



## Bridging India's Formalisation Gap

*This editorial is based on “[Extend the scope of formalisation in the informal sector](#)” which was published in The Hindu Business Line on 31/03/2025. The article brings into picture the dominance of India's informal sector, which employs 93% of the workforce, and highlights its recent growth.*

**For Prelims:** [Formalisation of the economy](#), [Labor laws](#), [Goods and Services Tax](#), [Aatmanirbhar Bharat Rozgar Yojana](#), [JAM trinity](#), [Occupational Safety Code \(2020\)](#), [EPFO](#), [PM Vishwakarma](#), [National Broadband Mission](#), [Skill India](#), [One District One Product](#), [GeM \(Government e-Marketplace\)](#).

**For Mains:** Current Status of Formalisation of the Indian Economy, Key Issues Hindering Formalisation of the Indian Economy.

[India's informal sector](#) remains the **backbone of employment**, encompassing **93% of the workforce** through unincorporated private enterprises. Recent **Annual Survey of Unincorporated Sector Enterprises data** reveals impressive growth in 2023-24, with a **12.84% increase in establishments**, 10.01% rise in workforce, and 16.52% growth in GVA. India needs to work harder in this regard to accelerate the formalisation of its economy, ensuring sustainable growth and better protections for millions of workers.

## What is the Current Status of Formalisation of the Indian Economy?

- **About:** [Formalisation of the economy](#) refers to the process of bringing informal economic activities, enterprises, and workers under the regulatory framework of the government.
  - This includes ensuring compliance with **taxation**, [labor laws](#), **social security benefits**, and **other legal provisions**.
  - In recent years, India has witnessed a **gradual but uneven trend** towards formalisation across sectors.
- **Macroeconomic Indicators of Formalisation**
  - **Formal Share of GDP:** According to Citi Research (2024), the formal sector's share in India's GDP has increased to **56%**, a jump of over **25 percentage points in the last four decades**, driven by GST, digital payments, and corporate growth.
  - **Widening Tax Base:**
    - The number of individual taxpayers increased from **51 million in 2013** to **90 million in 2022**.
    - Around **4.4 million new taxpayers** are being added annually.
    - Formal sector workers contribute significantly more — top 2% of earners pay **>40% of total income tax**.
- **Labour Market Formalisation:**

- **EPFO Registrations:**
  - Over **6.91 crore members** joined EPFO between Sept 2017 and July 2024.
  - In FY 2022-23 alone, **1.38 crore new members** were added; July 2024 alone saw **20 lakh new members**.
    - Increasing female participation and youth entry into the organised sector indicate a broadening base.
- **Manufacturing Sector Shift:**
  - Formal employment in manufacturing nearly **doubled** from 2005 (47 million) to 2019 (88 million).
  - **~90% of manufacturing GVA** is now formal; however, **~70% of employment in manufacturing** remains informal (India KLEMS data, 2018-19).
- **Informal Sector Still Dominates Employment:**
  - As per **ASUSE 2023-24**, the informal non-agricultural sector employed **~120 million workers**, with **only 0.3%** of hired-worker establishments under EPFO/ESIC.
    - **Employment per enterprise has declined**, indicating fragmentation despite sectoral growth.

#### ▪ Sectoral Nuances

Sector	Formalisation Trend
<b>Manufacturing</b>	Large firms highly formalised; smaller units (~70% of jobs) remain informal
<b>Construction</b>	Post-Covid job growth driven by self-employment in this sector – mostly informal
<b>Trade &amp; Services</b>	High concentration of own-account enterprises; limited formalisation
<b>Digital &amp; Financial Services</b>	Rapid formalisation via fintech, GST, UPI, and e-invoicing



#### ▪ Drivers of Formalisation

- **Policy & Regulatory Interventions:**
  - **Goods and Services Tax (GST):** Encourages registration and documentation.
  - **EPFO & ESIC coverage expansion**
  - **Aatmanirbhar Bharat Rozgar Yojana, PMRPY:** Incentivised formal job creation.
  - **Labour Codes:** Raise thresholds for applicability, easing compliance.
- **Technological & Financial Infrastructure:**
  - **UPI and JAM trinity** (Jan Dhan, Aadhaar, Mobile) have digitised payments and welfare delivery.

## What are the Key Issues Hindering Formalisation of the Indian Economy?

- **Dominance of Micro and Small Enterprises with Low Incentive to Formalise:** India's informal economy is dominated by micro-units, many of which **operate at subsistence levels** and **see little value in formalisation** due to **compliance costs and fear of taxation**.
  - The perceived complexity of **registration, record-keeping, and formal reporting** creates a disincentive for these enterprises to transition.
    - Formalisation is also seen as **increasing visibility without assured access to credit or benefits**.
  - According to ASUSE 2022-23, **63.2%** of establishments were **not registered under any authority**, and **only 0.3%** of hired-worker establishments were covered under **EPFO/ESIC**.
- **Rigid Labour Laws and Threshold Effects:** Despite recent labour code reforms, fear of increased compliance, especially for units crossing **employee thresholds (10 or 20 workers)**, discourages hiring and formal registration.
  - Even the new labour codes, though progressive, **are yet to be fully implemented across states, causing uncertainty**.
    - The link between crossing thresholds and losing regulatory flexibility leads many firms to remain small and informal. These **“threshold effects”** act as a **structural barrier to scalability and formalisation**.
  - Enterprises employing **10+ workers** form just **~7%** of informal manufacturing establishments (**2015-16**), showing deliberate size-capping.
    - The [Occupational Safety Code \(2020\)](#) raises these limits, **but rollout remains incomplete**.
- **Inadequate Access to Enabling Infrastructure in Informal Sectors:** Lack of basic infrastructure such as electricity, digital connectivity, and finance impedes the transition of informal enterprises, especially in rural areas, **to formal operations**.
  - Without **high-speed internet, digital skills, and reliable utilities, informal businesses** cannot leverage formal systems like **GST, Udyam, or EPFO effectively**.
    - This restricts productivity, market access, and inclusion in formal value chains. The digital divide thus reinforces informality.
  - The Centre has itself highlighted **rural underemployment and infrastructure bottlenecks in tier-2 and tier-3 cities** hindering formal job creation.
- **Exclusionary Design of Formal Employment Schemes:** Current **employment-linked incentive (ELI) schemes often require EPFO track records or formal registration**, which informal employers lack.
  - This eligibility barrier prevents a vast segment of enterprises from accessing incentives meant to encourage formal hiring.
  - Instead of incentivising formalisation, these schemes risk reinforcing duality by benefiting only existing formal firms.
  - Recent data shows only **0.3% of HWEs** are covered under **EPFO**, making most ineligible for **Scheme B & C** under ELI. Yet these enterprises employ millions without formal protection.
- **Gendered Barriers in Labour Formalisation:** Women face dual challenges in accessing formal jobs — limited skilling in emerging tech areas and exclusion from enterprise ownership.
  - Though self-employment among women has risen **post-Covid**, it is mostly informal and home-based.
  - ASUSE 2023-24 showed **28.12% female workforce share**. Yet, only a **small fraction** of these are informal jobs- with **EPFO reporting a rise but not a majority**.
    - Within Asia-Pacific, India had the widest gender gap in internet usage in recent years, a gender gap of 40.4% with **only 15% of women**.
- **Misalignment Between Economic Growth and Employment Formalisation:** India's GDP is increasingly formalising, but **job creation remains informal-heavy**.
  - High growth sectors like **fintech and digital services offer formal jobs**, but **construction, trade, and manufacturing (major employers)** still depend on informal labour.
    - This divergence creates a situation where the economy formalises without the labour force benefiting fully.
  - **Citi Research (2024)** notes **GDP formalisation at 56%**, but labour market formalisation at just **15%**.
    - Post-pandemic, **54 million new jobs** were created, mostly **self-employment** —

not formal wage work.

## What Measures can India Adopt to Enhance Formalisation of Economy?

- **Rationalise Compliance Framework for Micro Enterprises:** To incentivise transition, India must implement **differentiated regulatory thresholds** for **micro and small enterprises**, ensuring that **formalisation does not impose punitive compliance burdens**.
  - A simplified **single-window digital interface for registration, tax filing, and labour compliance** can ease procedural entry into the formal net.
  - Integrating **Udyam, GSTN, and EPFO** portals under a unified backend can reduce duplication. This will encourage voluntary registration.
- **Expand Scope and Targeting of ELI Schemes:** Existing Employment-Linked Incentive (ELI) schemes should be restructured to include **informal sector employers** who meet productivity and job creation benchmarks, even without prior EPFO track record.
  - A graded incentive model linked to progressive hiring and formalisation can ensure scalability.
    - Scheme B & C under ELI must broaden their eligibility beyond formal establishments.
  - **Linking ELI with Udyam and skill certification platforms** can enable more enterprises to qualify. This fosters **inclusive employment generation**.
- **Localised Cluster-Based Formalisation Strategy:** Adopt a **cluster-based approach** to formalisation by mapping informal enterprise hubs in trade, textiles, and food processing, and offering region-specific packages including **infrastructure, credit, skilling**, and market linkage.
  - District-level economic profiling should guide cluster interventions through schemes like **PM Vishwakarma** and **SFURTI**.
  - Convergence of **Skill India**, **One District One Product (ODOP)** and **Digital India** missions can create formal value chains from the ground up.
    - This builds **local economic ecosystems** with embedded formality.
- **Gender-Sensitive Formalisation Pathways:** Design formalisation strategies specifically for **female-led enterprises and self-employed women**, including tailored credit products, home-based digital skilling, and simplified onboarding processes.
  - Strengthening convergence between **DAY-NULM**, **PM SVANidhi**, and **FutureSkills Prime** can build digital capacity among urban poor women.
  - Creating **women-centric industrial parks** with social infrastructure like crèches and transport access can support sustained formal employment.
    - A **gender-smart formalisation lens** is vital to make economic inclusion equitable.
- **Incentivise Digital and Financial Traceability:** Encourage informal enterprises to adopt **digital payments, invoicing, and financial bookkeeping** through targeted incentives like GST rebates, subsidised POS machines, and interest subvention for compliant behaviour.
  - Linking such digital traceability with easier access to **MSME credit schemes** like **CGTMSE** and **Mudra** can accelerate formalisation organically.
  - Use of **AI-driven risk profiling** by banks and fintechs can reward digitally visible enterprises with better financial products, closing the gap between informality and formal credit access.
- **Strengthen Last-Mile Infrastructure for Formalisation:** Invest in **rural and peri-urban digital infrastructure**, electricity access, and common service centres to enable informal enterprises to onboard onto formal platforms.
  - The expansion of **National Broadband Mission 2.0**, convergence with **Digital Saksharta Abhiyan**, and use of **SHGs as digital enablers** can drive bottom-up inclusion.
  - Enabling **tele-law, e-payments, and Udyam registration** at the panchayat level brings government services closer to informal actors. **Infrastructure must be seen as a gateway to formality, not just connectivity.**
- **Formalisation Through Public Procurement Reform:** Mandate that a portion of **government procurement** be reserved for **registered informal enterprises transitioning into formal status**, especially in local construction, manufacturing, and services.



- Introduce preferential access to [GeM \(Government e-Marketplace\)](#) for enterprises that complete formal onboarding and fulfil basic quality norms.
- Linking formalisation with access to a **stable demand pipeline** will incentivise businesses to comply voluntarily. Public spending must act as a tool for **formality-led capacity building**.
- **Leverage Labour Codes to Encourage Scalable Formalisation:** Implement the **new labour codes uniformly across states with supportive guidelines** that allow enterprises to grow beyond size thresholds without fear of regulatory harassment.
  - Clear, digital-first enforcement mechanisms must **replace inspector raj**.
  - Labour flexibility should be balanced with access to **social security for workers**, such as **ESIC coverage** for gig and platform workers.
- **Foster Digital Aggregation Platforms for Informal Workers:** Build sector-specific **digital aggregation platforms** for informal workers — like artisans, gig workers, and construction labour — to onboard into formal structures.
  - These platforms should offer modules for **skill certification, wage payments, social security**, and employer linkages. Integration with **eShram, Skill India, and EPFO Lite** models can make these platforms effective.
    - This **decentralised digitisation** approach ensures workers **don't need to be tied to one employer for formality**.

## Conclusion

While India has made significant strides in economic formalisation through **digital payments, GST, and social security expansion**, a large portion of the workforce remains in the informal sector. A balanced approach—**simplifying compliance, leveraging technology, and ensuring social protection**—can drive sustainable and inclusive growth. Strengthening last-mile connectivity and financial incentives will be key to integrating millions of workers and enterprises into the **formal economy**.

### **Drishti Mains Question:**

Despite various reforms, the informal sector continues to dominate employment in India. Discuss the challenges in formalising the workforce and suggest solutions.

## **UPSC Civil Services Examination, Previous Year Question (PYQ)**

### **Mains**

**Q.** How globalization has led to the reduction of employment in the formal sector of the Indian economy? Is increased informalization detrimental to the development of the country? (2016)