Chapter One

INTRODUCTION

The term Informal Sector is a newcomer in the jargon of economic literature and has gained wide recognition and both instant fame and notoriety. The term was loosely evident for the first time in the context of the development models based on segregation of an economy into traditional and modern sectors and migration of labour force from the former to the latter (Lewis 1954, Ranis and Fei 1964). Major criticism against these models was that the migration was in response to wage differential and the employment in the modern sector was implicitly assumed to be assured. This lacuna was sought to be remedied by Todaro (1969) who hypothesised a model where migration decision rested on the probability of getting a job in the modern sector. This attempt was criticised because it failed to take account of the fact that the migrants can engage themselves in highly diversified and unorganised jobs in the 'informal sector'. It was argued that the migration decisions take into account the possibility of being engaged in the informal sector and so, this sector plays an important role in the decision making process of labour movement and hence in the development process. Once it came to limelight, it rose to immediate prominence.

CONCEPTS AND DEFINITIONS

The specific term informal sector and the informal – formal dichotomy, was first used by Keith Hart (1971) in his study on Ghana. And then again the terminology played a major analytical role in the ILO-UNDP Employment Commission on Kenya (ILO, 1972). Since then, it has gained significant attention in economic literature, specifically in the areas of employment and development. In spite of its wide application in development economics and policy prescriptions, it has no precise analytical definition till today. Different attempts have been made to define informal sector meaningfully. The ILO-
UNDP report on Kenya characterises the informal sector as 'a sector to which entry by new enterprises is comparatively easy; enterprises in this sector rely on indigenous resources and are family owned; they operate on a small scale, in unregulated and competitive markets and use labour intensive and adaptive technology; their workers have skills acquired outside the formal schooling system'. The informal sector has also been defined by Quijano (1974) as 'marginal pole acting as a reserve army of labour and producing cheap, poor quality subsistence goods and thereby enhancing capital accumulation in the formal sector'. John Weeks (1975) characterises informal sector as that which 'operates outside the system of benefits and regulations extended by the government, without access to formal credit and marketing institutions and improved technology; and in many cases operated illegally'. Moreover 'amenities and infrastructure like roads, electricity, water supply and sanitation are almost exclusively available to the formal sector'. Breman (1976) argues that the informal sector covers a considerable range of economic activities which are mostly self-employment, very little organised, if at all, difficult to enumerate and therefore often ignored by official census, and where working conditions are rarely upto the legal standards. Papola (1980) characterises informal sector as unorganised small producers operating on narrow margins in highly competitive markets using labour intensive indigenous technologies. Dhesi & Wadhwa (1980) in their study on informal sector in Nanga!, comment that the informal sector activities are characterised by ease of entry, reliance on indigenous resources, negligible capital investment, labour intensiveness and competitive unregulated markets. The statistical dept. of ILO in their 1987 proposal, suggested defining informal workers so as to include those working in an unregistered economic unit or in a registered economic unit having characteristics (level of organisation, scale of operation, level of technology etc.) similar to unregistered units. It is often contended that the informal sector is such a sector which is subordinated to the formal organised sector via direct linkages in terms of which the formal sector extracts surplus from it. Mead and Morrison (1996) argue that the dimension of informality concerns absence of legal presence, small size of employment and low capital intensity. However they also conclude that there is a high degree of heterogeneity within the informal sector and one may include or exclude segments according to objective and availability of data. Others who have defined informal sector in more or less similar lines on the basis of size of

Thus it seems that there have been varied ideas regarding the definition of informal sector. Though there has been diverse opinion, one thing emerges – the informal sector concerns all those activities, which are undertaken in a small scale and operate in unregulated, competitive markets with labour intensive technology. This sector can thus be conceptualised as household and small non household sectors characterised by high labour intensity, lack of adequate capital, less than legal minimum wage, low profit level, low bargaining power in the product exchange market – both while buying and selling commodities and services, leading to exploitation by external agents, limited access to institutional and infrastructural facilities, and, which are not officially registered, fostered, nurtured or regulated by the state.

This concept covers a wide spectrum of activities and units, and undoubtedly provides a notion regarding informal sector. But this heterogeneity also prevents giving a concrete shape and structure to the informal sector. The informal sector is still like a phantom whose presence can be felt but cannot be precisely described. The notion varies from region to region.

**ROLE OF INFORMAL SECTOR IN DEVELOPMENT**

The role of informal sector in shaping the economic profile of a region has been widely debated over. While some economists stress upon its positive impact, others are sceptical regarding its contribution to the process of development.

The foremost aspect of informal sector that is pointed out is its role in employment creation. Being a labour-intensive sector, it has tremendous potential for absorption of labour force. However, it is often argued, that the informal sector has acted as a sink and a large number of people who have no other earning opportunity have been deposited here. So, the informal sector is over-employed, leading to under-utilisation of labour force and low labour productivity. This argument can be countered from two standpoints. Firstly, even if it has low productivity, it provides employment to those who otherwise
would have been openly unemployed. So, informal sector provides a chance of survival to a large number of people. Secondly, whether informal sector has poor productivity throughout is itself questionable. It is accepted that there is a segment within the informal sector which is low productive and is an outcome of distress phenomenon; but there is also another segment which has tremendous growth potential and if explored properly can well be a competitor to the modern organised sector. It is pointed out that the informal sector can be separated into two parts – one suffering from lack of resources and therefore having large under-utilised labour force; and another lucky group with adequate resources showing efficient labour utilisation in spite of having labour-intensive technology. (House 1984).

It has also been argued that due to its high labour intensity the Value Added per Worker may be low; but it uses the scarce capital efficiently and its productivity measured in terms of Value Added per unit of Capital is high. Moreover, only a fraction of investment required in the organised sector can provide employment to a large mass of people in the informal sector. In the context of capital deficient developing economy the above adds significance to the informal sector.

Another aspect that has often been highlighted is the role played by informal sector through its relationship with the formal sector. Some economists have argued that a downward linkage exists between the formal and informal sector implying that the latter lives or dies with the former (Stark 1982). But what is the type of relation that binds them together? It is generally perceived that an exploitative relationship exists between the two sectors which is the crux of the existence of the informal sector. The nature of the linkage between them enables the organised sector to obtain cheap semifinished products and services from the informal sector and keep its own cost of production low. The formal sector thus allows the informal sector to operate only because they can exploit the latter and appropriate the surplus generated by them, thereby increasing their own profit margin. It then follows that policies to promote informal sector units may lead to disappearance of the exploitative relation and endanger their very existence. On the other hand the ILO and the World Bank contend that the exploitative linkages between the formal and informal sector should be replaced by relationship based on mutual advantages to both. Secondly, the informal sector also provides cheap
consumer products (mainly processed foods, ready-made garments and handicrafts) and services (transport, petty trading etc.) to urban society. The informal sector plays an important role in recycling the wastes and thus produces goods and services which satisfy the special needs of the household at the lowest step of the income ladder. Hemmer and Mannel have stated that the formal enterprises enjoy higher price margins by virtue of the state privileges. On the contrary, the informal market is insecure and exposed to highly competitive pressure. Although this narrows the profit margin of the individual entrepreneur, these factors increase the innovation potential and chances for development of this sector. Consequently, the informal sector has emerged as a vast sea of entrepreneurship and innovativeness. Also, since the informal sector is exploited both while buying resources (other than labour) and while selling products its contribution to national product is much greater than what is indicated by Value Added by this sector.

The Probabilistic Migration Models (Harris and Todaro 1970, Johnson 1971, Fields 1975) state that the informal sector is a transitional phase through which migrants to the urban centre pass before shifting to formal sector employment. So, it is argued, that since it is a temporary phenomenon, there is no need to develop the informal sector. It can however be pointed out that though the workers may shift over from the informal to the formal sector after sometime, they are replaced by fresh migrants and the informal sector itself continues to exist. It is also observed that not only are the units permanent, there is little mobility of the workers between informal and formal sector. Once individuals enter the informal sector they are trapped there; not so much because they lack the human capital, as because of institutional barriers on the demand side (Breman 1976). It can be said that informal sector is itself a magnet which attracts job-seekers from the overburdened rural areas and from among the unemployed mass of the urban sector; because even the low wage in the informal sector is higher than that in the rural areas. Thus it can be concluded that the informal sector is not a transitory sector that would progressively evolve so as to be integrated with the formal sector as the economy gets more developed. It is permanent by nature, and if planners and decision makers adopt specific approach to expand it with institutional support, it can generate substantial productive employment and thereby contribute substantially to the process of economic development.
Thus, it can be concluded, that the informal sector has a place of its own and plays a significant role in the process of economic development. It provides substantial employment opportunities to those who otherwise would have been openly unemployed. Its products and services are low priced and so they help to keep the cost of production of formal units and cost of living of the urban population low. If properly nurtured so that it expands and develops optimally without sacrificing the structural advantages, it can play an important role in the process of economic development.

In India, informal sector was thought to be a transient phenomenon which will ultimately be integrated with the mainstream of economic development. So, the policy makers paid little attention towards this sector and most of the policies were not conducive to the growth of informal sector. But it is found that more than 90% of the workforce are presently employed in the informal sector¹. Not only that the organised sector could not keep pace with the growing workforce, the employment elasticity of output of the organised sector is declining continuously over time (0.59 in 1972-73 to 0.38 during 9th plan). Moreover, labour force in India is projected to increase by 53 million during the 9th plan period. [The projection made for India’s Ninth 5 year plan suggests that the labour force will grow by 2.2% per annum for the next decade and more. Given the present level of elasticity of employment it requires growth rate of 7% per annum²]. Added to this is the backlog over the previous plan periods. Given the rigidity of the formal sector, the employers are restructuring their production through subcontracting to the unorganised sector. The reform program has proved to be less labour-intensive and the process of privatisation which leads to job cuts in initial phases has already set in. So, given the present scenario, informal sector is likely to exist in India providing employment to an overwhelmingly large population, and can no longer be neglected as a transient or temporary phenomenon.

It is argued that though informal sector provides employment to about 90% of the population its contribution towards NDP is only 60%, and this is due to the overall low-productivity in the informal sector. Naturally, the question arises whether to divert the scarce resource towards the development of this low-productive sector. The answer is that the informal sector can well

² GOI (1999).
be differentiated into two segments – one which is low productive and an outcome of a survival process only; and the other which has tremendous growth potential and can contribute significantly to economic growth and development. Proper identification of these segments is necessary so that appropriate policies can be evolved for them.

The time has come to turn the attention of the policy makers towards the informal sector.