

# India's Informal Economy

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Though complex as a process, there were certain broad features that were expected to characterise economic development. Among them was a diversification of economic activity away from agriculture combined with a transformation of non-agricultural activity based on modern technology and newer organisational forms. The latter was to be reflected in an increase in the size of enterprises, a rise in productivity and a growing role for impersonal forms of organisation (such as the joint-stock company). Though gradualism and the persistence of backward technologies and traditional forms of enterprise are to be expected for a host of reasons, the long-term trend was to be one of attrition of such forms of production.

However, over the years it has become clear that in terms of the number of enterprises (defined as units that offer for sale at least a part of their output), the share in employment, and, to a lesser extent, in output, units that fall under categories such as “[informal](#)” or “unorganised” have retained a position of considerable importance in India's non-agricultural sector. Though known to analysts and established by a number of field studies, the evidence to adequately assess and explain this persistence and reproduction of “backwardness” has been constrained by the limited aggregate evidence on economic activity outside of the organised or ‘registered’ manufacturing sector.

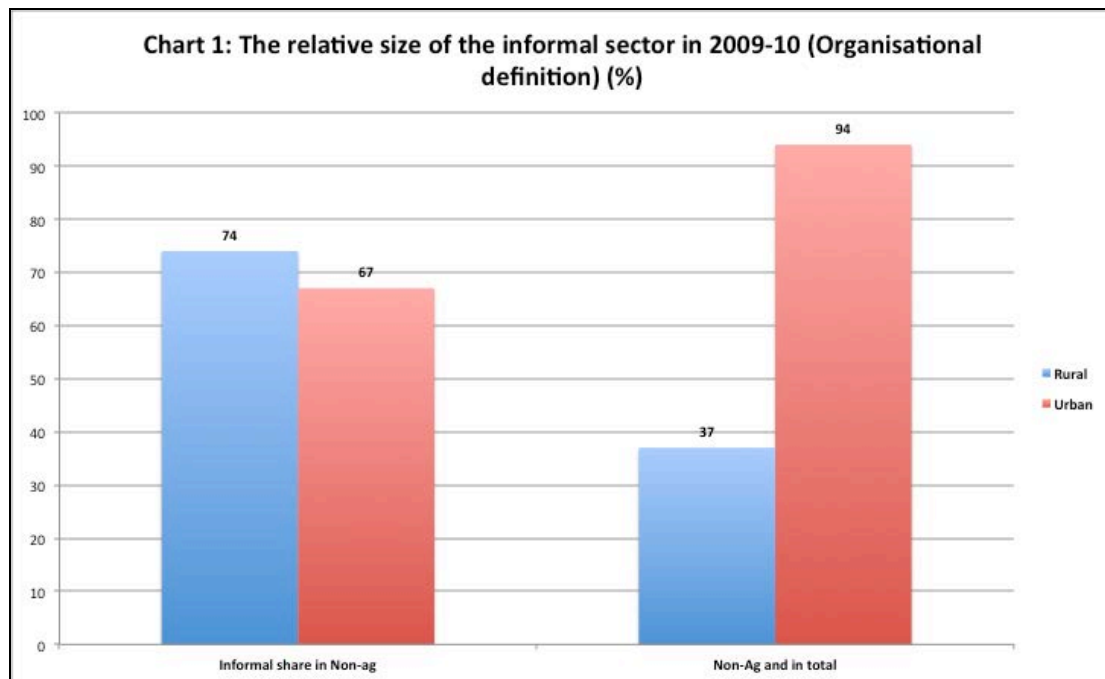
Though over the years since Independence different arms of the government's statistical apparatus have examined features of the ‘unorganised’ or ‘informal’ sector, the scope volume and periodicity of such evidence has lagged when compared to data collection relating to the agricultural sector. In particular, as the [Report of the Committee on Unorganised Sector Statistics](#) has noted, comparable and complementary evidence on different segments of the unorganised sector and of the unorganised and organised sectors, is still scarce or even absent.

Part of the problem is the variation in definitions of the unorganised or informal sector, which attempt to draw boundaries between organised and unorganised and formal and informal by differentially focusing on differences in features such as technology, employment size, legal status and organisational form. This definitional variation has been combined with the fact that most surveys have limited themselves to parts of the organised sector such as manufacturing, trade and other services, and that an area that accounts for a significant share of income and employment in the economy, namely construction, has invariably been left out.

The result is that the statistical basis for fully understanding the factors that underlie the persistence and reproduction of backwardness is still limited. However, there has been progress over time and besides the Censuses (both decennial Censuses and the few Economic Censuses conducted since the 1970s), there have been periodic surveys undertaken by the National Sample Survey Organisation, which covers the unorganised sector, in the [employment and unemployment surveys](#) (EUS) and the [enterprise surveys](#) (ES) conducted by it.

In general these surveys define the informal sector in terms of organisation forms and as consisting of proprietary and partnership enterprises (besides those run by non-corporate entities such as self-help groups and trusts). But there are differences

between NSS surveys too, with surveys of the unorganised manufacturing, for example, being based on legal status (in the sense of being registered under the Factories Act) and the number of workers employed in units operating with or without the use of power. The important dividing line here is the employment of 10 workers if functioning with the aid of power or 20 workers when functioning without the aid of power.

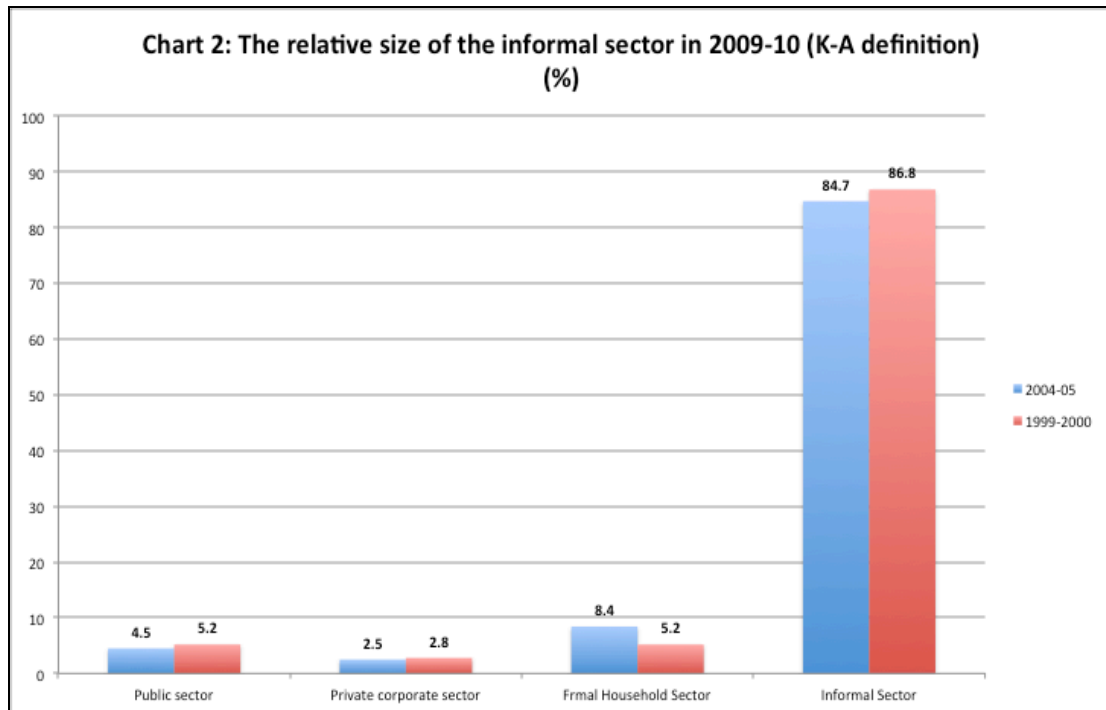


Using the classification that identifies the informal sector as consisting largely of proprietary and partnership enterprises, and restricting it to the non-agricultural sector and agriculture-related activities (excluding crop production) (AGEGC), the EUS for 2009-10 estimated employment in the informal component to be 74 per cent of total employment (principal and subsidiary status) in the relevant sectors in rural areas and 67 per cent in urban areas (Chart 1). The non-agriculture and AGEGC sectors themselves accounted for 37 per cent and 94 per cent of total employment. If the analysis is restricted to just the non-agricultural sector 71 per cent of workers in rural areas and 67 per cent in urban areas were engaged in the informal component.

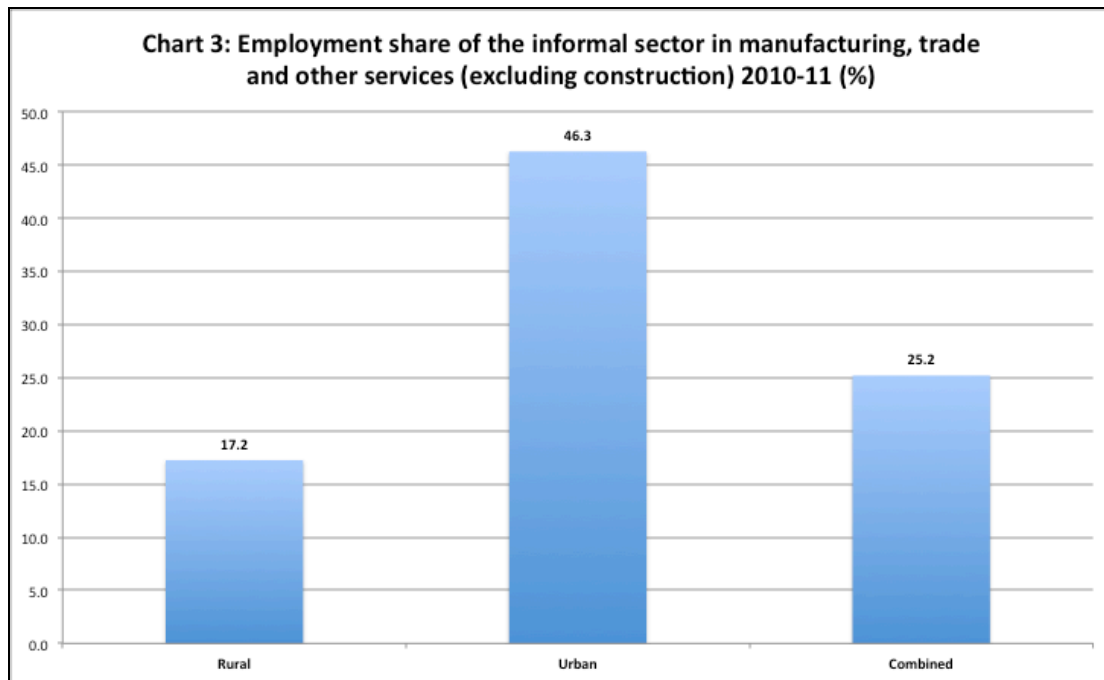
Approached from the employment side this is still an overwhelmingly large sector in the Indian economy. The sectors that account for a dominant share of informal employment are manufacturing construction and trade (wholesale and retail). They accounted for 76 per cent and 72 per cent respectively of all workers in the non-agriculture informal sector, in the rural and urban areas, as compared with 69 per cent and 59 per cent respectively of all workers in the non-agriculture sector.

However definitions do matter. Ramesh Kolli and Anindita Sinharay, in a paper titled [“Share of Informal sector and Informal Employment in GDP and Employment”](#) (The Journal of Income and Wealth July-December 2011) chose to define the informal sector as consisting of all enterprises outside the public and private corporate sectors which employed five or less workers. Based on that definition they found that the EUS data for 2004-05 showed that 84.7 per cent of jobs in the economy were in the informal sector, 4.5 per cent in the public sector, 2.5 per cent in the private corporate

sector and 8.4 per cent in the ‘formal’ household sector, consisting of enterprises employing more than five workers (Chart 2). Even with this more restrictive definition of informal enterprises the share of the formal sector was relatively small.



The most recent evidence on the structure and status of the unorganised sector comes from the NSS 67th Round Survey of Unincorporated Non-agricultural Enterprises in manufacturing, trade and other services (excluding construction) conducted during July 2010 to June 2011. The survey estimated that there were 48,810 such units in rural areas and 8,863 in urban areas, together employing 108 million workers who were more or less equally distributed between urban and rural areas, with 51 per cent located in the former and 49 per cent in the latter. Workers in these enterprises accounted for 17 per cent of the total rural work force and 46 per cent of the urban work force in 2009-10 (Chart 3). Two factors need to be kept in mind when reading these figures. First, the data is restricted to a few non-agricultural sectors, with the agricultural and construction sectors in particular, which are overwhelmingly informal, being left out. And, second, that the ratios measuring the contribution of the informal sectors in these enterprises are with respect to economy-wide employment in 2009-10.



What are the defining features of the informal sector when seen in terms of the units that populate it? To start with, the structure of the sector remains heavily biased in favour of small and organisationally “primitive” units. Across the rural and urban areas, “own account enterprises” (OAEs) or those that employ no hired labour on a regular basis account for an overwhelming 84-86 per cent of all enterprises. Though the presence of OAEs is greater in rural areas (91 per cent of the total), their share in total enterprises in urban areas too amounts to a remarkable 77 per cent.

In terms of organisation, proprietary concerns dominated. Among OAEs they accounted for 95 per cent in rural areas and 98 per cent in urban areas. The corresponding figures for establishments hiring workers were 95 and 94 per cent respectively. Clearly, the transition to impersonal forms of organisation has completely bypassed this sector.

The primitive nature of a substantial segment of the unorganised sector is also reflected in the fact that most units are typically “household units” located in household premises or units without a fixed location. In terms of location, 54 per cent of OAEs in rural areas and 40.2 per cent in urban areas operated within household premises and of those that were outside the household premises 16.1 and 17.3 per cent respectively had no fixed location, being activities undertaken by street vendors or in mobile markets. It was in the case of establishments employing hired workers that 63.1 per cent in rural areas and 83.9 per cent in urban areas operated in fixed locations outside the household premises. A dominant share of these units also had permanent structures.

In sum, units that in terms of characteristics such as size, technology, employment and location that cannot but be described as primitive overwhelmingly dominate the non-agricultural sector of the Indian economy. One factor explaining this is the absence of employment opportunities in the formal economy in a country that provides no social security to the vast majority. People cannot but work if they and their families have to be saved from starvation. If agriculture does not provide the

required opportunity, they find something to do in the non-agricultural economy earning low incomes.

This is indeed true. But the implicit perception here is that the informal economy exists because low wages allow it to compete with the formal sector in a host of non-agricultural activities varying through manufacturing, construction and trade. However, the large relative size of the informal economy suggests that this 'ability to compete' cannot be the sole explanation. It must be the case that there are many areas where the informal sector is not only "not in competition" with the formal sector, but actually services its requirements. The vast, unorganised 'logistics' apparatus (offering services such as transportation and catering) that supports the India's IT and IT-enabled services sector is one example. In the process low wages in the informal economy help sustain profits in the formal sector. Only when this possibility is taken into account can we explain the size and scope of India's informal economy.

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