



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
Manufacturing	Large firms highly formalised; smaller units (~70% of jobs) remain informal
Construction	Post-Covid job growth driven by self-employment in this sector – mostly informal
Trade & Services	High concentration of own-account enterprises; limited formalisation
Digital & Financial Services	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)