The Widening Wealth Chasm: How the Divergence between the Registered and Informal Economies Exposes the Blind Spots of Modern Economic Policy

PRASHANT KUMAR DIXIT
ASSTT. PROFESSOR
VIVEK UNIVERSITY, BIJNOR (U.P.) INDIA

How to Cite this Article:

DIXIT, P. K. (2026). The Widening Wealth Chasm: How the Divergence between the Registered and Informal Economies Exposes the Blind Spots of Modern Economic Policy. International Journal of Creative and Open Research in Engineering and Management, <i>02</i>(7), 1-9. https://doi.org/10.55041/ijcope.v2i7.137

https://doi.org/10.55041/ijcope.v2i7.137

Abstract

Across both advanced and developing economies, a growing share of economic life takes place outside the ledgers that policymakers use to see it. This paper examines the structural divergence between registered (formal) and unregistered (informal) economies and argues that this divergence, rather than any single tax loophole or transfer failure, is a principal driver of the wealth gap that official statistics persistently understate. Drawing on labour-market data from the International Labour Organization, enterprise-census research on India's "missing middle" of firms, and recent long-run inequality series constructed from tax, wealth and survey data, the paper shows that roughly 58 per cent of the world's workforce, and by some estimates closer to 90 per cent of India's, is informally employed, disconnected from social insurance, formal credit and the statistical instruments used to design welfare policy. The literature review synthesizes four strands of scholarship: dual-economy theory, the structuralist and legalist accounts of informality, enterprise-size research, and the emerging critique of inequality metrics such as the Ginny coefficient. The paper then develops a conceptual framework describing how formal-informal divergence compounds wealth concentration through four channels: differential access to credit and capital, exclusion from social protection, weak enforcement of labour standards, and the statistical invisibility of informal wealth and income. It concludes that policy instruments built around registration, taxation records and payroll data will systematically miss the population most exposed to precarity, and it proposes a research and policy agenda oriented around non-registration-dependent identification, asset-based social protection and revised inequality metrics that incorporate informal-sector data.

Keywords
informal economy; formal-informal divergence; wealth inequality; enterprise informality; labour market dualism; social protection policy; India; Ginny coefficient

1. Introduction
Modern economic policy is built, almost by necessity, on what can be counted: registered firms, payroll records, tax filings, and household surveys that assume a formal wage relationship. Yet for a majority of the world's workers, none of these records exist in any meaningful sense. The International Labour Organization estimates that informal employment accounted for about 58 per cent of global employment in the most recent comparable data, comprising close to 2 billion workers, with the rate exceeding 88 per cent in low-income countries and falling to roughly 13 per cent in high-income ones (International Labour Organization [ILO], 2023; Statista, 2025). This is not a marginal residual category; it is, in much of the developing world, the economy itself.

The concern of this paper is not informality as a labour-market curiosity but as a structural fault line that runs beneath conventional measures of inequality. When a government designs a minimum-wage law, a pension scheme, a credit-guarantee programme or a progressive tax schedule, it is implicitly designing for the registered half of the economy. The unregistered half, meanwhile, keeps growing in absolute numbers even as its relative share sometimes declines, and the wealth generated within it, or denied to it, rarely appears in the datasets from which policy is drawn (ILO, 2024a). This produces what this paper terms a divergence effect: two economies that increasingly diverge in their access to capital, protection and voice, even as national accounts continue to describe a single, unified economy.

The paper proceeds as follows.

Section 2 reviews four bodies of literature relevant to this divergence: dual-economy and structuralist theories of informality; enterprise-level research on the "missing middle" of firm size distributions; empirical work connecting informality to wealth and income inequality; and the emerging critique of standard inequality metrics. Section 3 develops a conceptual framework describing the channels through which formal-informal divergence compounds wealth concentration. Section 4 presents empirical patterns, drawing primarily on global ILO data and India as an illustrative and data-rich case. Section 5 identifies specific blind spots in current policy design. Section 6 discusses implications and Section 7 concludes.

2. Literature Review

2.1 Dual-Economy Theory and the Origins of the Informality Concept

The theoretical starting point for most informality research is W. Arthur Lewis's (1954) model of economic development with unlimited supplies of labour, which described developing economies as split between a modern capitalist sector and a traditional subsistence sector, with surplus labour migrating from the latter to the former as industrialization proceeds. This framework implicitly treated informal or traditional activity as a temporary, residual phenomenon destined to shrink as formal industrial employment expanded.

The term "informal sector" itself was introduced by Keith Hart (1973) in his study of urban employment in Ghana, where he documented income-generating activities operating outside regulated wage employment and argued that these activities were not marginal survivalism but an organized, persistent feature of urban economies. Hart's work reframed informality from a temporary transitional stage into a durable structural feature of developing economies, a reframing that subsequent decades of research have largely vindicated: informal employment has not withered away with growth, and in several fast-growing economies its absolute size has increased even as formal employment has also grown (ILO, 2024b).

2.2 Structuralist, Legalist and Voluntarist Accounts

Later scholarship split into competing explanations for why informality persists. The structuralist school views informality as a product of capitalist restructuring, in which formal firms subcontract to informal units to reduce labour costs and regulatory exposure, effectively integrating informal workers into formal value chains while denying them formal protections. The legalist school, associated with Hernando de Soto (2000), instead attributes informality to excessive bureaucratic cost: entrepreneurs and workers remain unregistered because the cost of formal registration, in time, money and procedural complexity, exceeds its benefits, leaving valuable assets as "dead capital" that cannot be leveraged as collateral. A third, voluntarist, view holds that some informal operators rationally opt out of formal status even when registration costs are low, weighing tax liability against perceived benefit. These are not mutually exclusive explanations, and most contemporary case studies, including those on India discussed below, find elements of all three operating simultaneously across different segments of the informal economy.

2.3 Enterprise-Level Evidence: The Missing Middle

A distinct empirical literature examines informality at the level of firms rather than workers.Giri and Mehrotra (2023), using a newly constructed database drawn from India's Annual Survey of Industries, National Sample Survey and Economic Census, document that India's non-farm enterprise sector exhibits a pronounced bimodal, "missing middle" distribution: a vast number of tiny, unregistered units employing at most a handful of workers, alongside a small number of large formal firms, with very few enterprises in between. They find that India is an outlier even relative to other Asian economies on this dimension, and they attribute the pattern not to market forces alone but to a policy framework that has historically entrenched informality by failing to make formal registration attractive or administratively feasible for small units, and by treating all micro, small and medium enterprises as a single undifferentiated category rather than targeting the specific constraints facing the smallest, least visible firms.
This finding matters for the wealth-divergence argument because firm size and registration status are closely tied to access to formal credit. Enterprises outside the formal registry typically cannot pledge assets as collateral, cannot access lower-cost institutional credit, and remain dependent on informal finance at higher effective interest rates, a constraint that compounds over time into a widening gap in accumulated capital between registered and unregistered enterprises of otherwise similar productive potential.

2.4 Informality, Inequality and Social Protection

A parallel body of work connects informal employment directly to income and wealth disparity. Cross-country evidence assembled by the ILO shows a strong inverse relationship between per-capita income and the share of informal employment, with informality concentrated among the poorest workers, women in many low- and middle-income countries, and rural populations, where three-quarters or more of employment is informal even as urban informality remains below half globally (Women in Informal Employment: Globalizing and Organizing [WIEGO], 2024). Because informal employment is systematically associated with lower earnings, greater income volatility and an absence of employer-linked social insurance, its persistence has been identified as a structural driver of the gap between median and top-end income and wealth accumulation (International Labour Organization, 2023).
Research on maternal and occupational health has extended this argument by showing that informal workers are also excluded from policy domains far beyond labour and tax law; Bhan et al. (2020) note that despite informal work constituting the majority of employment in many countries, it received only cursory attention in a major series of studies on India's health system, illustrating how informality functions as a blind spot that extends across multiple, ostensibly unrelated areas of public policy rather than being confined to labour regulation alone.

2.5 The Indian Case and the Limits of Standard Inequality Metrics

India offers a particularly well-documented illustration of the divergence this paper describes. Long-run inequality estimates constructed by Bharti, Chancel, Piketty and Somanchi (2024), combining national income accounts, tax tabulations, rich lists and household surveys, find that income and wealth concentration declined after independence until the early 1980s before rising sharply, with the increase becoming especially pronounced after 2014-15. By their estimates, the top 1 per cent of the population held 22.6 per cent of national income and 40.1 per cent of national wealth in 2022-23, among the highest such shares recorded anywhere in the world. The authors note that India's high income-tax exemption threshold means tax records capture only the very top of the distribution well, while household surveys in turn understate the wealth of the very richest, so that neither data source alone, and certainly not either in isolation from the vast informal economy beneath both, can be relied upon to fully describe the distribution.
This measurement problem has led some commentators to question the reliability of conventional inequality indices in economies with large informal sectors. Analysts have argued that a low headline Ginny coefficient can coexist with visibly stark disparities in living standards precisely because a large, untaxed and undocumented informal sector leaves much of the population's true economic position unrecorded,

producing a statistical picture that is difficult to reconcile with observed gaps between, for example, luxury consumption and prevailing informal wages (House of UPSC, 2025). Complementary commentary on India's inequality trends further notes that a large share of workers, cited at roughly 88 per cent based on Periodic Labour Force Survey micro-data, lack any written employment contract, which limits the practical reach of minimum-wage and labour-protection laws regardless of their statutory scope (Lukmaan IAS, 2025).

Together, this literature suggests three consistent findings that motivate the present paper: informality is a durable structural feature rather than a transitional stage of development; it is tightly linked to unequal access to credit, protection and formal-sector wages; and it substantially compromises the statistical instruments, from labour force surveys to inequality indices, that policymakers rely on to detect and respond to rising wealth concentration.

3. Conceptual Framework: The Divergence Mechanism

This paper proposes that formal-informal divergence widens wealth gaps through four interacting channels.

Capital-access channel. Registered firms and individuals can offer verifiable collateral, credit histories and audited accounts, granting access to lower-cost institutional finance. Unregistered units are pushed toward informal credit markets with materially higher costs of capital, so that returns to otherwise identical productive activity diverge over time purely as a function of registration status (Giri & Mehrotra, 2023).

Protection Channel. Social insurance, employer-linked pensions, health coverage and unemployment protection are typically administered through formal payroll systems. Informal workers absorb income shocks, illness and old age largely through private savings or family networks, which are themselves harder to build without the capital-access channel above (ILO, 2023).

Enforcement Channel. Minimum-wage, occupational-safety and anti-discrimination statutes are enforced principally through inspection of registered establishments and written contracts. Where the majority of a workforce lacks a written contract, statutory protections exist on paper but not in practice (Lukmaan IAS, 2025).

Statistical-visibility Channel. Tax records, payroll data and formal-sector surveys are the primary inputs to inequality measurement and policy targeting. Wealth and income generated informally, whether modest or, in the case of large unregistered enterprises, substantial, is systematically undercounted, which both understates measured inequality and misdirects redistributive policy toward populations that are easiest to observe rather than those most in need (House of UPSC, 2025; Bharti et al., 2024).

These four channels are mutually reinforcing rather than independent: exclusion from capital limits the ability of informal actors to formalize, which in turn perpetuates their exclusion from protection and enforcement regimes, while their absence from statistical records ensures that policy responses continue to be calibrated to the formal economy alone. The result is a self-sustaining divergence rather than a one-off gap that growth alone can close.

4. Empirical Patterns: Global and Indian Evidence

Table 1 summarizes headline figures on the scale of informality and its association with inequality, drawn from the sources reviewed above. The figures illustrate both the global scale of informal employment and the particular acuteness of the Indian case, which combines a very large informal workforce with a formal sector that has recently recorded some of the highest top-end wealth and income shares in the world.

Indicator	Estimate	Source
Global informal employment share	**~58% (~2 billion workers)**	**ILO (2023, 2024a)**
Informal employment, low-income countries	**~88.5%**	**Statista (2025), ILO**
Informal employment, high-income countries	**~13.5%**	**Statista (2025), ILO**

Indicator	Estimate	Source
India: formal-sector share of employment	**~10-12%**	**Socio.Health (2025)**
India: workers without a written contract	**~88%**	**Lukmaan IAS (2025), PLFS**
India: top 1% share of national income (2022-23)	**22.6%**	**Bharti et al. (2024)**
India: top 1% share of national wealth (2022-23)	**40.1%**	**Bharti et al. (2024)**

Two patterns stand out. First, the scale of informality is inversely related to national income, meaning that the countries least equipped to fund universal, non-contributory social protection are also those where the largest share of the population depends on it. Second, and more specific to the wealth-divergence argument of this paper, India's formal economy has itself become highly unequal at the same time that the vast majority of its workforce remains outside that formal economy altogether; the two facts are not separate stories but two faces of the same structural divergence, since a shrinking, increasingly concentrated formal sector is precisely what one would expect where entry into formality is costly and where the returns to formal status, in capital access, protection and enforcement, are correspondingly high.

5. Policy Blind Spots

5.1 Registration-Centric Social Protection

Many contributory social insurance schemes, by design, require a registered employer or a traceable income record. Where the majority of the workforce is self-employed, in casual daily-wage work, or employed without written contracts, contributory design excludes precisely the population most exposed to income shocks (ILO, 2023). Non-contributory alternatives exist but are frequently underfunded relative to the scale of need implied by the informality figures in Table 1.

5.2 Tax- and Payroll-Based Measurement of Inequality

Inequality metrics built primarily from tax filings and household consumption surveys systematically miss both ends of the distribution in economies with large informal sectors: they undercount informal-sector income and assets at the lower and middle ranges, and, as Bharti et al. (2024) note, they also struggle to capture the very top of the wealth distribution where tax avoidance and underreporting are most feasible. Policymakers relying on a single summary statistic such as the Ginny coefficient risk understating both the scale and the trend of wealth concentration (House of UPSC, 2025).

5.3 Undifferentiated Enterprise Policy

Giri & Mehrotra (2023) argue that treating all micro, small and medium enterprises as a single policy category obscures the fact that the smallest, unregistered units, which make up the overwhelming majority of India's non-farm enterprises, face fundamentally different constraints from the small number of larger, already-formal firms that most benefit from credit-guarantee and subsidy schemes nominally designed for the entire MSME sector. Programmes intended to support small business formalization consequently reach the units that need them least.

5.4 Sectoral and Fiscal Blind Spots in a Digitizing Economy

Even as informal employment persists at scale, a small, capital-intensive segment of the formal economy, notably financial services and digital platforms, has captured a disproportionate share of corporate profit relative to the workforce it employs, according to district-level fiscal analysis cited in recent Indian policy commentary, which finds such sectors capturing nearly half of corporate profits while employing under 2 per cent of the workforce (Lukmaan IAS, 2025). This sectoral tilt compounds the divergence described in Section 3: fiscal policy debates increasingly concern a narrow, highly formalized and highly profitable segment of the economy, while labour-market policy debates concern an increasingly large informal segment, with little institutional mechanism connecting the two.

6. Discussion

The evidence reviewed here suggests that closing the wealth gap between registered and informal economies cannot rely solely on growth-led formalization, the assumption embedded in the original dual-economy models of the 1950s. Informality has proven durable rather than transitional across decades of growth in many economies, including India's, and in several respects the formal and informal economies have grown further apart rather than converging Giri & Mehrotra &, 2023; ILO, 2024b).

Three policy directions follow from the analysis. First, identification and benefit delivery mechanisms that do not depend on employer registration, such as portable, worker-linked social security accounts tied to biometric or digital identity rather than to a specific formal employer, could extend protection without waiting for formalization to occur. Second, statistical agencies could supplement tax- and payroll-based inequality measures with asset- and consumption-based estimates specifically designed to capture informal-sector wealth, an approach partially adopted by the long-run inequality series constructed by Bharti et al. (2024) but not yet standard in official statistics. Third, enterprise policy could disaggregate the MSME category by registration status and firm size rather than treating it as a single bloc, targeting the specific barriers, documentation cost, collateral requirements, and compliance complexity, that keep the smallest units informal, as recommended by Giri and Mehrotra (2023).

These proposals are not without trade-offs. Extending social protection to informal workers requires fiscal space that many governments, already facing combined deficits in the high single digits of GDP in India's case, may be reluctant to commit (Lukmaan IAS, 2025). Revising inequality statistics risks methodological disputes of the kind that have already accompanied recent Indian wealth-inequality estimates, where alternative approaches to the same underlying data have produced materially different conclusions about the pace and scale of rising concentration. Disaggregating enterprise policy by firm size raises administrative complexity and could, if poorly designed, create new incentives for firms to remain artificially small in order to qualify for targeted support. None of these trade-offs is a reason to preserve the status quo, but they indicate that closing the registered-informal divergence is a multi-decade institutional project rather than a single policy fix.

7. Conclusion

The widening wealth chasm documented in recent inequality research is not simply a story about tax policy or corporate concentration; it is, in substantial part, a story about which parts of the economy modern policy instruments are built to see. With close to 60 percent of the world's workforce and a substantially larger share of India's operating outside the registers, payrolls and contracts that underpin conventional social protection, labour regulation and inequality measurement, the divergence between registered and informal economies functions as a structural blind spot rather than a peripheral gap. Addressing it will require identification and protection systems that do not presuppose formal registration, statistical frameworks that can see informal wealth and income, and enterprise policy calibrated to the realities of the smallest, least visible firms rather than to the formal sector's upper tier. Until policy instruments are redesigned with this divergence explicitly in view, measured progress against inequality will continue to understate the true scale of the wealth chasm it purports to track.

References

Bhan, G., Surie, A., Horwood, C., Dobson, R., Alfers, L., Portela, A., & Rollins, N. (2020). Informal work and maternal and child health: A blind spot in public health and research. Bulletin of the World Health Organization, 98(3), 219–221. https://doi.org/10.2471/BLT.19.231258

Bharti, N. K., Chancel, L., Piketty, T., & Somanchi, A. (2024). Income and wealth inequality in India, 1922–2023: The rise of the Billionaire Raj (World Inequality Lab Working Paper No. 2024/09). World Inequality Lab.

De Soto, H. (2000). The mystery of capital: Why capitalism triumphs in the West and fails everywhere else. Basic Books.

Hart, K. (1973). Informal income opportunities and urban employment in Ghana. The Journal of Modern African Studies, 11(1), 61–89.

House of UPSC. (2025, July 30). Why the Gini Index is wrong about India. https://houseofupsc.com/gini-index-inequality-india-misleading/

International Labour Organization. (2023). Women and men in the informal economy: A statistical update. ILO.

International Labour Organization. (2024a). World employment and social outlook: May 2024 update. ILO.

International Labour Organization. (2024b). World employment and social outlook: Trends 2024. ILO.

Lewis, W. A. (1954). Economic development with unlimited supplies of labour. The Manchester School, 22(2), 139–191.

Lukmaan IAS. (2025, July 14). India's inequality paradox: Measuring, understanding and bridging the income–wealth divide. https://blog.lukmaanias.com/2025/07/14/indias-inequality-paradox-measuring-understanding-and-bridging-the-income-wealth-divide/

Mehrotra, S., & Giri, T. (2023). Enterprise informality in India: The blind spots in public policy. The Indian Journal of Labour Economics, 66(3), 687–710. https://doi.org/10.1007/s41027-023-00450-9

Socio.Health. (2025, November 17). Income inequality in India: Economic and social dynamics. https://socio.health/population-and-development-issues-challenges/income-inequality-india-economic-social-dynamics/

Statista. (2025, October 7). Chart: Mapping the world's informal workforce. https://www.statista.com/chart/30349/map-of-informal-employment/

Women in Informal Employment: Globalizing and Organizing (WIEGO). (2024). Statistical picture of the informal economy. https://www.wiego.org/informal-economy/statistical-picture/