



Mains Practice Question

Q. The informal sector remains both a strength and vulnerability of the Indian economy. Analyze the challenges in formalizing the informal sector while preserving its employment generation potential." (250 words)

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Approach

- Introduce the answer by briefing about the Informal Sector in India with data
- Give Challenges in Formalizing the Informal Sector
- Suggest Measures for Preserving Employment Potential While Formalizing
- Conclude suitably.

Introduction

The **informal sector constitutes over 90% of India's workforce** and contributes nearly **50% to GDP**, playing a dual role as a critical employment generator and a vulnerability-prone segment. Formalizing this sector without undermining its employment potential is a pressing challenge for policymakers.

Body

Challenges in Formalizing the Informal Sector:

- **Structural Challenges**
 - **Absence of Documentation:** Many informal businesses and workers lack proper documentation, making integration into formal systems difficult.
 - According to the e-Shram portal, over **94% of workers earn less than ₹10,000 per month**, and many lack proper identification or records of employment history, making formal registration difficult.
 - **Low Literacy Levels:** As per the 2021 National Statistical Office report, **only 77.7% of the Indian population is literate**, with lower rates among informal workers, particularly women.
 - Limited financial and digital literacy among workers hinders their understanding of formal mechanisms such as the EPFO or e-Shram portal.
 - **Fragmentation of Enterprises:** Informal enterprises are often small, family-run, and scattered, making regulation and formalization efforts arduous.
- **Economic Constraints**
 - **Cost of Compliance:** Registering a business under the GST framework requires an **upfront cost for tax filings and compliance**, which is unaffordable for many small vendors or artisans earning subsistence-level income.
 - **Credit Access Issues:** Among the 64 million MSMEs in the country, only **14% have access to credit**, as they lack collateral or formal documentation.
- **Social Challenges**
 - **Gender Inequities:** Women make up **52.81% of informal workers (e-Shram Portal)** but earn **30-50% less than men** for the same work.

- They are further disadvantaged by the lack of childcare or maternity leave.
- **Cultural Resistance:** Rural workers often view formalization with suspicion, fearing bureaucratic hurdles or loss of autonomy.
- **Policy and Administrative Issues**
 - **Lack of Robust Data:** The absence of comprehensive statistics (though progressed through E-shram but still lagging) on the informal economy hinders evidence-based policymaking.
 - **Ineffective Grievance Redressal:** Informal workers often have no access to mechanisms to address disputes or seek social security benefits. (**Samsung India workers strike in October 2024**)

Preserving Employment Potential While Formalizing:

- **Gradual and Incentive-Based Formalization:** Offering **tax incentives** and **subsidized compliance costs** for businesses transitioning to formal structures.
 - Providing financial literacy and awareness campaigns for workers to build trust in formal mechanisms like **EPFO and digital payment systems**.
- **Flexible Labour Regulations:** Adopting tiered compliance systems where smaller businesses have relaxed norms and gradually transition to full compliance.
 - **Simplifying registration processes on portals like e-Shram** to encourage participation without disrupting economic activity.
- **Social Security for All:** Expanding universal social security coverage to informal workers through schemes like **PM-SVANidhi and Pradhan Mantri Shram Yogi Maan-dhan and effective implementation of Social Security Code**.
 - Ensuring portability of benefits such as pensions, insurance, and healthcare across states and employers.
- **Gender-Sensitive Measures:** Enforcing equal pay for equal work **under Article 39(d)** and offering maternity benefits for female workers.
 - Encouraging **women-centric self-help groups (SHGs)** to foster financial independence and create avenues for skill development.
- **Leveraging Technology:** Using digital platforms to track, register, and manage workers' employment histories and social security contributions.
 - Promoting **digital payment systems and mobile banking** to integrate informal workers into formal financial networks.

Conclusion

Formalizing the informal sector is **indispensable for sustainable economic growth**. While challenges like **low literacy, gender inequities, and economic constraints persist, data-driven policymaking** and incentive-based formalization can address these issues. A balanced, inclusive approach will ensure that formalization strengthens both the economy and its most vulnerable contributors.