



## Mains Practice Question

**Q.** Analyze the structural, financial, and regulatory challenges in formalizing India's informal sector while preserving its employment generation potential. (250 words)

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### Approach :

- Briefly define the India's informal sector.
- Analyze the structural, financial, and regulatory challenges in formalizing India's informal sector
- Suggest measures for preserving its employment generation potential.
- Conclude with a suitable way forward.

### Introduction:

**Informal employment** broadly refers to workers who are employed in jobs where they do not have access to social security benefits under existing labour legislations. According to **NITI Aayog (2021)**, nearly 90% of India's workforce is employed in the informal sector, contributing almost 50% of GDP. Formalizing India's large informal sector is vital for productivity, welfare, and revenue, but structural, financial, and regulatory hurdles make it risky for livelihoods if poorly executed.

### Body

#### Structural Challenges

- **Fragmented firm structure:**
  - Predominantly micro and nano firms with low capital intensity and thin margins resist the fixed costs of compliance; many operate on subcontracting chains that complicate direct regulation.
  - Units are dispersed and poorly documented, making it hard to bring them into platforms like e-Shram, which has registered 29 crore workers but still excludes many.
- **Heterogeneity of activities:**
  - The informal sector spans street vending, construction, home-based manufacturing, domestic work and platform gigs — a single policy instrument cannot suit all.
- **Low Productivity and Skill Gaps:**
  - Informal workers often lack training, making transition into formal enterprises difficult.
  - As per **Periodic Labour Force Survey (PLFS) 2022-23**, over 60% of informal workers are engaged in low-skilled occupations.
- **Digital Divide:**
  - Reliance on digital portals for registration and compliance excludes those lacking access to smartphones or internet literacy.

#### Financial Challenges

- **Credit Constraints:**
  - Informal enterprises depend on moneylenders; formal banking penetration is shallow.

Despite **MUDRA Yojana (2015)** disbursing over ₹19 lakh crore, many borrowers remain stuck in small-ticket loans.

- **Cost of Compliance**
  - Filing GST returns or maintaining digital accounts is costly for micro-entrepreneurs.
  - A 2020 **World Bank** report found that compliance costs often exceed potential benefits for micro units.
- **Fear of Tax Burden**
  - Many workers fear that formalization will increase taxation without proportionate benefits like pensions or healthcare.
- **Social Security Funding**
  - Extending EPFO or ESIC benefits strains both the exchequer and small firms, leading some to avoid registration.

### **Regulatory Challenges**

- **Multiplicity of Laws**
  - Despite codification into four Labour Codes (2020), overlaps in state-level rules create confusion.
- **Bureaucratic Hurdles**
  - Lengthy registration and licensing discourage small units from entering the formal fold.
- **Weak Enforcement**
  - Informal workers remain outside legal protection due to poor monitoring.
  - The **Unorganised Workers' Social Security Act, 2008** has seen limited success.
- **Worker Protection vs. Employer Viability**
  - Rigid labour regulations may deter micro enterprises, leading them to remain informal to cut compliance costs.

### **Government Initiatives for Formalization of the Informal Sector in India**

- **Udyam Registration** - formal identity for Micro, Small and Medium Enterprises (MSMEs).
- **Goods and Services Tax (GST), 2017** - incentivizes registration via tax credits.
- **Pradhan Mantri Rojgar Protsahan Yojana (PMRPY)** - government pays Employees' Provident Fund (EPF) share for new hires.
- **e-Shram Portal** - national database of unorganized workers.
- **Pradhan Mantri Shram Yogi Maandhan (PM-SYM)** - pension for informal workers.
- **Pradhan Mantri Street Vendor's Atmanirbhar Nidhi (PM SVANidhi)** - loans to street vendors.
- **Micro Units Development and Refinance Agency (MUDRA) Yojana** - collateral-free loans.
- **Labour Codes (2019-20)** - consolidated, simplified regulatory framework.

### **Formalization While Preserving Employment Potential**

- **Phased and Incentive-Based Formalization** - Tax breaks, credit access, and simplified GST slabs for micro businesses.
- **Skill Development** - Tailored programs under PMKVY to upgrade informal workers' skills.
- **Digital Platforms with Outreach** - Strengthening e-Shram with benefit portability across states.
- **Cluster-Based Models** - MSME clusters can reduce compliance costs. Example: Tirupur textile cluster adopted simplified norms and mechanization.
- **Learning from Abroad** - Brazil's SIMPLES law simplified taxes for micro firms, boosting compliance without harming jobs.

## **Conclusion:**

Formalizing India's informal sector is not just a legal exercise but a socio-economic transformation. As **Amartya Sen** argued, development must enhance both freedom and security—formalization should therefore provide dignity and protection without eroding employment potential. A calibrated, inclusive, and incentive-driven approach remains the way forward.

