



## India's economy and the challenge of informality

Policy efforts to formalise the economy will have limited results as the bulk of informal units are petty producers.

### Efforts at formalization:

Since 2016, the Government has made several efforts to formalise the economy.

- Currency demonetisation,
- the introduction of the Goods and Services Tax (GST),
- the digitalisation of financial transactions and
- enrolment of informal sector workers on numerous government Internet portals

### Need for Formalization:

The formal sector is more productive than the informal sector, and formal workers have access to social security benefits.

### Persistence of informal sector:

1. Informality is an outcome of structural and historical factors of economic backwardness.
2. The persistence of the informal sector is linked to excessive state regulation of enterprises and labour which drives genuine economic activity outside the regulatory ambit.
3. Arguably, excessive regulation and taxation ensure the endurance of informal activities.
4. Hence, 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.

### Sign of underdevelopment

1. However, global evidence suggests that the view that legal and regulatory hurdles alone are mainly responsible for holding back formalisation does not hold much water.

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2. A well-regarded study, 'Informality and Development', argues that the persistence of informality is, in fact, a sign of underdevelopment.
3. Across countries, the paper finds a negative association between informality (as measured by the share of self-employed in total workers) and per capita income.
4. The finding suggests that informality decreases with economic growth, albeit slowly. A similar association is also evident across major States in India, based on official PLFS data.
5. Hence, the persistence of a high share of informal employment in total employment seems nothing but a lack of adequate growth or continuation of underdevelopment.

### Transformation in Asia

1. The defining characteristic of economic development is a movement of low-productivity informal (traditional) sector workers to the formal or modern (or organised) sector — known as structural transformation.
2. East Asia witnessed a rapid structural change in the second half of the 20th century as poor agrarian economies rapidly industrialised, drawing labour from traditional agriculture.

### Indian Case

1. However, 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 (open and disguised) unemployment.
2. Despite witnessing rapid economic growth over the last two decades, 90% of workers in India have remained informally employed, producing about half of GDP.
3. Combining the International Labour Organization's widely agreed template of definitions 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 9.7% (47.5 million).
4. Official PLFS data shows that 75% of informal workers are self-employed and casual wage workers with average earnings lower than regular salaried workers.



5. Significantly, the prevalence of informal employment is also widespread in the non-agriculture sector. About half of informal workers are engaged in non-agriculture sectors which spread across urban and rural areas.

		Enterprise Type	
		Organised	Unorganised
Employment Type	Formal	Regular salaried work with some job security and benefits, in enterprises employing 10 or more workers.	Regular salaried employment with some benefits, in enterprises employing less than 10 workers.
	Informal	Various types of contract work and employment of short duration, without job security, in enterprises employing 10 or more workers	All types of casual work, work for daily, weekly, or monthly wages, and self-employment with no benefits or security, in enterprises employing less than 10 workers.

### Effect of the Pandemic:

1. Despite (well-intentioned) efforts at formalisation, the challenge of informality looms large for India. The novel coronavirus pandemic has only exacerbated this challenge.
2. Research by the State Bank of India recently reported the economy formalised rapidly during the pandemic year of 2020-21, with the informal sector's GDP share shrinking to less than 20%, from about 50% a few years ago — close to the figure for developed countries.
3. These findings of a sharp contraction of the informal sector during the pandemic year (2020-21) do not represent a sustained structural transformation of the low productive informal sector into a more productive formal sector.
4. They are a temporary (and unfortunate) outcome of the pandemic and severe lockdowns imposed in 2020 and 2021.
5. The informal sector will perforce spring back to life soon, for sheer survival, to produce whatever it can, using its abundant labour and meagre resources.

### The necessary elements

1. Policy efforts directed at bringing the tip of the informal sector's iceberg into the fold of formality by alleviating legal and regulatory hurdles are laudable.



2. 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.
3. Therefore, these attempts will yield limited results. The continued dominance of informality defines under-development. Policy-induced restrictions are minor irritants, at best.
4. The economy will get formalised when informal enterprises become more productive through greater capital investment and increased education and skills are imparted to its workers.
5. A mere registration under numerous official portals will not ensure access to social security, considering the poor record of implementation of labour laws.

The International Labour Organization (ILO) defines decent work as “productive work for women and men in conditions of freedom, equity, security and human dignity”.

In general, work is considered decent when:

- it pays a fair income
- it guarantees a secure form of employment and safe working conditions
- it ensures equal opportunities and treatment for all
- it includes social protection for the workers and their families
- it offers prospects for personal development and encourages social integration
- workers are free to express their concerns and to organise

#### What is Decent Work?



Secure Employment



Fair wages



Safe working conditions



Social protection



Social Dialogue



Labour Rights and Standards