



India's Transition Towards Workforce Formalisation

For Prelims: [Formalization](#), [Employee's Provident Fund Organisation](#), [e-Shram Portal](#), [Udyam Portal](#), [Pradhan Mantri Shram Yogi Maan-dhan Yojana](#), [Informal sector](#), [Goods and Services Tax](#)

For Mains: Formalization of the Economy in India, Social Security Schemes in India, Social Security and Economic Stability

Source: [PIB](#)

Why in News?

India's economy is undergoing a **transformative shift** toward [formalization](#), redefining job structures, [employment security and social benefits](#) for millions, ensuring a larger segment of the population is covered by **social security systems**, offering greater economic stability and a more secure future.

- This transition, supported by the [Employee's Provident Fund Organisation \(EPFO\)](#), enhances economic stability by integrating more workers into social security systems.

What is Formalization of the Workforce?

- **Definition:** Workforce formalisation is a **crucial step toward building an equitable and resilient Indian economy**.
 - It not only empowers workers through improved social security and working conditions but also strengthens economic fundamentals such as **productivity, tax compliance, and global competitiveness**.
 - Formalization is when jobs move from the [informal sector](#) (small, unregistered businesses and daily wage workers) into the [formal sector](#) (where employees have contracts, job security, and access to benefits).
- **Features:** Businesses operate under clear legal frameworks, ensuring compliance with laws and regulations.
 - Boosts tax revenues, **expanding the tax base** and ensuring a [fairer distribution of the tax burden](#).
 - Employees **receive social security**, healthcare, and benefits under labour laws, including minimum wage enforcement, retirement benefits, pensions, and insurance.
 - **Formal businesses** have **easier access to financial services** and credit from banks and institutions.
 - Formalization encourages **entrepreneurship**, enhances competitiveness, and promotes overall economic growth.

What is Significance of Workforce Formalisation for the Indian Economy?

- **Widespread Informal Employment:** Approximately **85% of India's workforce is part of the**

informal sector, which is not protected by [formal labour laws](#) or social security systems.

- Formalisation ensures better access to social security, healthcare, and pensions, reducing vulnerability to economic shocks.
- **Accurate Data Collection:** Formalisation allows for better data collection on employment trends, which aids in **effective policy-making and economic planning**.
- **Increased Tax Revenue:** A formal workforce contributes more to the [tax base](#), enabling the government to fund public services and infrastructure projects.
- **Reduce Black Money:** Enhances transparency, making [money laundering and illegal activities harder to conduct](#).
- **Digital Inclusion:** Formalisation encourages the adoption of digital tools and technologies, improving efficiency and transparency in the workforce.
- **Attracts Investment:** A formal workforce offers businesses a better operating environment and encourages investment, both domestic and international.

What is EPFO and its Role in India's Workforce Formalization?

- **About:** The EPFO is one of the **world's largest social security organizations**, providing a wide range of social security benefits to millions of workers across India.
 - It was established under the **Employees' Provident Funds & Miscellaneous Provisions Act of 1952**.
 - EPFO manages over **29.88 crore accounts (EPFO's Annual Report 2022-23)**, underscoring its extensive reach and the magnitude of financial transactions it handles.
 - The EPFO is under the administrative control of the **Ministry of Labour & Employment, Government of India**.
- **Benefits of EPFO:** Ensures long-term financial security through retirement funds, insurance under [Employees' Deposit Linked Insurance \(EDLI\) Scheme, 1976](#), monthly pensions via [Employees' Pension Scheme \(EPS\), 1995](#), and partial withdrawals under EPF (1952) for emergencies, education, or home purchases.
 - The [Employees' Provident Fund \(EPF\) Scheme, 1952](#) allows partial withdrawals for emergencies, education, or home purchases, making it a versatile financial tool.
- **Role of EPFO in Increased Formalization:** From 2017 to 2024, over **6.91 crore members joined EPFO**, with a record 1.38 crore new members registering in the fiscal year 2022-23.
 - In July 2024 alone, **nearly 20 lakh new members were added**, indicating a steady increase in monthly registrations.
 - Many members chose to transfer their funds when changing jobs, ensuring continued access to social security benefits.
 - A significant portion of **new EPFO members are youth**, many of whom are first-time job seekers. Additionally, **more female workers are registering with EPFO**, reflecting a positive trend toward a more inclusive workforce.
 - The rise in EPFO registrations highlights the **growth of formal jobs in India**, with more employees gaining access to essential benefits such as job security, retirement savings, and insurance.

What are the Challenges in Workforce Formalisation in India?

- **Cost of Formalisation:** Many [MSMEs \(Micro, Small, and Medium Enterprises\)](#) and small businesses find workforce formalisation costly and cumbersome, as nearly **80-90% of India's workforce operates informally**. Small businesses **prefer informality to avoid compliance burdens**.
 - Simplifying compliance and reducing financial barriers will be crucial in overcoming this challenge.
- **Seasonal Workforce:** Migrant and seasonal workers in agriculture, construction, and low-wage jobs **often lack formal contracts** due to frequent relocations, lack of documentation **hinder their formalisation**.
- **Resistance to Change:** Workers in the informal sector are **reluctant to formalise due to a preference for flexibility** and lack of awareness about the benefits.
- **Digital Divide:** Limited access to digital tools in rural areas hinders formal employment despite [Aadhaar](#) and [Unified Payments Interface \(UPI\)](#) advancements.

- **Skill Gaps:** Informal workers often lack the **necessary skills required** for formal jobs, and there is a **shortage of accessible skill development programs** for these workers.
- **Gender Inequality:** [Women face disproportionate barriers to formal employment](#), including socio-cultural constraints, lack of **childcare services**, and gender bias in the workplace.

India's Initiatives Related to Formalisation of Workforce

- [e-Shram Portal](#)
- [Udyam Portal](#)
- [Pradhan Mantri Shram Yogi Maan-dhan Yojana](#)
- **Labour Reforms:** The [labour codes](#), such as the [Social Security Code, 2020](#), [Industrial Relations Code, 2020](#), and [Occupational Safety, Health and Working Conditions Code, 2020](#), aim to simplify archaic labour laws, improve working conditions, and make it easier for businesses to hire formally.
- **GST and Digital Payment Systems:** [Goods and Services Tax \(GST, 2017\)](#) and [Digitalisation](#) are helping reduce informality by encouraging businesses to operate **transparently and contribute to the tax system**.
 - Increased financial transparency via digital payment systems and streamlined indirect taxation are formalising businesses.

Way Forward

- **Incentivise Formalisation:** Policies should focus on reducing the cost of formalisation, providing incentives for businesses to transition to the formal sector.
- **Improve Financial Inclusion:** Expanding access to banking services through the [Pradhan Mantri Jan Dhan Yojana \(PMJDY\)](#) and promoting digital payment systems will help integrate more businesses into the formal economy.
- **Education and Skill Development:** Improving access to quality education and vocational training under the Skill India Mission will equip workers with the skills needed for formal jobs.
- **Promote MSMEs:** Strengthening MSMEs **through funds and functionaries** and making them more competitive on a global scale will boost formalisation and create more jobs.
- **Targeted Schemes:** Implement schemes specifically designed to formalise **tribal workers**. Ensure tribal workers are covered under social security schemes like [Pradhan Mantri Jeevan Jyoti Bima Yojana](#) and [Pradhan Mantri Suraksha Bima Yojana](#).

Conclusion

The formalization journey strengthens India's workforce by providing job security and a safety net, crucial in uncertain times like the Covid-19 pandemic. This rise in EPFO registrations underscores India's progress toward a more organised economy, ensuring a secure and brighter future for millions.

Drishti Mains Question:

Discuss the importance of formalising the Indian economy. How does this transition benefit workers and the country's economic stability?

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)**

