

Labour Formalization After GST Implementation: Challenges and Opportunities

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Abstract

The Goods and Services Tax (GST) regime in India came into effect in July 2017 and has been a game-changer for the country's indirect tax regime, and thus, for the nature of labour markets and business activities. This research paper aims to understand the relationship between the GST implementation with the formalisation of labour in India from the Management, Public Policy and Human Resource Management (HRM) angle. The study is secondary in nature and uses only secondary data sources like reports prepared by the GST Council, Ministry of Labour and Employment, Employees' Provident Fund Organisation (EPFO), Employees' State Insurance Corporation (ESIC), Reserve Bank of India (RBI), International Labour Organization (ILO), World Bank, National Sample Survey Office (NSSO), Centre for Monitoring Indian Economy (CMIE), peer-reviewed journals. The study is conducted using descriptive and analytical research methodologies, which are applied to analyse the trends in MSME registration, payroll formalisation, digital systems for compliance, documentation of employee workforce and organisational employment growth post-GST. The study shows that GST has led to the growth in business registration, introduction of digitised payroll systems, extension of social security provision and enhanced documentation of the workforce. Yet problems like compliance cost, technical difficulties, informal contractual job and financial burden on MSMEs are still affecting the process of full labor formalisation. Thus, the study comes to an end, and identifies some opportunities and structural problems created by GST in India's labour market. The paper suggests that policies need to be revamped in these areas - MSME support, digital literacy, labour awareness and integrating compliance frameworks to boost inclusive economic growth and formal employment.

Keywords: *Goods and Services Tax, Labour Formalisation, Informal Employment, MSMEs, Workforce Documentation, Organised Employment*

1. Introduction

The Indian economy has always been dominated by the informal sector which plays a crucial role in employment generation. The International Labour Organization (ILO) estimates that a large percentage of India's population is engaged in informal jobs where there is no social security, legal protection or structured employment benefits. On 1st July 2017, the Goods and Services Tax (GST) was introduced in independent India, which was one of the most important tax reforms. GST introduced a new tax regime comprising a single tax on value-added that aimed to increase transparency, eliminate the cascading effect of taxes, and streamline the economy.

The funds of the GST regime were not only to make the tax system simpler but also to promote formalisation of the economy. Formalisation is the integration of economic activities, enterprises and workers into the formal regulatory and institutional arrangements of the state. Labour formalisation, in particular, refers to workers moving from informal employment to formal employment systems in which employment is recorded in written contracts, wages are paid, there are social security, and workers have legal rights.

Formal jobs play a key role in sustainable economic development as they can lead to increased productivity, better worker welfare, better social protection and better tax compliance. Formal labour markets provide governments with the opportunity to increase social security systems and enhance labour governance. Labour formalisation is strongly correlated to enterprise formalisation, as formal businesses are more likely to record their labour force in developing economies like India, where formalisation of labour is linked to that of the enterprise.

GST implementation imposed a number of compliance measures like mandatory digital invoicing, input tax credit

systems, filing of returns online and registration criteria. These systems helped businesses move towards a formal accounting and payroll. Indirectly, businesses had to keep digital records of transactions and follow tax requirements, which encouraged businesses to document employees and implement formal employment contracts.

Insights into post-GST trends in India suggest higher numbers of EPFO registrations, growth in digital payroll solutions, and increased formalisation in medium and large businesses. Recently released government data indicates that, following the introduction of the Goods and Services Tax (GST) and other labor reforms, payroll registration has increased. But the effect has not been even, varying from one sector to another and one region to another. Although the organised sector gained from better transparency and compliance, there were operational and financial difficulties experienced by many Micro, Small, and Medium Enterprises (MSMEs) as a result of compliance burdens and technological requirements.

Hence, the connection between GST and labour formalisation has emerged as a significant topic of study and research in the policy realm. This paper explores the opportunities as well as the difficulties of labour formalisation following the roll out of GST, and examines how effective GST has been in shaping organised employment and documentation of the workforce in India.

2. Statement of the Problem

India has one of the world's largest informal labour markets, where many workers lack social security, legal protection, and formal employment benefits. The implementation of GST introduced digital taxation and compliance systems that influenced business operations and workforce documentation. While GST encouraged enterprise formalisation and increased EPFO and ESIC registrations, many MSMEs faced challenges such as compliance costs, technological barriers, and informal contractual employment. Despite policy reforms, labour formalisation remains incomplete, especially in rural and unorganised sectors. Therefore, it is important to examine the impact of GST on labor formalisation, employment patterns, and workforce compliance in India.

3. Objectives of the Study

The study is based on the following objectives: 1. To examine the relationship between GST implementation and labor formalization in India. 2. To identify challenges faced by workers and MSMEs after GST implementation. 3. To analyze opportunities created by GST for organized employment. 4. To study the role of GST in increasing compliance and workforce documentation.

4. Research Questions

Research Questions: How has GST implementation influenced labour formalisation in India?, What challenges have MSMEs and workers faced after GST implementation?, To what extent has GST contributed to organised employment and workforce documentation?, What role do digital compliance systems play in promoting labour formalization? and How has GST affected employment patterns in the informal and organised sectors?

5. Review of Literature

GST and Economic Formalization

GST has been a subject of numerous studies as a significant economic reform since its launch in 2017. The Economic Survey of India (2018) reports that GST has led to an improvement in tax compliance and in the efficiency of inter-state trade. Tax reforms in developing economies have also been shown to play a role in enterprise formalisation, particularly through the process of incorporating enterprises into digital tax systems, according to the World Bank (2020).

Purohit (2019) opined that the introduction of GST has enhanced transparency of tax framework in India and has helped in promoting formal accounting practices among businesses. Likewise, Bhatia and Singh (2020) noted that the registration of GST led to the growth of businesses in the formal economic system.

Informal Economy and Labour Formalisation

Informal economy is still a significant issue in developing countries. According to the International Labour Organisation (ILO, 2018), labour formalisation is the shift from vulnerable and unregulated employment to protected and regulated employment arrangements. The informal sector is related to low wages, absence of social protection and insecure working conditions.

According to Chen (2019) coordinated reforms are needed, including in taxation, social protection, labour law enforcement and digital governance, to enable labour formalisation. Labour formalisation in India has been linked with social security schemes like EPFO and ESIC.

GST and MSMEs

MSMEs are crucial in terms of employment generation and industrial production in India. The Ministry of MSME (2022) estimates that MSME is responsible for a large share of India's GDP of around 30 percent and employs millions of people.

The effect of GST on MSMEs has been the subject of several studies. According to Sharma and Gupta (2021), the implementation of GST has presented several challenges for small businesses, including the process of filing returns, digital compliance and the strain on working capital. The study results also indicated that GST influenced businesses to use formal bookkeeping and payroll systems. As per a Deloitte India study (2020), integration of supply chain under GST encouraged MSMEs to register formally to avail input tax credits and be competitive.

Employment and Payroll Formalisation

The payroll registrations under EPFO and ESIC were also increasing along with the introduction of GST. In addition to this, the number of payroll registrations under EPFO and ESIC also went up with the introduction of GST. EPFO payroll data (2023) shows that after 2017, millions of new subscribers have been registered. Some researchers believe that this rise is due to better formalisation of labour and the adoption of digital payroll.

Rani and Furrer (2020) have observed that tax reforms and digital governance mechanisms can have a positive indirect effect on labour documentation and social security inclusion. They warned, however, that the rise in payroll registrations could be due to reclassification of existing employees rather than the creation of new formal jobs.

Digitalisation and Compliance Systems

Digitalisation is a pivotal aspect of the governance of labour and taxes. GST's online registration, online invoicing and filing systems helped businesses adopt digital financial records. The RBI (2022) reported that digital business processes increased the transparency of operations and decreased cash exchanges.

Digital payroll systems add to better workforce monitoring and social security compliance, Kumar and Joseph (2021) contend. However, there are still technological challenges for small and rural businesses.

Research Gap

The literature tends to be on the economic and taxation effects of GST. There is little research that explores the impacts of GST on the process of labour formalisation from the integrated HRM and public policy standpoint. Additionally, there is a lack of analysis of the impact of digital documentation of workforces, regulated work, and labour governance under a digital GST regime in MSMEs and informal sectors. The present study tries to fill this void by examining the labour formalisation following the implementation of the Goods and Services Tax (GST) through secondary data analysis and policy-oriented analysis.

6. Conceptual Framework

The conceptual framework of this study is grounded in the relationship between the implementation of GST, enterprise formalisation, digital compliance systems, MSME transformation and labour formalisation.

GST paved the way for levying mandatory registration for businesses, e-filing of taxes, e-invoicing and input tax credit. These mechanisms helped to stimulate companies to formalize their accounting and working methods.

Businesses started to become part of the formal tax system, which meant that the documentation of workers' and payroll transparency became more important.

Digital compliance systems offered rewards to companies to keep employee records, payroll and social security registration in place. MSMEs looking to be part of the supply chain and get tax benefits were urged to institutionalise their operations. This process resulted in higher enrolment numbers with EPFO and ESIC and encouraged formal employment.

The framework also acknowledges the moderating factors in the compliance costs, technological hurdles, financial barriers and lack of awareness of small businesses and workers. These challenges have an impact on the effectiveness of GST in favouring the formalization of labour.

Descriptive Conceptual Model

GST Implementation → Business Registration → Digital Compliance Systems → Enterprise Formalisation → Workforce Documentation → Labour Formalisation → Social Security Inclusion and Organised Employment



Moderating Factors: Compliance burden, Technological barriers, Financial limitations, Informal, contractual practices and Awareness levels

7. Research Methodology

Nature of the Study: The study is descriptive and analytical in nature. It uses secondary data and policy interpretations to analyse the link between implementation of GST and formalisation of labour.

Type of data: Only secondary data is used.

Sources of Data: The sources of data are as follows: reports from GST Council, reports by Ministry of Labour and Employment, EPFO and ESIC annual reports, publications of Reserve Bank of India, reports by NSSO, reports by CMIE, publications by International Labour Organization, reports by World Bank, reports from the Ministry of MSME, reports from Research journals and databases, reports from the Economic Survey.

Timeframe of study: The study is done in the post-GST implementation era from 2017 onwards.

The analytical tools used are: Trend analysis, Comparative analysis, Percentage analysis, Thematic interpretation, Policy analysis.

Scope: The study's scope is on the formalisation of labour in India after the implementation of the GST, specifically the organised employment, documentation of labour force, and social security coverage of MSMEs.

Limitations of the Study

The study has its limitations : The study uses only secondary data, the percentage of unemployed young people in the population differs by data source, there may be reclassifications of workers in some payroll data, not new jobs created and Sector specific differences may not be adequately reflected.

8. Data Analysis and Discussion

GST and MSME Registration Growth

The increase in the formal business registration is one of the significant effects of GST. GST has been used by many MSMEs to join in organized supply chains and avail input tax credit benefits.

Table 1: Growth in GST Registrations After Implementation

Year	Estimated GST Registrations (Millions)
2017	6.5
2018	10.3
2019	11.8
2020	12.2
2021	13.4
2022	13.9
2023	14.5

Source: GST Council Reports and Ministry of Finance Publications

The number of registrations for GST has been rising, which means that there is increasing formalisation of enterprises. Compliance requirements and pressures on supply chains pushed businesses into the regulated economy that were previously part of the non-regulated economy.

Increase in EPFO and ESIC Registrations

Registration of EPFO & ESIC has been increased. However, post-GST payroll formalisation trends show an increase in social security registrations.

Table 2: Growth in EPFO and ESIC Subscribers

Year	EPFO Subscribers (Millions)	ESIC Subscribers (Millions)
2017	4.1	2.3
2018	8.6	3.8
2019	10.2	4.4
2020	11.1	5.1
2021	12.3	5.8
2022	13.8	6.4
2023	15.0	7.2

Source: EPFO and ESIC Annual Reports

The rise in payroll registrations indicates better documentation of workers and social security coverage. The introduction of digitalisation in the context of the GST prompted businesses to keep proper records of employment.

Digital Payroll Systems

After GST implementation, the number of digital payroll systems increased significantly. Digital accounting software and online salary payment methods were becoming more popular, ensuring transparency and compliance for businesses. The advantages of digital payroll are many: Enhanced employee record handling, Accurate wage documentation, Better compliance with labour laws, Enhanced transparency of financial transactions, Easier incorporation with social security systems. Convergence of payroll systems has enhanced the organised framework of employment for medium and large enterprises.

Compliance Burden on Small Businesses

Though there were benefits of GST, there were significant challenges in compliance for MSMEs. A lack of technological infrastructure and professional expertise for online filing and accounting systems was a common problem with small enterprises. Some of the key compliance issues were: Routine return filing, Complex digital systems, Working capital restrictions, Accountant costs and Lacks of digital literacy. The impact of these challenges were seen in the operation and viability of many small businesses and in some instances resulted in loss of jobs and informal contract work.

The shift from ISE to Formal Employment.

GST provided incentives for formalising the workforce structure of enterprises. An increasing number of firms recorded the records of employees for input tax credits and for participating in organised supply chains.

But there has been unevenness in the distribution of workers between informal and formal jobs by sector. The formalisation rate of organised manufacturing, logistics and e-commerce and services was higher than that of agriculture and rural enterprises.

Sector-Wise Impact

Manufacturing Sector: More rigorous compliance and documentation needs were put in place for the manufacturing sector. Vendor formalisation was encouraged, indirectly affecting labour documentation, and this was done by larger manufacturers.

Retail and Trade Sector: Retail companies have seen a lot of transformation as a result of digital billing and invoicing systems. Organised retail was more successful than small businesses in traditional formats.

Construction Sector: Despite the improvement in documentation of contractors, the construction sector had continued to be dependent on informal labour.

Service Sector: Digital service industries experienced more growth of organised employment and payroll formalisation.

Challenges faced by Farmers in Rural and Unorganised Sector

There were some structural challenges for rural businesses and the unorganised sector: Poor access to internet, Limited knowledge of technology, Low level of digital literacy, Poor accounting system and reliance on cash payments. The factors limited the formalisation of the labour in the rural parts of India.

9. Challenges of Labour Formalisation After GST

Compliance Cost: GST compliance increased operational expenses for many MSMEs. Businesses incurred additional costs related to software systems, accounting services, internet infrastructure, and professional consultation.

Technological Barriers: Digital filing systems created challenges for enterprises with limited technological capacity. Rural and small-scale businesses often lacked digital skills and infrastructure.

Lack of Awareness: Many workers and employers were unaware of social security schemes and labour compliance requirements. Limited awareness reduced the effectiveness of formalisation initiatives.

Job Losses in Small Enterprises: Some small businesses experienced financial stress after GST implementation, resulting in workforce downsizing and reduced employment opportunities.

Informal Contractual Employment: In some cases, employers adopted informal contractual arrangements to avoid

compliance costs and labour obligations. This practice limited the extent of genuine labour formalisation.

Financial Constraints: Working capital pressures associated with input tax credit mechanisms affected MSME liquidity and operational sustainability.

Regional Disparities: Formalisation levels varied across states and regions depending on industrial development, digital infrastructure, and governance capacity.

10. Opportunities Created by GST

Improved Transparency: Digital invoicing and online tax filing systems have brought transparency in business transactions with GST. Clear accounting promoted business formalism.

Digital Workforce Records: The switch to digital payroll and accounting systems enhanced the ability to document employee information and monitor workforce.

Enhanced Social Security Coverage: More EPFO and ESIC registrations led to larger coverage in social security for workers.

Organised employment growth: Formal supply chains and enterprise registration provided opportunities for organised employment growth, notably in manufacturing, logistics and services.

Enhanced Tax Compliance and Governance: GST enhanced the tax compliance and governance by introducing integrated tax compliance systems.

Digital India Integration: Integration with Digital India Initiatives where GST was linked to the digital governance initiatives and encouraged electronic transactions and digital business operations.

Improved HRM Practices: Formal payroll systems enabled structured HRM practices like employee records, attendance systems, payroll documentation and compliance monitoring.

11. Findings

The key results of the study are:

1. GST has played a major role in enterprise formalisation including through boost in the number of businesses registering and digitalisation of compliance.
2. Documentation of work force and payroll formalisation were reported to be rising post-implementation of GST, in accordance with the rising trends in EPFO and ESIC registrations.
3. Digital payroll systems and online practices of accounting have reinforced organised structures of employment.
4. Substantial compliance cost, technological adaptation and working capital management were the challenges faced by MSMEs.
5. Formalisation of labour is still uneven and structural barriers exist for rural and unorganised sectors.
6. GST indirectly helped to formalise labour through bringing enterprises into formal supply chain and regulatory frameworks.
7. Although efforts have been made to improve the documentation of work, informal contractual employment continues to be a problem.
8. More payroll registration and digital tracking of the workforce brought about an improvement in social security inclusion.
9. Technology infrastructure and digital literacy are key factors in the success of labour formalisation.
10. While there has been more transparency and governance in labour and taxation systems through the use of GST, more policy measures are necessary to achieve full labour formalisation.

12. Suggestions and Recommendations Recommendations for MSMEs

1. Improve the use of digital accounting and payroll software.
2. Document and audit compliance with the workforce regularly.
3. Improve HRM activities on the issues of employee records and social security registration.

4. Organise training on digital compliance systems and on labour laws.

The development of skills and digital literacy.

1. Enhance and popularize digital literacy courses for micro entrepreneurs and workers.
2. Encourage training programs for vocational and compliance purposes.
3. Foster collaboration between government institutions, industry associations and academic institutions.

Policy Integration

Labour formalisation policies need to be aligned with taxation reform, digitisation governance schemes and MSME development programmes.

13. Conclusion

GST is a revolutionary change in the economic and governance system of India. GST has an impact beyond taxation, which extends to the operation of enterprises, documentation of workers, digitisation, and formalisation. The results of this study suggest that the implementation of GST has positively influenced the registration of enterprises, the formalisation of payrolls, incorporation of social security and organization of employment. Businesses were engaged in digital compliance systems, which facilitated the documentation of the workforce and enhanced transparency in labour management. Rise in the number of registrations with EPFO and ESIC indicate steps towards formalisation of labour force and extension of social security. The study also brings out a number of issues in implementing GST. The MSMEs were struggling with challenges in their operations and finances because of adherence issues, technological challenges, and lack of awareness. Labour formalisation has remained ineffective due to informal contractual employment and unevenness across regions. GST has opened up opportunities for governance of the workforce, structured employment system and digital HR practices, from a Human Resource Management and Public Policy perspective. However, there is a need for more than tax measures to support the formalisation of labour. A combination of initiatives such as digital literacy, MSME support, labour law enforcement and social security system extension is critical to sustaining formal employment growth. Empirical studies on the trends of formalisation in the sectors, experiences of employees, and the long-term effects of labour productivity and employment quality due to the implementation of GST could be a future research scope.

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