. Although the Minimum Wages Act and the recently enacted Code on Wages (2019) aim to provide a statutory framework for wage regulation, the system remains highly fragmented and ineffective in practice. Minimum wages vary widely across states, sectors, and skill categories, creating complexity and confusion. More importantly, enforcement mechanisms are weak, and a large number of workers continue to receive wages below the legally mandated minimum (Basu, Chau, & Kanbur, 2010). Employers often lack awareness of minimum wage regulations, and labour institutions are frequently more focused on data collection than on effective implementation. As a result, the minimum wage system fails to ensure even a basic standard of living for a substantial portion of the workforce.

The present study elaborates the present status of informal worker and also exploring novel approach to determine the minimum wage determination in present segmented labour market in India. The approach is to intergrate the wages of formal sector with wages of informal sector, so that informal workers gains also the power of collecting bargaining.

Literature Review:

The issue of minimum wages and labour market outcomes has been widely debated in economic literature. Classical economic theory suggests that higher minimum wages may lead to unemployment due to increased labour costs (Stigler, 1946). However, modern empirical studies challenge this view, arguing that moderate increases in minimum wages have negligible or even positive effects on employment (Card & Krueger, 1995). In the Indian context, studies have highlighted the limited effectiveness of minimum wage legislation due to weak enforcement and widespread informality (Basu, Chau, & Kanbur, 2010). Rani, Belser, and Ranjbar (2013) argue that minimum wages can reduce inequality and improve living standards when effectively implemented. Agrawal (2013) emphasizes the



growing phenomenon of “informalization within formal sectors,” where workers lack access to social security despite being employed in structured organizations. Similarly, Kannan and Papola (2007) note that labour market reforms in India have disproportionately benefited capital at the expense of labour. Recent studies suggest that extending minimum wage coverage could significantly reduce poverty and inequality, benefiting millions of low-wage workers (Dube, 2019).

Wage Inequality, Informality and Labour Market Reforms in India:

The process of economic liberalization in India since the 1990s has undoubtedly contributed to higher economic growth, industrial expansion, and integration into the global economy. However, it has also led to increased labour market flexibility, often at the cost of employment security and wage stability. The expansion of contractual and casual forms of employment has resulted in the informalization of the workforce, even within the organized sector. Consequently, the share of labour in national income has declined, while the share of profits has increased, contributing to widening income inequality (Piketty & Chancel, 2019). This imbalance reflects a deeper structural issue in the labour market, where economic gains are unevenly distributed.

The Indian labour market is characterized by a distinctly pyramidal structure, where a vast majority of workers are concentrated at the lower end of the wage distribution. This structural feature reflects deep-rooted inequalities in income, employment conditions, and access to social protection. Empirical evidence suggests that nearly three-fourths of the workforce earns below a decent wage level, indicating the prevalence of working poverty and wage inadequacy. Such a pattern is particularly pronounced in developing regions like Bihar, where economic opportunities are limited and dependence on informal employment remains high. Casual workers, who form a significant proportion of the labour force, are the most vulnerable segment due to irregular employment, absence of job security, and lack of access to social security benefits (ILO, 2018).

A defining feature of the Indian labour market is the coexistence of formal and informal employment, which has resulted in a highly segmented structure. Workers engaged in similar economic activities often receive vastly different wages and benefits depending on whether they are employed formally or informally. This segmentation undermines the principle of equal pay for equal work and perpetuates inequality. The emergence of “regular informal workers” has further complicated the labour market dynamics. These workers are employed on a regular or contractual basis but lack formal employment benefits such as provident fund, health insurance, and job security. Despite performing similar tasks as formal workers, they receive significantly lower wages. The proportion of such workers increased



substantially between 1999 and 2011 in both public and private sectors, reflecting a trend towards informalization within formal enterprises (Agrawal, 2013).

Despite the existence of legislative provisions, the minimum wage system in India faces several structural and operational limitations. One of the primary challenges is fragmentation, as minimum wages vary widely across states, sectors, and occupations. This multiplicity creates administrative complexity and leads to inconsistencies in wage determination. Furthermore, weak enforcement mechanisms significantly undermine the effectiveness of minimum wage laws. Many employers, particularly in the informal sector, fail to comply with statutory wage norms due to inadequate monitoring and enforcement capacity (Basu et al., 2010). In addition, a lack of awareness among workers regarding their legal entitlements further exacerbates the problem, as many are unable to claim the wages they are legally entitled to. Another critical issue is the inadequacy of minimum wage levels, which often fail to meet the basic cost of living, thereby defeating the purpose of ensuring a decent standard of life for workers.

In contrast to India, wage determination in many developed economies is largely based on collective bargaining mechanisms involving trade unions, employers, and the state. These systems help ensure fair wages, reduce income inequality, and improve working conditions. However, in India, trade unions are predominantly concentrated in the organized sector and have limited reach in the informal economy, where the majority of workers are employed. As a result, informal workers lack effective representation and bargaining power, which further reinforces wage disparities (Kannan & Papola, 2007). The absence of strong labour institutions in the informal sector remains a major impediment to achieving equitable wage outcomes.

Integrating Minimum Wage with Pay Commission:

The informal workers are not gaining bargaining power but formal organized sector are getting better wage, negotiated with collective bargaining. When the wage process integrate the minimum wage with the minimum wage salary of the pay commission, it will give a better result and informal sector will also get the advantage of collective bargaining of formal sector employee. It will better for decent work and sustainable economic development. The Pay Commission determines wages for government employees through a structured process. Linking minimum wages to the lowest Pay Commission salary can create a **unified wage standard**.

Proposed Model

- National minimum wage based on central Pay Commission



- State-level wages linked to state pay structures
- Fixed ratio between highest and lowest wages

In this context, integrating the minimum wage framework with the Pay Commission mechanism offers a promising approach to wage reform in India. The Pay Commission determines wages for government employees through a systematic and evidence-based process, taking into account factors such as inflation, cost of living, and productivity. Linking minimum wages to the lowest Pay Commission salary could establish a unified and rational wage standard across the economy. A proposed model may include a national minimum wage benchmarked to the central Pay Commission, state-level wage adjustments aligned with state pay structures, and a fixed ratio between the highest and lowest wages to ensure equity. Such a framework would help reduce wage disparities, extend the benefits of structured wage determination to informal workers, and promote fairness in the labour market.

The economic implications of wage reform are multifaceted. An increase in minimum wages can stimulate aggregate demand by enhancing the purchasing power of low-income workers, thereby contributing to economic growth. It can also improve worker productivity by enhancing motivation, reducing turnover, and improving health and well-being. Furthermore, higher wages can play a significant role in reducing poverty and income inequality. While there may be short-term concerns regarding employment adjustments and increased cost pressures on firms, empirical studies suggest that the long-term benefits of minimum wage increases outweigh the potential costs (Card & Krueger, 1995; Dube, 2019).

Role of Trade Unions

Trade unions have a crucial role to play in shaping wage outcomes and advocating for workers' rights. However, the effectiveness of trade unions in India is constrained by fragmentation, sector-specific focus, and limited engagement with informal workers. Strengthening inclusive unionism that encompasses both formal and informal workers is essential for addressing labour market inequalities. This requires institutional reforms, capacity building, and policy support to enhance the bargaining power of labour.

From a policy perspective, achieving sustainable and inclusive development in India necessitates comprehensive labour market reforms. Key measures include the universalization of minimum wages across sectors and regions, strengthening enforcement mechanisms through improved monitoring and compliance systems, linking minimum wages with Pay Commission frameworks to ensure rational wage determination, and promoting inclusive labour institutions that represent the interests of all workers. Such



reforms are essential not only for reducing wage inequality but also for fostering a more equitable and resilient economic system.

Conclusion

India's labour market is marked by deep structural inequalities driven by informality and weak wage regulation. Despite legislative frameworks such as the Minimum Wages Act and the Code on Wages (2019), a significant proportion of workers continue to earn below subsistence levels. The current minimum wage system is insufficient to ensure decent living standards. Integrating minimum wages with Pay Commission frameworks offers a viable solution to address these challenges. Such reforms can promote inclusive growth, reduce inequality, and contribute to sustainable development. Ensuring decent work for all is not only a social imperative but also an economic necessity.

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