



A Comparative Analysis Of Formal And Informal Sector Employment In India

¹Ankita Mishra, ²Atika Khatoun
¹Research Scholar , ²Assistant Professor
¹University of Lucknow

Abstract

This study presents a detailed comparative examination of India's formal and informal sector employment, focusing on the wage gap and economic contributions. As explained in the tables, we use NSSO, PLFS, Economic census, and ASUSE surveys for this study. The study also investigates the interplay between demographic factors, regional disparities, and policy interventions in shaping employment trends. The study aims to present a clear and analytical scenario of formal and informal sectors of the workforce. This analysis helps to understand the broader discourse on labour economics in emerging economies, offering recommendations for fostering sustainable and equitable employment opportunities in India.

Keywords: Employment, wage gap, demography, regional disparity, workforce, etc.

Introduction

In labour economics, the pay disparity between workers in the certified and informal sectors has grown to be a crucial issue, exclusively in evolving and emerging countries like India. As globalisation and economic restructuring shape labour markets, there has been growing concern regarding the disparities in income and working conditions between these two segments of the workforce. Understanding the dynamics of this wage gap is crucial for policymakers aiming to design inclusive labour policies and improve the livelihoods of workers across different sectors.

The labour market can broadly be separated into two main groups: the formal sector and the informal sector. Workers in the formal sector typically enjoy authorized and social protections, including job security, health insurance, and pension benefits, while informal sector workers often lack such protections, facing irregular employment, lower wages, and limited access to social services. The informal sector is often characterized by unregulated employment relationships, self-employment, and work in small enterprises or in activities not covered by formal labour laws. Despite these challenges, informal sector employment continues to provide livelihoods for a significant portion of the global workforce, particularly in low and middle-income countries.

Economic theories suggest several reasons for wage disparities between formal and informal sector workers. Human capital theory posits that formal sector workers may earn higher wages due to better education, skills, and training. Additionally, firms in the formal sector tend to be larger, more productive, and subject to regulation, which can result in higher wages and benefits. In contrast, informal sector workers often have lower levels of education and training and work in environments where productivity is lower, contributing to lower wages.

The pay disparity is also significantly shaped by institutional variables. Social protection programs, collective bargaining agreements, and minimum wage legislation are more likely to apply to workers in the formal sector, all of which contribute to higher earnings. Informal sector workers, however, often operate outside these legal frameworks, making it difficult to enforce such protections. Furthermore, gender, age, and social status can exacerbate the wage gap, with women, younger workers, and marginalized groups often facing additional barriers to accessing formal employment and earning equitable wages.

Despite the importance of the informal sector in providing employment, there is limited access to data on its economic contributions and the wage differentials within it. This lack of comprehensive data creates challenges in understanding the full extent of the wage gap between formal and informal workers. Moreover, the informal sector is often extremely diverse, consisting of an extensive range of actions that vary in productivity, profitability, and working conditions, which makes it difficult to generalize about wage gaps across different regions and industries.

In current years, around an increasing interest in considering the drivers of informality and its implications for wage inequality. Some studies argue that the informal sector may act as a buffer during economic downturns, employing those who cannot find positions in the official sector. However, this comes at the cost of reduced pay, unstable employment, and few opportunities for upward mobility. The persistence of wage gaps between formal and informal sector workers highlights the need for targeted interventions, such as labour market reforms, social protection programs, and skills development initiatives, to bridge these disparities.

Formal hired worker: An officially employed employee is entitled to paid time off and social security benefits from the company, such as health insurance, provident fund, and ESIC. (ASUSE 2021-22).

Informal hired worker: An informal hire is not entitled to remunerated time off or social security benefits such as the employer's provident fund, ESIC, health insurance, etc. It is anticipated that many small businesses will employ people on an informal basis. (ASUSE 2021-22).

To put it simply, the fundamental characteristics of the informal sector are primarily defined by elements like (a) low productivity and small-scale operations, (b) family ownership of businesses, (c) easy entry for new businesses, (d) labour-intensive technology, etc. These units can be used in homes, small stores, or workshops, or they can function without a permanent location. The activities that are covered range from those that require little to no capital and skills, like shoe cleaning and street vending, to those that demand a certain amount of cash and competence, like tailoring, auto repair, and professional services. Numerous unofficial businesses are run by one person, either as an own-account worker, self-employed entrepreneur, or with unpaid family assistance (ASUSE, 2022-23).

Existing literatures

(FIELDS, 2012): Wage Gaps and Labour Markets in Developing Countries

Fields' study on labour markets in developing countries identifies a persistent wage gap between formal and informal sector workers, driven by variation in human capital, labour market segmentation, and institutional factors. He argues that workers in the informal sector typically receive lower pay due to limited access to education, training, and productivity-enhancing technologies. Additionally, formal sector workers benefit from regulations such as minimum wage laws, which do not typically apply to those in the informal sector. Fields highlight that informality is often a by-product of exclusion from formal labour markets rather than a voluntary choice.

(Loayza and Rigolini, 2011): Informal Employment and Wage Differentials

Loayza and Rigolini provide an in-depth analysis of the wage gap amid formal and informal workers, focusing on Latin American countries. They contend that, especially during recessions, the unorganised sector contributes significantly to the creation of jobs. However, the wages in the informal sector remain substantially lower due to lower productivity, lack of access to social protection, and reduced bargaining power. The authors

also discuss the heterogeneity within the informal sector, suggesting that while some informal workers are self-employed entrepreneurs, the majority are low-wage earners with limited upward mobility.

(Gunther And Launov, 2012): Informal Employment and Wage Inequality

Gunther and Launov's research provides pragmatic evidence on income inequality between formal and informal sector workers, focusing on data from Eastern European and Central Asian countries. They discover that compared to their official counterparts, informal labourers make much less money, even when controlling for education, experience, and other worker characteristics. The study attributes this wage disparity to labour market segmentation, where informal workers are often trapped in low-paying jobs due to institutional and regulatory barriers that limit their transition to the formal sector.

(Maloney, 2004): Informality Revisited

Maloney's work critically examines the conventional views on informality, challenging the perception that informal sector workers are primarily excluded from formal employment. He suggests that many workers in the informal sector may voluntarily choose this employment due to flexibility and lower tax burdens. Despite this, Maloney acknowledges that informal sector workers often experience lower wages and fewer social protections. His research emphasizes the need to consider the heterogeneity of the informal sector when addressing wage gaps.

(Freeman, 2009): Labour Regulations, Unions, and Wage Gaps

Freeman's research focuses on the role of labour regulations and unions in influencing the wage gap between formal and informal sector workforces. He finds that countries with strong labour market institutions and high levels of unionisation tend to have smaller wage gaps. In contrast, in economies where informal employment is prevalent, weak enforcement of labour laws and the absence of collective bargaining contribute to larger wage differentials between sectors. Freeman advocates for policies that strengthen labour market institutions to reduce wage disparities.

Some Indian economists also have examined many differences between formal and informal sector workers in India.

(Mehrotra, Gandhi and Saha, 2013): Turnaround in India's Employment Story

This study by Mehrotra, Gandhi, and Saha examined the trends in employment and wages in India's formal and informal sectors. It found that despite the growth of the formal sector, the informal sector still accounts for a significant portion of the labour force, with informal workers earning considerably lower wages. The authors discussed the role of education, skill development, and economic policies in determining wage levels across sectors and called for targeted interventions to reduce the wage gap and improve the economic well-being of informal workers.

(Papola, 1981): Informal Sector in India

Papola's early work explored the structure of the informal sector in India, converging on its role in employment generation and wage distribution. He observed the importance of unorganised sectors in absorbing the surplus labour in urban areas, but the workers are often subjected to low wages and deprived circumstances. Papola found that remuneration disparities between formal and informal sector workers were largely due to the unfettered nature of work in the unorganised sector, where labour protections and benefits are minimal.

(Unni, Rani, 2003): Informal Sector and Informal Employment in India

In their study, Unni and Rani analysed the remuneration differentials between formal and informal sector labourers in India. They found that informal workers earned substantially lower wages than their formal sector counterparts, even after controlling for factors such as education, experience, and skills. The study highlighted the role of gender in exacerbating wage disparities, with women in the informal sectors grossly paying much lower income than men. The authors called for policy interventions to reduce wage inequality by improving access to education, skill development, and social protections for informal workers.

Objectives of the Study

1. The primary objectives of this research are to conduct a comparative investigation of the employment situation in both the formal/organised and informal/unorganised areas in India.
2. To evaluate their respective contributions to the Indian economy.

Methodology

The current investigation is predicated on secondary data, which is authentically collected by the different rounds of the PLFS survey, Economic Census, NSSO, ASUSE and other governmental sources. The data type is longitudinal, which represents the scenario of formal and informal sectors from various sources, as explained above.

Employment Distribution in the Formal and Informal Sector

Table:1

Year	Type of Employment	Organised (in millions)	Unorganised (in millions)	Total (in millions)
2017-18	Formal	4.43	0.28	4.70
	Informal	4.62	37.79	42.43
	Total	9.05	38.07	47.13
2018-19	Formal	4.91	0.45	5.35
	Informal	4.55	38.87	43.43
	Total	9.46	39.32	48.78
2019-20	Formal	5.09	0.80	5.89
	Informal	4.46	43.19	47.64
	Total	9.55	43.99	53.53

Source: Directorate General of Employment & Training

The occupation distribution in the formal and informal sectors is explained above. In 2017-18, the total portion of the organised sector was 9.05 million, and it is documented as 38.07 in the unorganised sector. The share increased to 9.46 million in the organised sector in 2018-19 and 39.32 in the organised sector. After that, a clear increase can be seen in 2019-20, where the total share of the organised sector is 9.55 million and the unorganised sector is 43.99 million. According to this survey, the unorganised sector has been leading since independence in India.

Labour force participation rates (in per cent) in usual status (ps + ss) estimated from PLFS for persons of 15-59 years

Table:2

Survey Period	Rural (%)	Urban (%)	Rural + Urban (%)
2017-18	37.0	36.8	36.9
2018-19	37.7	36.9	37.5
2019-20	40.8	38.6	40.1
2020-21	42.7	38.9	41.6
2021-22	42.2	39.0	41.3
2022-23	43.4	39.8	42.4

Source- Annual PLFS Survey2022-23

The labour force participation rate is the proportion of the population that is active as compared to the total population (LFPR). Both those from the remaining population who had worked for at least 30 days during the reference period of 365 days prior to the survey date and those who worked or were looking for work for a significant portion of the 365 days prior to the survey date are included in the estimate of the labour force in the usual status (ps+ss). (PLFS Annual report 2017-18, 2018-19, 2019-20, 2020-21, 2021-22, 2022-23).

The regular wage/salaried workers in the usual status

Table: 3

Category	Year	Employees with no inscribed job contract (%)	Employees not entitled to paid leave (%)	Employees not entitled to any specified social security benefit (%)
Rural	2023-24	61.1	52.2	58.8
	2022-23	62.2	51.1	59.9
	2021-22	64.9	52.7	58.2
Urban	2023-24	55.7	43.7	49.4
	2022-23	56.0	43.5	49.4
	2021-22	59.9	46.6	49.1
Rural + Urban	2023-24	58.0	47.3	53.4
	2022-23	58.6	46.8	53.9
	2021-22	62.0	49.2	53.0

Source- PLFS Annual Report

Those who work in non-agricultural fields and do not have a signed employment contract are considered normal wage/salaried employees in typical status. They are also not eligible for paid leave or any particular social security benefits.

As per the newly adopted ILO Transition from the Informal to the Formal Economy Commendation, 2015 (No. 204), countries should progressively cover minimum wage protections in law and practice to include workers in the informal sector as they formalise. Recommendation No. 204 provides instructions to facilitate the movement of labourers and economic entities to the formal sector while ensuring the preservation and improvement of existing means of subsistence. It promotes a combination of compliance, enforcement, and reward programs. These could include improving access to business services or financing as a result of the shift, reducing compliance costs for micro and small economic units through simplified tax and contribution regimes, and broadening the scope of labour inspections in the informal economy.

Discussing a single average pay would be improper given the dualistic nature of the Indian economy, which is divided between formal and informal, organized and unorganized, sectors. This research analyses earnings based on this duality, referring to regular/salaried and casual workers, while also accounting for the workers' labour status or type of employment.

Although hiring casual and contract workers on short-term or fixed-term contracts is becoming more common, regular workers still make up the vast majority of organised sector workers (India Wage Report, 2018).

Percentage of persons in WPR and LFPR

Table: 4

Years	Male WPR	Male LFPR	Female WPR	Female LFPR
2017-18	71.2	75.8	22.0	23.3
2018-19	71.0	75.5	23.3	24.5
2019-20	73.0	76.8	28.7	30.0
2020-21	73.5	77.0	31.4	32.5
2021-22	73.8	77.2	31.7	32.8
2022-23	76.0	78.5	35.9	37.0
2023-24	76.3	78.8	40.3	41.7

Source: different rounds of PLFS survey

In this table, the percentage of LFPR and WPR for both males and females has been increasing trend. The LFPR for male and female in 2023-24 was 78.8 % and 41.7 %, respectively. The WPR for male and female in 2023-24 was 76.3% and 40.3%, respectively. The data shows very low participation of female workers in both WPR and LFPR as well.

**The Allocation of the Total Estimated Workforce Based on Various Employment Terms of the Year
2022-23**

Table: 5

Sl. No.	Sectors	Self Employed (%)	Regular (not on contract) (%)	Employees (on contract) (%)	Fixed Term Employees (%)	Casual Employees (%)
1	Manufacturing	0.91	66.97	26.88	1.75	3.49
2	Construction	0.32	75.05	13.50	1.12	10.01
3	Trade	2.36	82.04	10.37	1.33	3.90
4	Transport	0.37	74.68	20.78	2.19	1.97
5	Education	0.37	82.24	11.53	3.17	2.68
6	Health	0.25	71.65	21.34	4.04	2.72
7	Accommodation & Restaurants	3.53	74.50	12.08	4.78	5.12
8	IT/BPOs	0.01	96.58	3.34	0.07	0.01
9	Financial Services	5.92	86.11	6.43	0.72	0.01
Total		0.96	75.64	18.44	2.06	2.90

Source: Sixth Round of Quarterly Employment Survey

According to the report of the sixth quarterly employment assessment across nine chosen nonfarm sectors of the Indian economy, Table 5 details the distribution of the total estimated workforce based on various employment based on the sectors in 2022–2023. The data represents the highest percentage of regular workers who are not qualified for any social security benefits or paid time off. This shows the higher growth in the informal sector which gives maximum employment. In the IT/BPO sector, the non-contract workers are the highest because of several variables, including the requirement for constant quality in service delivery, the fact that many activities are repetitive, the expectation of stability from clients, and the comparatively lower entry-level job barrier.

Estimated Employment in Public and Private Sectors

Table:6

Year	(in Million)
2010-11	29.00
1. Public sector	17.55
1.1 Central Government	2.26
1.2 State Government	7.22
1.3 Local Bodies	2.05
2. private sector	11.45
2.1 Large	10.03
2.2 Small	1.18
Total Employment	29.00

About 47 crore individuals were employed nationwide in both the organised and unorganised sectors, according to a 2011–12 research by the National Sample Survey Organisation. About 8 crore of this came from the organised sector, with the remaining 39 crore coming from the unorganised sector. The unorganised sector employs more than 90% of all workers in the country. Many unorganised labourers work from home and engage in crafts including beedi rolling, papad making, agarbatti manufacturing, tailoring, and embroidery. (2011) Central Government Employee Census

The Percentage of Estimated Establishments by Sector, Broad Activity Category, and Kind of Establishment

Table:7

all-India Source: ASUSE

Broad activity category	Share of estimated establishments (%)								
	Rural			Urban			Rural + Urban		
	OAE	HWE	All	OAE	HWE	All	OAE	HWE	All
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Manufacturing	30.44	26.00	30.08	24.76	22.23	24.17	28.12	23.34	27.41
Trade	32.70	29.34	32.43	36.43	40.86	37.46	34.22	37.47	34.71
Other services	36.86	44.66	37.49	38.81	36.91	38.37	37.66	39.19	37.88
All	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

survey
2022-
23

(NSSO, 2022-23)

Of the total expected number of establishments, manufacturing, trade, and other services make up 27.41%, 34.71%, and 37.88% of the total. Other services account for the largest share of formations in both rural (37.49%) and urban (38.37%) areas. The establishment that can be selected for ASUSE is either a Hired Worker Establishment (HWE) or an Own Account Establishment (OAE). OAEs make about 5.53 crore of the estimated 6.50 crore establishments. As mentioned before, companies that do not regularly have at least one paid employee are considered OAEs. Only 75 lakh HWE establishments are anticipated. Furthermore, it is observed that the vast majority of selected HWEs and OAEs work largely in other services.

Percentage of Non-Agricultural Establishments by Major Sources of Finance**Table:8**

	Self-Finance	Financial Assistance from Govt Sources	Borrowing from Non-Institutions/Money Lenders	Borrowing from Financial Institutions	Loan from Self Help Group	Donations Transfers from Agencies
Rural	72.7	10.0	1.0	2.4	0.7	13.2
Urban	83.7	3.7	0.9	2.2	0.3	9.2
Combined	78.2	6.9	0.9	2.3	0.5	11.2

Source: Sixth Economic Census (2013-14)

The table explains that in the total amount of 35.48 million, 78.2% of Non-agricultural businesses were funded entirely by themselves. The percentage was 72.7% in rural areas and 83.7% in urban areas, representing this source's major contribution. Another source has less contribution as economic assistance from government sources and donations/transfers from agencies were 6.9% and 11.2%, respectively. According to the data the difference can be visible in rural and urban areas due to unawareness of government schemes and policies.

Policy Initiatives for Employment Generation in Unorganised Sectors

The government of India implemented various flagship programmes for employment generation and opportunities for rural and urban workers. The schemes aim to reduce unemployment and poverty and foster economic growth.

Government Flagship Initiatives with the Potential to Create Worthwhile Job Opportunities

- 1. Digital India Programme (2015):** The programme ensures village-level broadband connectivity, better accessibility through IT-enabled platforms, more government process transparency, and increased domestic manufacture of IT gear and software for export and better domestic accessibility.
- 2. Atal Mission for Rejuvenation and Urban Transformation (AMRUT) (2015):** The scheme delivers essential services to homes, and developing city amenities will raise everyone's standard of living.
- 3. Make in India (2014):** The scheme was launched to promote investment, encourage creativity, improve the development of skills, protect intellectual property, and construct world-class industrial infrastructure.
- 4. Smart Cities Mission (2015):** In order to provide communities and their residents with a decent standard of living, a sustainable and healthy environment, necessary amenities, and the implementation of "smart" solutions, the mission was successfully started.
- 5. Shyama Prasad Mukherji Rurban Mission (2016):** The scheme was launched to provide integrated project-based infrastructure, including the growth of economic activity and skill sets, in rural areas.
- 6. National Industrial Corridor Authority (2007):** The programme was launched to accelerate India's growth in manufacturing and urbanisation. Smart cities connected to transportation networks should be developed in tandem with industrial corridors.

7. **Stand Up India Scheme (2016):** The scheme was to facilitate women, SC, and ST applicants in getting bank loans to launch new businesses in the manufacturing, trading, or service sectors.
8. **Start-Up India (2016):** The scheme was to enable entrepreneurs to create jobs and expand through innovation and design.
9. **Pradhan Mantri Awas Yojana – (PMAY) (2015):** Through the Central Nodal Agencies (CNAs) and States/Union Territories (UTs), the program provides implementing agencies with central support to meet verified housing needs and provide homes to all eligible families and beneficiaries.
10. **Swachh Bharat Mission- Grameen (2014):** The scheme must prioritize sanitation and quicken the process of achieving universal sanitation coverage.
11. **Swachh Bharat Mission - Urban (SBM-U) (2014):** The program's goals were to eradicate open defecation in India's cities and achieve 100% accurate solid waste management in the 4,041 legal towns that make up the country.
12. **Smart City Mission (2015):** The scheme was launched to encourage inclusive, sustainable cities that apply 'smart' solutions, sustain a clean, justifiable environment, and offer their residents a reputable standard of living.
13. **Pradhan Mantri Garib Kalyan Yojana (PMGKY) (2016):** It is a welfare scheme that was launched for economically weaker sections of the nation during challenging times. It provides free food grains, cash transfers, insurance coverage and other essential services. During the pandemic, the government extended the scheme to affected people.

Way Forward:

Several significant actions are needed to address the employment and income inequalities that exist in India among the formal and informal sectors. To provide workers in the unorganized sector with safeguards including formal contracts, health insurance, and social security benefits, policy reforms should first concentrate on strengthening labour laws. Informal units may be encouraged to enter the formal sector by streamlining the formalization procedures for small businesses and providing incentives for adhering to labour rules.

Second, skill-building initiatives designed specifically for informal workers can boost output and job prospects, possibly increasing pay and opening doors to formal employment. Partnerships between the public and commercial sectors should also concentrate on enhancing loan availability and financial awareness for enterprises and informal workers.

One new generational concept is the 'Gig Economy' introduced in the informal sector that works with the digital economy. The gig economy is a fast-growing trend that gives employment on a short-term or part-time basis. The workers in this field are paid hourly or weekly basis. In the coming era, the gig economy will dominate in the unorganised sector because of the flexibility and regulation it provides workers and customers. Gig and platform workers would have access to benefits and job security if formal labour laws recognized them.

Last but not least, further study is required to monitor shifts in the formal-informal divide, particularly in an economy recovering from a pandemic. Developing focused policy responses will require an understanding of how informal employment is changing and how it intersects with global market trends, urbanization, and digital platforms. Studies with a longer time frame that look at how these interventions affect employment and income disparities would also be invaluable in shaping future policy.

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Abbreviations:

- PLFS: Periodic Labour Force Survey
- NSSO: National Sample Survey Office
- WPR: Worker Population Ratio
- LFPR: Labor Force Participation Rate
- UR: Unemployment Rate
- ASUSE: Annual Survey of Unincorporated Sector Enterprise
- EPFO: Employees Provident Fund Organisation
- OAE: Own Account Establishment
- HWE: Hired Worker Establishment