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## **Resource Misallocation in India: the Role of Cross-State Labor Market Reform**

by Adil Mohommad, Charlotte Sandoz, and Piyaporn Sodsriwiboon

**I N T E R N A T I O N A L M O N E T A R Y F U N D**

**IMF Working Paper**

Asia and Pacific Department

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**Prepared by Adil Mohommad, Charlotte Sandoz, and Piyaporn Sod斯里wiboon<sup>1</sup>**

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**Abstract**

At the macro level, productivity is driven by technology and the efficiency of resource allocation, as outcomes of firms' decision making. The relatively high level of resource misallocation in India's formal manufacturing sector is well documented. We build on this research to further investigate the drivers of misallocation, exploiting micro-level variation across Indian states. We find that states with less rigid labor markets have lesser misallocation. We also examine the interaction of labor market rigidities with informality which is a key feature of India's labor markets. Our results suggest that reducing labor market rigidities in states with high informality has a net positive effect on aggregate productivity.

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<sup>1</sup> This paper builds on India's selected issues paper on "Resource Misallocation and the Role of Labor Market Reform," which accompanied India's Staff Report for the 2018 Article IV Consultation. It has benefited from discussions with Romain Duval and seminar participants at APD discussion forum, as well as comments from IMF departments and Indian authorities provided in the earlier version of the paper. The paper was presented at the 2<sup>nd</sup> IZA/World Bank/NJD Conference on Jobs and Development: Improving Jobs Outcomes in Developing Countries" held at the World Bank in Washington D.C. in June 2019.

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