



Economy and Informality

This editorial is based on [“India’s Economy and the Challenge Of Informality”](#) which was published in The Hindu on 28/01/2022. It talks about the prevalence of the informal sector in India’s economy and the challenges associated with the formalization of the sector.

For Prelims: Economic and Social Development-Sustainable Development, Informal Economy, E-Shram Portal, Periodic Labor Force Survey, Ecowrap Report.

For Mains: Formal Vs. Informal employment, Quality of Employment, Need for formalization of the informal sector, challenges posed by the informal sector in the economy, issues associated with formalization of the informal sector.

In the last few years, the Government of India has made several efforts to formalize the Indian economy via the introduction of the [Goods and Services Tax \(GST\)](#), [digitalisation of financial transactions](#) and enrolment of informal sector workers on government portals such as [E-Shram](#).

Despite these well-intentioned efforts at formalization, the challenge of informality looms large for India. The novel coronavirus pandemic has only exacerbated this challenge.

Lack of job security, absence of social security benefits, tax evasion, all point towards the need for the formalization of the informal sector at a faster yet sustainable pace. Policy interventions, fiscal support, education and upskilling have a major role to play in the formalization of the economy.

Informal Sector and Formalization

- **Informal Economy in India:** An [informal economy](#) represents enterprises that are not registered, where employers do not provide social security to employees.
 - In many parts of the developing world, including India, informality has reduced at a very sluggish pace, manifesting itself most visibly in urban squalor, poverty and unemployment.
 - Despite witnessing rapid economic growth over the last two decades, **90% of workers in India have remained informally employed**, producing about half of GDP.
 - Official [Periodic Labor Force Survey](#) data shows that **75% of informal workers are self-employed and casual wage workers** with average earnings lower than regular salaried workers.
 - Combining the ILO’s widely agreed upon definition with India’s official definition (of formal jobs as those providing at least one social security benefit — such as EPF), the **share of formal workers in India stood at only 9.7% (47.5 million)**.
- **Formal-Informal Linkage:** The fiscal perspective has a long lineage in India going back to tax reforms initiated in the mid-1980s.
 - Early on, in an attempt to promote employment, the Government of India protected small

enterprises engaged in labor intensive manufacturing by providing them with fiscal concessions and regulating large-scale industry by licensing.

- However, such measures led to many labor-intensive industries getting diffused into the informal/unorganized sectors.

▪ **Need of Formalization:**

- The **formal sector is more productive** than the informal sector, and formal workers have access to social security benefits.
- The persistence of a high share of informal employment in total employment **represents a lack of adequate growth or continuation of underdevelopment.**
- According to Oxfam's latest global report, out of the total 122 million people **who lost their jobs in 2020, 75% were lost in the informal sector.** This raises the need to **provide social protection to the vulnerable informal sector.**
- As the businesses of the informal economy are **not directly regulated**, they **usually avoid one or more taxes by hiding incomes** and expenses from the regulatory framework.
 - This poses a challenge for the government as a **major chunk of the economy remains out of the tax net.**

Challenges to Formalization

- Undoubtedly, widening the tax net and reducing tax evasion are necessary. However, global evidence suggests that the view that **legal and regulatory hurdles alone are mainly responsible for holding back formalization.**
- A recently released report- '[Ecowrap](#)' by the [State Bank of India \(SBI\)](#) recently **reported shrinkage in the informal sector's share** in the overall economy from 52% in 2017-18 to 15-20%.
 - However, these findings **do not represent a sustained structural transformation** from informal to formal sector but a **temporary outcome of the severe lockdowns** imposed in 2020 and 2021.
- Policy efforts directed at bringing the informal sector into the fold of formality by alleviating legal and regulatory hurdles are laudable.
 - However, these **initiatives fail to appreciate that the bulk of the informal units** and their workers are essentially petty producers (self-employed and casual workers) eking their subsistence out of minimal resources. Therefore, **these attempts will yield limited results.**
- The registration of workers on the E-Shram portal is no indicator of formalization of jobs unless the workers are able to get all the social security benefits listed on the portal as a matter of right.
 - Increasing digitalization and registration in official records is neither a necessary **nor sufficient condition for any enterprise/worker to be classified as formal.**

Way Forward

- **Simpler regulatory framework:** The transition of the informal sector to the formal sector can only occur when the informal sector is given **relief from the burden of regulatory compliance** and is given enough time to adjust with the modern, digitized formal system.
 - It is believed that **simplifying registration processes, easing rules for business conduct, and lowering the standards of protection of formal sector workers** will bring informal enterprises and their workers into the fold of formality.
- **Education, Investment and Skilling:** The continued dominance of informality defines underdevelopment. The economy will get formalized and the nation will develop when informal enterprises become more productive through **greater capital investment and increased education and when the skills are imparted to the workers.**
- **Strengthening MSME:** Nearly 40% of the informal workforce is employed with MSMEs. Therefore, it is natural that the **strengthening of MSME** will lead to **economic recovery, employment generation, and formalization of the economy.**
- **Financial Support for Formalisationx:** Giving financial support to **help small-scale industries stand on their own** is a crucial step in bringing them to the organized sector.
 - Schemes like [MUDRA loans](#) and [Start-up India](#) are **helping the youth carve a niche in the organized sector.**

Drishti Mains Question

Discuss the need for the formalization of the informal sector and the steps that can be taken for a smoother structural transformation of informal to formal economy.

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