CHAPTER-1

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In recent years, research workers and policy makers have recognized the existence of a dualistic economic structure in the developing economies. The developing economies are characterized by a highly formalized sector and an unorganized informal sector and this is reflected in the labour markets of these economies by a formidable reservoir of workers employed in the 'informal sector'. The workers in this sector on account of their disadvantageous position are unable to derive the benefits of development and contribute to the process of development to the full extent of their position.

The term 'informal sector' came into wide usage during the last two decades. Before that informal sector was considered as a transitory phenomenon, which was expected to fade away as the formal sector of the economy created more and more jobs. Marx introduced the concept of 'reserve army' consisting of unemployed persons and 'petty commodity producers', who waited in the ranks to fit into the grand scheme of capitalist production. The capitalists squeezed the labourers with the threat of unemployment looming large, to extract surplus. The concept of 'petty commodity producers' still exists in today's world and in current terminology they are the 'self employed workers', constituting a large part of the informal sector of the developing economies. Lewis (1954), Fei and Ranis(1964), Harris- Todaro (1970) have used the concept of 'surplus labour' and have explained how this 'residual' will facilitate the transition of the economies from agriculture to industry and rural to urban in different ways. All these theories have expected that the informal sector would wither away with the passage of time.

However, economic recession, structural adjustment policies, continued high rate of urbanization, technical advancement and population growth in the developing economies, have forced the modern sector enterprises to retrench workers or to reduce wages drastically. These workers have been absorbed by the informal sector of the economy alone, which has led to an unusual expansion of the informal sector in the developing
economies. Therefore it is to be believed that in many years to come, informal sector will be an expanding part of developing economies and this belief has forced the researchers and policy makers to recognize the importance of informal sector in developing economies.

It is very difficult to give a precise definition of informal sector. However, it is Hart (1973), who has first used the term to explain a dichotomy in his dual model for urban workers in Ghana. The study has been mainly based on one simple characteristic, namely, the distinction between income opportunities in wage employment and self employment. The self employed workers have formed the “unenumerated” sector of the urban settlements. The migrants from the rural sector to the urban labour market have been forced to work in the informal sector partly due to lack of adequate opportunities in the formal sector and partly due to the workers’ lack of skills and experience required for the jobs in the formal sector. The terms “informal income generating activities”, “unorganized sector”, “unenumerated sector”, “self employed individuals” and “urban proletariat” have been used more or less alternately and interchangeably by Hart (1973) in his study of urban Ghana.

The concept of informal sector was used widely by International Labor Organization (ILO) in the early 1970s in various studies of number of countries and cities in Asia, Latin America and West Africa. The International Labor Organization- United Nations Development Programme (ILO-UNDP) Employment Mission to Kenya has also adopted the term “informal sector” for analyzing the employment situation and for working out an employment strategy in Kenya. The ILO’s definition of the informal sector in 1972 has been descriptive in nature. According to it the informal sector has the following characteristics: easy entry for the new enterprises, small-scale of operation, family ownership, reliance on indigenous resources, labour intensive and adaptive technology, skills acquired outside the formal system and operation in unregulated and competitive markets. The formal sector has the obverse of these characteristics. The characteristics that have been proposed by ILO are appropriate in the context of Kenya, but it has not been relevant to the general case.
Weeks (1975) has attempted to provide an analytical base to the highly descriptive nature of the distinction between formal and informal sectors. According to him all government activities fall in the formal sector. The formal sector private enterprises are officially recognized, fostered, nurtured and regulated by the State. Thus, all the formal sector enterprises have an access to different kinds of official favours like restrictions of competition and reduction in risk and uncertainty through tariff and quota protection for import substitution industries, tax rebates and holidays, low interest rates, selective credit controls and licensing of operations. They also have an easy access to formal credit institutions and foreign technology, which the informal sector enterprises do not have. Due to privileged access to resources, the formal sector has certain characteristics like large scale of operations, capital intensive techniques, high wage rate and salary scales, foreign ownership, imported technology and sophisticated market. The informal sector, on the other hand, deprived of privileged access to resources is characterized by small scale operations, labour intensive techniques, low levels of income and indigenous ownership. But, this definition of formal-informal distinction also remains doubtful. The informal sector in a regulatory framework has also been studied by De Soto (1989). In this approach also, the legal status is the main element which distinguishes informal from formal activities. Papola (1981) has suggested that the distinction between the formal and informal sector enterprises can be made on the basis of mode of production, organization, scale of operation, technology, productivity and labour markets.

After many years of negotiations, an agreement had been reached regarding the definition of informal sector, in the Fifteenth International Conference of Labour Statisticians (ICLS) 1993, and it was adopted in the new System of National Accounts (SNA)(1993). The fifteenth ICLS, 1993, adopted an operational definition of informal sector, irrespective of the kind of workplace, the extent of fixed assets, the duration of the activity of the enterprise and its operation as a main or secondary activity. The SNA (1993) characterizes the informal sector as consisting of units engaged in the production of goods and services with the primary objective of generating employment and income to the persons concerned. Thus the ICLS/SNA definition of the informal sector is based on the legal status of the enterprise, which is useful for National Accounts and in
estimating the contribution of the informal sector in the gross national product of the economy but it fails to exhibit the heterogeneity in the status and working conditions of the workers of the informal sector.

Thus, the forgoing discussions about the definition of the informal sector and the bases of distinction between formal and informal sector does not enable us to come to a precise definition of the informal sector. To search for a true definition of informal sector Sethuraman (1977) has provided the simplest solution. He has said\(^1\) “The informal sector, as its name suggests, is not formal in its character”. As a rule of thumb, we can only say that all enterprises with ten persons or less and engaged in manufacturing, construction, transport, trade and service sector constitute informal sector\(^2\). However, there exists some definite characteristics of the informal sector, which have been identified from number of empirical studies of several urban areas of developing countries. The most observed features of the informal sector in a developing economy are as follows:

**Small Size of Operations:** From empirical point of view, it has been believed that informal sector consists of small establishments. The “smallness” is generally implied in terms of the size of employment. It has been observed that whether an enterprise falls into a formal or an informal sector depends on the fact that the particular enterprise is officially registered or not and it is well known that official registration is applied to the units above a given employment size only. In general, the cut-off point of size of employment is suggested as ten workers. Therefore, it is commonly believed that all the enterprises which employ less than ten workers are officially unregistered and thus they form the informal sector of the economy.

**Informal Structure and Family Ownership:** Informal sector enterprises are generally very small in size and so there is not much of functional division of labour and specialization. In most of the cases, the management and supervisory and sometimes some of the production functions are performed by the proprietor itself. There also exists extensive

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1 See the work of Sethuraman (1977), pg 196.
use of family labour. Thus, overall it can be concluded that informal sector enterprises do not have a formally structured organization.

Non-Modern Technology: Informal sector units generally uses labour intensive, predominantly manual, low productivity units of production as compared to the capital intensive, highly mechanized and highly productive techniques of production used by the formal sector units. Informal sector producers do not use capital-intensive and modern technology, either because they do not have an access to it or because it does not suit them in the given relative cost position of capital and labour as they can hire labour at a much lower wage rate than the formal sector employers.

Lack of Access to Government Favours: Informal sector enterprises do not enjoy the advantages of organized capital market, bank finance, foreign technology, imported raw material, protection from foreign competition, etc as the formal sector enterprises do, due to their lack of access to the resources controlled and distributed by the government of the economy. It is not that these facilities are officially denied to the informal sector enterprises, but they cannot avail the facilities, even when the government of the economy has tried to give them some preference treatment in order to mitigate their problem, because of their meager material resources. They could not cope up with the official procedures required to obtain the government favours. In other words, following Joshi and Joshi (1976), we can argue that the bureaucratic procedures which have to be followed in order to obtain the scarce inputs are very complicated and lengthy. These complicated and lengthy procedures have put the informal sector enterprises into serious disadvantageous position and often led to black market transaction.

In most of the developing economies, the informal sector enterprises operate on pavements, crowded streets, and other odd places which they do not own due to the lack of suitable space that they can posses within their means. These result in overcrowding, traffic congestion and environmental degradation, which cause the government of the economy to force them to evacuate the spaces which they had occupied. The attempts of the government to enforce certain regulations are considered by these enterprises as
“hostile” conditions due to which they feel insecure and are therefore reluctant to approach the public authorities.

Again, many of the enterprises in the developing economies carry out their activities informally not because of the disadvantaged position of the operator but because of higher profitably of operating informally than with legal sanction.

*Competitive and Unprotected Product Market:* It is usually believed that most of the informal sector units produce goods for the domestic market\(^3\), whereas the formal sector enterprises satisfy the demand for the higher income section of the population and for the foreign market. The formal sector products have the advantage of brand names and better marketing network. As a result they do not face much competition in the market, where they sell their products. But the informal sector enterprises, supplying products to the domestic market, neither have much of holding capacity due to meagerness of resources and small scale of operations, nor proper marketing arrangements. Therefore, most of the informal sector enterprises operate in a highly competitive market, which does not allow the informal sector enterprises to realize the same revenue per unit of their product from the market as do the formal sector producers. They sell to whatever buyers are at hand at the time their product is ready for sale, and therefore not able to realize full value of their product. But, there also exists some informal sector enterprises, which operate in a market devoid of any competition. The whole range of artistic handicrafts produced in the informal sector in a country like India, is a good example of it.

*Unprotected Labour Market:* The labour market for the informal sector is unregulated and highly competitive on the supply side, with absolute freedom to entry. The supply of labour in the informal sector consists of mostly new entrants in the urban labour market, who has migrated from rural sector to the urban sector of the economy, in order to find job in the formal sector of the economy. But finding the opportunities for it is limited and entry is restricted, they start doing something or the other in the informal sector either as

\(^3\) Though there are some exceptions in this regard. Many gems and jewellery producers produce tradeable products on an informal basis in developing economies.
self-employed, part-time workers or full time workers in small establishments. Thus, informal sector of an economy bears the brunt of excess labour supply, which leads to low wages of the sector. In other words, we can conclude that in the informal segment of the labour market free entry of labourers exists due to high labour turnover and this in turn leads to low wage rate of the workers of this sector.

In India, the term informal sector has not been used in the official statistics or in the National Accounts Statistics (NAS). The terms that have been used in the Indian NAS are ‘organized’ and ‘unorganized’ sectors. The organized sector comprises enterprises for which the statistics are available from the budget documents or reports etc. On the other hand the unorganized sector refers to those enterprises whose activities or collections of data are not regulated under any legal provision or which do not maintain any regular accounts. In the unorganized sector, the unincorporated propriedoms or partnership enterprises, enterprises run by cooperative societies, trust, private and limited companies are covered. The informal sector is considered as a sub-set of the unorganized sector.

The results of the survey in 1999-2000 of the National Sample Survey Organization (NSSO) show that out of total workforce of 397 million, only 28 million workers are employed in the organized sector and remaining are in the unorganized sector. It reveals that over a decade, the employment in the organized sector has been almost stagnant or slightly declined. In the light of definition of informal sector encompassing private unincorporated enterprises as mentioned above, NSS 55 round 1999-2000 also has covered non-agricultural enterprises in the informal sector in India. As per survey, there are 44.35 million enterprises and 79.71 million workers employed thereof in the non-agricultural informal sector of the economy. Among these, 25.01 million enterprises employing 39.74 million workers are in rural areas whereas 19.34 million enterprises with 39.97 million workers are in the urban area. Among the workers engaged in the informal sector, 70.21 million are full timers and 9.5 million are part timers. Percentage of female workers to the total workers is 20.2 percent.
Since a high percentage of population of India is engaged in the informal sector of the economy, majority of the population lives in poverty, as the income earned from the informal sector of the economy is very low. In a report of International Labour Organization (ILO hereafter) (1990), it was stated that 37% of the urban population and 39% of the rural population of India used to live in poverty. Families living in poverty need money to survive and for them children are the sources of additional income. Child labour is a source of income for poor families. A study conducted by the ILO Bureau of Statistics (1995) found that in the poor families, the contribution of child labour is essential in maintaining the economic level of households. The child labour either supplements the low household income by earning wage income or they help in household enterprises or in household chores, so that the adult members of the family are free for economic activity elsewhere. In some cases, the study found that a child’s income accounted for between 34 and 37 percent of the total household income. This study concludes that a child labourer’s income is important to the livelihood of a poor family. Though there exists other causes like inadequate schooling facilities, lack of social security etc. but poverty is the main cause behind the predominance of child labour in India. In a report Nangia (1987) stated that 63.74% of child labourers said that poverty was the reason for which they worked. Inspite of the predominance of child labour in the informal sector of the economy, it is difficult to cite a current figure for the number of children engaged as child labour. The National Census in 1991 estimated that there were 11.28 million working children in India, whereas 43rd round of the National Sample Survey in 1987-88 estimated the figure to be 17.5 million. On the other hand, in a study sponsored by the Labour Ministry, concluded that the child-labour force was 44 million whereas UNICEF cites figures ranging from seventy-five to ninety million child laborers under the age of fourteen in India. A universal difficulty in obtaining accurate data may be that individuals fail to report child labour participation during surveys, for fear of persecution.

4 See ILO Bureau of Statistics (1995); pg 107
5 Stated by Mehra-Kerpelman (1996); pg 8
6 See page 174 of the work of P. Nangia (1987)
7 See Weiner (1991); pg nos 20-21.
8 See Human Rights Watch (1996); pg 122.
The existence of enormous magnitude of unorganized sector in India not only contributes to the increasing rate of child labour of the economy, but also has number of other negative impacts on the economy. It leads to environmental degradation of the economy. A current study makes a rough estimate of the total magnitude of economic costs associated with environmental degradation in India. The study tries to analyze several of the priority areas discussed in the Indian Government's National Environmental Action Program (1993): (a) urban degradation, including both air and water pollution caused by industrial, municipal and transport sources; (b) urban and rural water supply and sanitation issues; (c) soil and rangeland degradation; (d) forest loss and impact of pollution on the growth of tourism. The Environmental costs are measured in terms of health impacts and productivity impacts. The health impacts of air pollutants are most easily estimated through the use of dose response function drawn from epidemiological studies done around the world. Recent World Bank studies were used to conduct these studies. The results show that the total environmental damage was $9.7 billion per year, or 4.5% of GDP in 1992 values. The average values of the estimated environmental impacts were listed sector wise. The health impacts of water pollution were found to be $5,710 million, the agricultural output loss due to soil degradation was $1,942 million, health impacts of air pollution came around $1,310 million and the loss of live stock carrying capacity due to rangeland degradation was found to be $328 million an the cost of deforestation came to $214 million and the loss of international tourism was found to be $213 million.

Besides all these negative impacts of the existence of informal sector of India, it also contributes to the national product of the economy significantly. The contribution of the unorganized sector to the net domestic product and its share in the total net domestic product (NDP) at current prices has been over 60%. In the matter of savings the share of household sector in the total gross domestic saving mainly unorganized sector is about three fourth. Thus unorganized sector has a crucial role in our economy, both in terms of employment and its contribution to the National Domestic Product, savings and capital formation.
Thus, the informal sector of India not only provides employment and income to a large portion of the population of India but also contributes to the NDP of the economy. In other words, we can say that the advantages of informal sector of an economy are (i) its employment generating capacity; (ii) it provides a significant portion of the consumer goods bought particularly by the lowest income group; (iii) it provides the source of an indigenous capital goods industry and a training ground for indigenous entrepreneurs; and (iv) growth in informal sector would mean shift over time towards more labour-using form of industrialization, which would ensure a more efficient utilization of capital. Therefore, looking at the various impacts of informal sector in a developing economy along with its increasing predominance, it can be realized that different aspects of this sector provides enough scope for research.

In a theoretical study it is not possible to consider all the aspects of informal sector in a developing economy that we have mentioned earlier. It must be noted that the present study is a stylized theorization of the empirical facts that we observe for informal sector in a developing economy. It is true that such stylization should not be an abstract one and should reflect the major features of an informal sector that we find in developing economies. Such theorization will be a useful guide for the policy makers of developing economies in the context of its welfare improvement, given that there is large degree of informalization in the economy. The need of the hour is to consider a suitable compartmentalization of formal-informal division of the economy. In the present study we have used the term ‘informal sector’ in a relatively broad sense. Usually, the agricultural sector of an economy is treated as a part of informal sector. Here, however, we have considered agricultural sector as a separate sector and have not clubbed it with informal sector. We refer to informal sector as a sector which is informal in every sense. It receives no benefit from the government (in the form of subsidies) and is not under any type of control. The agricultural sector (though sometimes uses informal capital) gets various benefits from the government and is an important component of the policy packages of the government. Though in reality informal sector produces various types of goods (including services) in the present thesis we have confined ourselves mainly to manufacturing informal sector which produces either final traded goods or intermediary
non-traded goods for the formal manufacturing sector. Various development policies are considered using this classification of formal-informal division of the economy. Our objective is to examine the impact of various contemporary policies relevant for a developing economy on its level of welfare and to highlight the role of informal sector in this regard. Hence, it is a challenging task for the researchers to examine the different issues associated with informal sector in a developing economy. The present dissertation is a preliminary attempt on this line.

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9 See chapter 2, section 2.3 for chapter-wise classification.