



DEVELOPMENT ECONOMICS REPORT

Topic: Role of informal sector in economic
development of India

Submitted To:
Prof. Dr. Kishor Goswami

Submitted By:
Birru Lavanya
21HS10018

Introduction:

All countries' economic progress depends heavily on the informal sector. Only this unorganised sector accounts for one third of the national income in emerging countries. The challenges with unemployment are lessened by the informal sector. The business owners are employed in this industry to support their families, not to increase profits. In our nation, some unofficial business owners—vegetable sellers, agents, brokers, footpath dealers, etc.—earn more than the formal employees. The majority of businesspeople in this field have local roots. Every community in India owns its own business. There are more community-based entrepreneurs in rural, urban, and city areas. For instance, shoes and beauty salons, etc.

Characteristics of the Informal Sector

- Low levels of productivity and employment
- People look at their jobs as temporary
- Health and safety are always at risk
- More labor-intensive
- Non-payment of taxes
- Workers are paid below the minimum wage
- Absence of social protection and benefits
- The company or workers are not registered
- The business is not considered a legal entity which is independent from its owner or owners
- It is usually owned and managed by blood relatives
- It is usually not well-organized and has only a few workers.



The majority of businesspeople in this field have local roots. Every community in India owns its own business. There are more community-based entrepreneurs in rural, urban, and city areas. For instance, shoes and beauty salons, etc. The Indian economy grows covertly thanks to the informal sector. Due to a lack of employment opportunities, the majority of rural and urban residents in India continue their family businesses. In India, the informal economy accounts for the majority of family companies. The earnings from this industry have been used towards their families' obligations, personal savings, and the education of their children. Therefore, the government should take the required actions to formalise this industry.

Informal sector

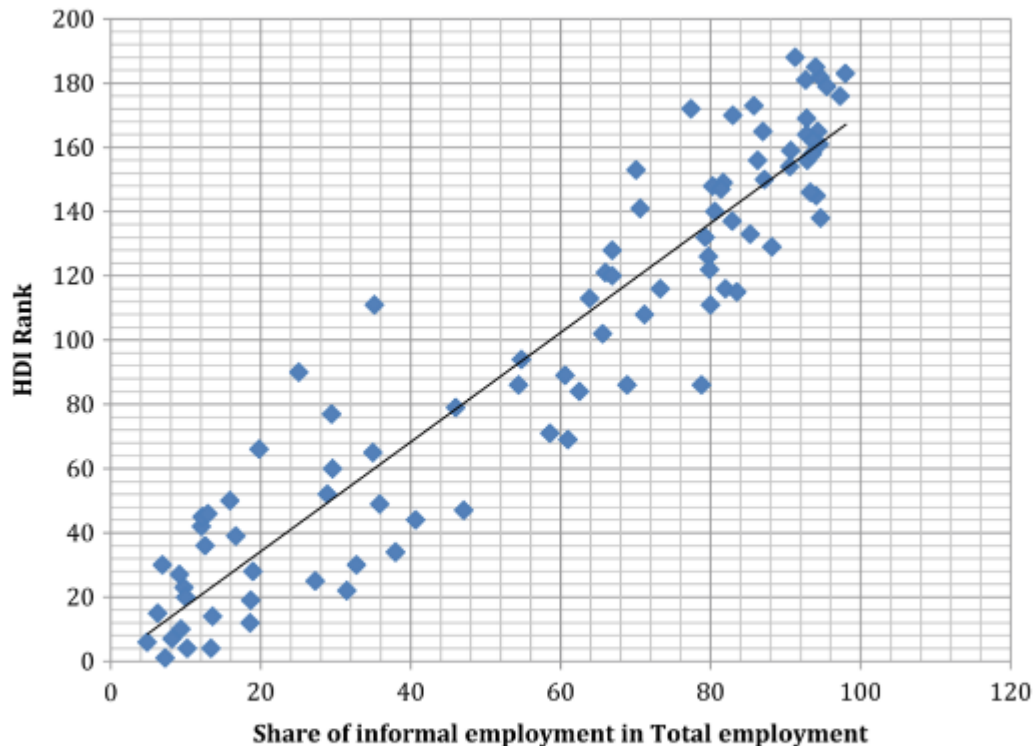


Fig. 2.1 Association between HDI Rank of countries and share of informal employment in total employment of the country. *Source* Author's compilation from ILO (2019a) and HDR (2018)

Economic operations not subject to governmental control, frequently not subject to registration or taxation, are referred to as operating in the informal sector. Small, unregistered enterprises, independent contractors, market vendors, and other types of informal employment make up this sector. These workers frequently do not have access to social security or labour regulations, which leaves them vulnerable to exploitation and unstable income.

Many people in developing nations, especially those who are unable to find employment in the formal sector, rely heavily on the informal sector as a source of employment and income. Despite its significance, government policies and programmes frequently ignore and underserve the informal sector.

There have been initiatives in recent years to formalise the unorganised economy and give these people improved working conditions and protections. This may entail registering enterprises, granting access to financial services, and enhancing social and labour norms. Governments can aid in promoting economic growth, reducing poverty,

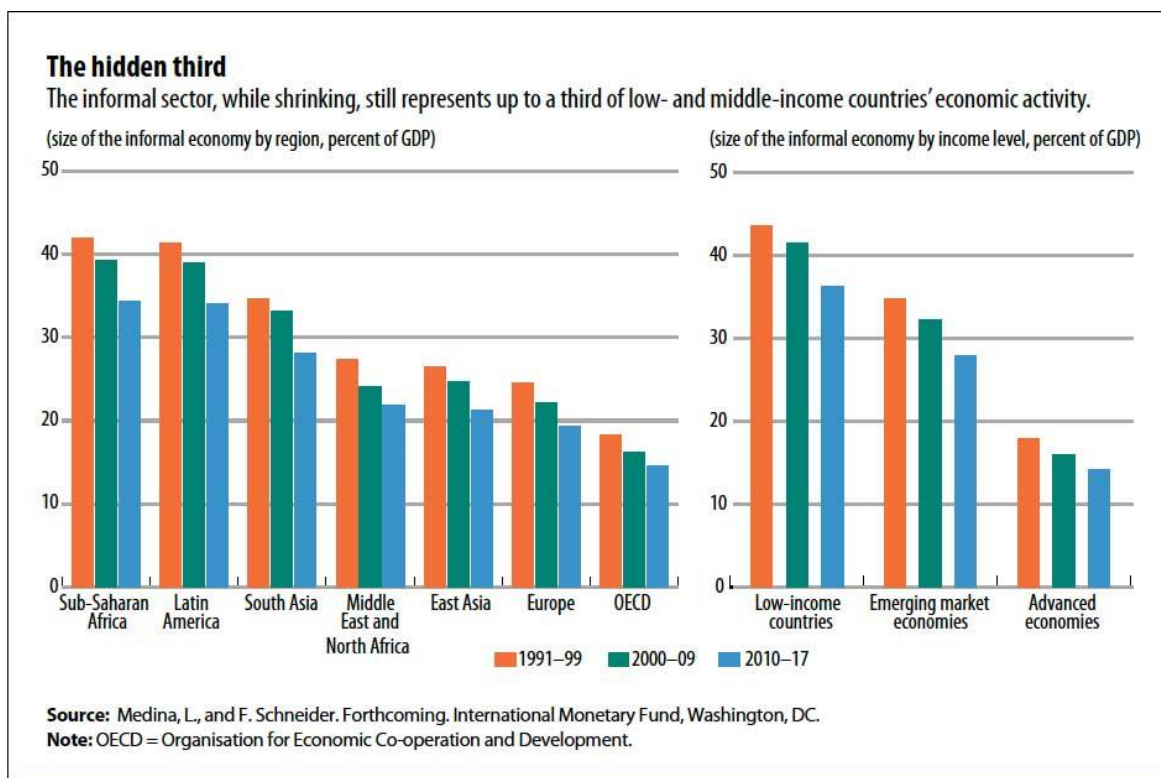
and improving the lives of sector employees by formally recognising the informal sector.



Source: THE GLOBAL DEVELOPMENT RESEARCH CENTER

Indian informal sector

A sizable and expanding section of India's economy, the informal sector, employs a sizable fraction of the labour force. Some estimates place the informal sector—which includes small enterprises, street sellers, home-based employees, and other types of informal employment—as high as 90% of the workforce in India.



Particularly in rural areas where official sector jobs can be hard to come by, India's informal sector is frequently viewed as a major force behind economic growth and job creation. Despite this, workers in the informal sector are frequently not covered by social security or labour regulations, and their wages and working conditions might be unstable.

The Indian government has taken action in recent years to formalise the unorganised sector and enhance working conditions for these individuals. This has included measures to promote economic growth and job creation, as well as steps to increase access to credit and financial services and jobs in the formal sector. The government has also implemented measures, including as health insurance and pension plans, to better the working conditions and protections for employees in the unorganised sector.

Overall, the informal sector continues to play a significant role in the Indian economy, and the government is committed to enhancing the quality of life and working conditions for those employed in it.

Role of informal sector in economic development of a nation

The informal sector can play both a beneficial and a negative role in a country's economic development. On the one hand, the informal sector can contribute significantly to job creation, income generation, and economic growth, particularly in developing nations where access to official sector employment may be limited. For people who are unable to find employment in the official sector, the informal sector offers a safety net and can be a source of creativity and entrepreneurship.

SBI Research

Increasing size of formal economy~	
Number of jobs formalised since FY18 (as per EPFO records)	~36.6 lakh or ~0.66 lakh crore
Unorganized workers registered on E-shram portal (as on 30 Oct)	5.7 crore or ~Rs 6.8 lakh crore
Formalisation of cash usage since pandemic	~Rs 1.2 lakh crore
Amount of Agriculture credit formalised since FY18	~Rs 4.6 lakh crore
Increase in digital payments towards Petrol + Diesel on Petrol Pumps during last three years	~Rs 1.0 lakh crore

Share of informal economy across broad sectors to GVA (%)			
Sector	2011-12	2017-18	2020-21 P
Agriculture, forestry and fishing	96.8	97.1	70-75
Mining and quarrying	22.6	22.5	15-17
Manufacturing	25.5	22.7	19-21
Electricity, gas, water	4.3	5.3	0
Construction	76.4	74.5	35-40
Accommodation; food services; trade	86.6	86.6	40-45
Transport, storage, communication	47	47.7	
Financial services	9.3	11.9	20-25
Real estate, ownership of dwellings	63.1	52.8	
Public administration and defense	0	0	0
TOTAL GVA at basic prices	53.9	52.4	15-20
Source: IMF Policy Paper Feb-21; P: SBI Projections			

The informal sector is a critical component of many developing countries' economic structures. Informal sector enterprises are a critical form of production organisation and a significant source of employment and income in both rural and urban areas. Parallel to the large number of jobs created in the informal sector (i.e., employment in the informal sector), various forms of informal (or unprotected) employment in the formal sector have grown rapidly in recent years. According to studies, the informal sector could account for more than 50% of non-agricultural employment and nearly 30% of non-agricultural GDP in many developing countries. Even in many transitional economies, the informal sector is estimated to be around 10% of the total.

However, we have a tendency to overlook and undervalue the importance of this multifaceted sector.

According to the ILO India Labour Market Update (2016) and NSSO data (2011-12), more than 90% of agricultural employment and nearly 70% of non-agricultural employment falls into the informal category.

Dominant sector: It is clear that the informal sector is not the economy's residual sector. In reality, it is the most important sector.

Contribution: While the informal sector does not contribute much to national income, its employment dominance is likely to continue for some time.

While the organised sector has lagged, the informal sector has improved in productivity, real wages, employment, and capital accumulation.

Perception shift: It may be incorrect to dismiss the informal sector as stagnant and underperforming.

Performance: Empirical data show that the informal sector outperforms its formal counterparts in economic parameters such as investment, job creation, and fixed asset accumulation, among others.

However, the informal sector can also have detrimental effects on economic growth, especially if its employees are not covered by social security or labour rules. The well-being of workers and their families may suffer as a result of exploitation, low pay, and unfavourable working conditions.

Despite these obstacles, the informal sector, especially in developing nations, can be extremely important to a country's economic development. Promoting the formalisation of informal enterprises and giving workers improved working conditions, rights, and career possibilities are the keys to realising this sector's full potential.

This can be accomplished by combining policies and initiatives that support entrepreneurship, open up access to credit and financial services, and enhance social and labour standards. Governments may support economic growth, eliminate poverty, and build a more just and sustainable economic future for their population by promoting the formalisation of the informal sector and enhancing the lives and working conditions of informal sector workers.

Role of informal sector in economic development of india

An important section of India's population receives employment and income from the informal sector, which is essential to the country's economic progress. Some estimates place the informal sector—which includes small enterprises, street sellers, home-based employees, and other types of informal employment—as high as 90% of the workforce in India.

Particularly in rural areas where official sector jobs can be hard to come by, India's informal sector is frequently viewed as a major force behind economic growth and job creation. Despite this, workers in the informal sector are frequently not covered by social security or labour regulations, and their wages and working conditions might be unstable.

Women's roles in the informal economy and the challenges they face

Although there is no precise and authentic information on the total number of women working in the informal sector, an estimate is made based on available data. According to 2001 census reports on workers and their distribution, there are approximately 60 thousand women workers in the categories of main workers, marginal workers, and those engaged in household industries.

Percentage of Regular Employment to Total Employment			
very low, less than 10%	Low, 10 to 15%	Medium, 15% to 20%	High, 20% and above
Bihar, Chhattisgarh, Jharkhand, Orissa, Uttar Pradesh	Rajasthan, Madhya Pradesh, Assam, Andhra Pradesh, Karnataka, Uttaranchal, Himachal Pradesh, West Bengal	Jammu and Kashmir, Gujarat, Kerala, Haryana	Maharashtra, Tamil Nadu, Punjab, Delhi,

Table 4 : Informal Women Workers Living Conditions (In Percentage)

Informal Sectors	Sampled Respondents	Poor Housing Conditions				Average	Water & Sanitation Conditions						Average
		Kutcha House	Less than 2 rooms	Not Proper Ventilation	Cooking in Multi-purpose Room		Water source outside premises	Toilet facility outside premises	Drainage does not exist	Road side	Disposal around the house	In the drain	
Rag Pickers	132	100	53.79	100	37.88	72.92	100	100	100	1.52	98.48	0	66.67
Domestic Workers	108	82.41	49.07	82.41	60.09	68.52	99.07	85.19	35.19	10.19	54.63	35.19	53.24
Coolies	79	89.87	43.04	100	17.72	62.66	100	100	97.47	35.44	49.37	0	63.71
Vendors	60	30	25	65	18.33	34.58	55	73.33	38.33	41.67	23.33	10	40.27
Beauticians	56	0	1.79	0	0	0.44	0	0	14.29	0	23.21	0	6.25
Construction Labour	42	100	26.19	100	40.48	66.67	100	100	71.43	30.95	40.48	28.57	61.91
Garment Workers	23	13.04	4.35	39.13	34.78	22.83	86.96	82.61	8.7	30.43	21.74	0	38.41
Total	500	71	37.2	78	33	54.8	82.6	81.6	62	17.2	55.4	11.2	51.67

Source: Based on Field Survey (2011-2012)

According to another estimate, nearly 90% of India's total female labour force is employed in the informal sector (National Perspective Plan for Women, 2000). Previous research and other reports have identified the following categories of women workers in the informal sector:

Contractor labour: Women are always required to work as unskilled labourers, carrying construction materials on their heads to the construction site, while men perform skilled/semi-skilled work.

Domestic workers: This occupation is primarily held by women, particularly young girls. In 1997-98, there were approximately 1.68 million female domestic workers, while only

0.62 million male domestic workers were employed. Part-time and full-time employees are among the household workers.

Garment workers: These women work for major drapers, boutiques, and stores; the same bias is evident here, as the women serve as assistants to male tailors (called as masters). Knitters are among those who work in this industry.

Seller: This is the most dispersed category, which includes women selling a variety of commodities such as broomsticks, cane baskets, utensils, petty cosmetics, bangles, vegetables, and those operating roadside tea stalls, among others. Women account for nearly 40% of total vendors, with 30% of these women being the sole earners in their families.

Marketing girls: These workers are further classified into two groups: those who move from door to door and place to place, and those who work in stores (mostly women related items like jewellery, garments and cosmetics etc.).

India's economy has benefited greatly from the informal sector in a number of ways:

1. Creation of jobs: A lot of people, especially those with little formal education and skill-sets, find work in the unorganised sector. It reduces poverty by acting as a safety net for people who are unable to find formal employment and by offering chances for entrepreneurship.
2. Informal sector contribution to GDP: According to recent estimates, the informal sector is anticipated to contribute 50% or more to India's GDP. Particularly during times of economic difficulty, this contribution has been crucial in preserving economic growth.
3. Innovation and entrepreneurship: The informal sector is a significant source of innovation and entrepreneurship, which fuels economic expansion and employment creation. In India, a sizable portion of new businesses are created by small, unorganised businesses, which also serve as crucial suppliers to larger, legal businesses.
4. Economic adaptability: The informal sector can react swiftly to shifting economic conditions because it is more flexible and adaptive than the formal sector. This makes it a crucial source of economic resilience and contributes to shock absorption during periods of economic downturn.
5. Informal-formal linkages: By supplying inputs and generating demand for goods and services, the informal sector functions as a stimulant for the formal sector. The rise of

the informal sector fuels the growth of the formal sector, and vice versa, creating a positive feedback loop.

The Indian government has taken action in recent years to encourage the formalisation of the unorganised sector and enhance the working conditions for these individuals.

This has included measures to promote economic growth and job creation, as well as steps to increase access to credit and financial services and jobs in the formal sector. The government has also implemented measures, including as health insurance and pension plans, to better the working conditions and protections for employees in the unorganised sector.

To fully exploit the potential of the unorganised sector in India's economic development, however, there is still considerable work to be done. This would necessitate ongoing initiatives to encourage entrepreneurship, open up access to credit and financial services, and enhance labour laws and social safeguards for employees in the informal economy.

To sum up, the informal sector is a significant component of the Indian economy, and the government must play a crucial role in encouraging its formalisation and ensuring that employees there are protected and have access to chances for growth and development.

Role of government in improving informal sector:

The government must play a significant role in enhancing the informal economy and fostering its expansion and development. The government can take a number of important measures, including:

1. **Legal recognition:** To give informal enterprises and workers access to legal protection and rights, the government might grant them legal status. This may lessen exploitation and boost trust in the unorganised sector.
2. **Financing:** The informal sector frequently has limited access to finance, which impedes its expansion and advancement. To give loans and other forms of financial assistance to unregistered enterprises and employees, the government can collaborate with banks and other financial institutions.
3. **Skill development:** To assist workers in the informal sector in upgrading their abilities and enhancing their ability to generate revenue, the government might sponsor skill development initiatives.

4. Improvements to infrastructure can lower the cost of doing business for businesses in the unorganised sector, facilitating their expansion and success. Examples of improved infrastructure include roads, electricity, and water.
5. Business support: To assist informal enterprises in starting, expanding, and succeeding, the government can offer business support services including information and training.
6. Safety nets: To assist shield informal sector workers from economic shocks and financial uncertainty, the government should offer safety nets like health insurance and pension benefits.
7. Integration with the formal sector: The government can encourage the formal and informal sectors to collaborate and create opportunities for informal businesses and workers to transition into formal employment and business.

Finally, the government must play an important role in improving the informal sector and fostering its growth and development. The government can create a more inclusive and sustainable economy where all citizens have the opportunity to thrive by implementing policies and programmes that address the sector's key challenges.

Government initiatives:

The Indian government has taken several initiatives to improve the informal sector and support its growth and development. Among the key initiatives are:

1. Pradhan Mantri Jan Dhan Yojana: This financial inclusion programme aims to provide access to banking services to the unbanked and underserved segments of the population, including those in the informal sector.
2. Atmanirbhar Bharat Scheme: The government has launched this scheme to support the growth of micro, small, and medium enterprises, many of which are in the informal sector. The scheme offers a variety of services, including credit, marketing assistance, and skill development programmes.
3. National Skill Development Corporation: This organisation was established to provide skill development programmes to workers in the informal sector, assisting them in upgrading their skills and increasing their earning potential.
4. National Rural Livelihoods Mission: This programme assists rural households, including those involved in informal sector activities, in improving their livelihoods and increasing their earning potential.

5. Mahatma Gandhi National Rural Employment Guarantee Act: This act guarantees the right to work for rural workers, including those in the informal sector, and contributes to poverty reduction and economic growth in rural areas.

6. National Urban Livelihoods Mission: This programme assists urban households, including those involved in informal sector activities, in improving their livelihoods and increasing their earning potential.

7. Pradhan Mantri Rozgar Protsahan Yojana: This scheme rewards employers for hiring more workers, including those in the informal sector.

In conclusion, the government has taken a number of steps to help the informal sector grow and develop. These initiatives seek to address the sector's key challenges, such as limited access to finance, a lack of legal recognition and protection, and precarious working conditions. Dams, mines, roads, harbours, sculptures, and industries have displaced approximately 60 million people, many of whom are poor or have no rehabilitation.

Pandemic Covid-19 and the Informal Economy

- Migrant workers enter a web of precarious employment: By 2020, the first wave of COVID-19 had exposed serious flaws in the economic system that had driven tens of millions of people into unprotected jobs overnight, with no other options or a safety net.
- It is the end of an era for 90% of Indian workers in the informal sector.
- Small and medium-sized farmers are abandoning the agricultural sector: Since 1991, an estimated 15 million farmers have left agriculture, many of them because the economic system makes farming unprofitable.
- Failure of the private government package: The "Atmanirbhar Bharat" (India confident) government increased control of remote and corporate markets in people's lives while also increasing environmental damage.
- Unrest in society: An economy that encourages high levels of vulnerability exacerbates social ills, creating a climate conducive to social violence by class.
- It will eventually haunt us all, with the exception of the very wealthy, who will flee to a safer place on the planet.
- Cities have seen a threefold increase in the number of unemployed people: Urban and self-employed (non-agricultural) workers are disproportionately affected, accounting for 67 percent of the workforce.
- Around 80 to 90 percent of Indian workers work in the "informal sector," which is not covered by the social security system.

What is the current employment situation in India?

Data presented: Only 10% of India's over 470 million workforce is currently employed in the formal sector. In other words, 90% of India's workers do not have the same benefits as their formally employed counterparts, such as social security and workplace benefits.

Estimation by the NSSO: According to the NSSO, 84.7% of jobs in the Indian economy are in the informal or unorganised sector. Manufacturing, construction, and trade are the leading contributors of informal employment, excluding agriculture.

Report: According to the Report of the Committee on Unorganized Sector Statistics, the informal economy contributes significantly to the economy and meets the needs of the formal economy. However, its negative consequences must not be overlooked.

According to studies, employees in formal employment are significantly more productive than those in informal employment. Furthermore, the amount of value added by someone in a formal job is nearly double that of someone in an informal job.

Working conditions: Informal workers face similar challenges, with little job security, no perks or protections, and low wages. Workers' rights guaranteed by various laws are not respected by the informal sector, and they are also outside the purview of the authorities.

A large informal sector also has an impact on the government in terms of revenue foregone because the units operating in the informal sector are not included in the government's fiscal revenue net (This leads to low tax GDP ratio).

Long run: As a result, the informal sector harms the interests of the working population, the government, and, in the long run, the employer.

Conclusion

The evidence we have presented is broadly consistent with the dual view of informality: informal firms remain permanently informal, they hire informal workers for cash, buy their inputs for cash, and sell their products for cash, they are extremely unproductive, and becoming formal is unlikely to benefit them much. This approach generates the strong prediction that economic growth is the cure for informality.

Over the last two years, the central and state governments have announced a number of relief packages. Despite these efforts, the pandemic has exacted a high price from those who are least able to pay. The need to put in place a social protection

architecture capable of providing timely and adequate assistance to those in need is a key learning from this crisis. This will prevent future crises from resulting in such high humanitarian costs.

Reinforcing the social protection architecture to make it more robust and effective will necessitate not only an increase in entitlements during crises, but also an expansion in coverage to support those who were previously ineligible for assistance but experience a sharp decline in income or lose employment during downturns and thus require assistance. The question of how to design social protection programmes to achieve these goals deserves careful consideration. The Covid-19 crisis has highlighted the importance of automatic stabilisers in protecting people in developing countries from losing their jobs and income. This is not only a promising path towards providing timely assistance without any administrative discretion, but it is also a promising path towards reducing macroeconomic volatility and building resilience against downturns.

The evidence strongly supports this prediction: informality decreases with development, albeit slowly. This approach implies that structural policies promoting formality should be implemented with caution. Their wisdom is influenced by whether they promote formalisation or discourage informal activity.

Thus, the simplification of business registration advocated by De Soto (1989) is probably a good idea, even if evidence suggests that it is unlikely to yield significant benefits. On the other hand, we are sceptical of any policy that would tax or regulate informal businesses. Rather than encouraging informal businesses to become formal, such policies may drive them out of business, resulting in poverty and destitution for informal workers and entrepreneurs. Recognizing the fundamental fact that informal firms are extremely inefficient suggests exercising extreme caution with policies that impose any kind of additional costs on them.

There is mounting evidence that the formation and expansion of formal firms managed by educated entrepreneurs is driving the growth that kills the informal sector. Uneducated entrepreneurs run small and inefficient businesses in both the informal and formal sectors; educated entrepreneurs and managers run larger and more efficient businesses. This is the negative side of dualism: informal economies are so prevalent in poor countries because entrepreneurs are so inefficient.

The evidence suggests that an important bottleneck to economic growth is not a lack of better-educated workers; in fact, workers in informal and formal firms are quite similar on many observable characteristics. Rather, the supply of educated entrepreneurs—people who can run profitable businesses—is the bottleneck.

These entrepreneurs establish and expand modern businesses with which informal firms simply cannot compete, despite their advantages of avoiding taxes and regulations. This is how the informal economy dies out during the development process. From this vantage point, the policy message for how to grow the formal economy while shrinking the informal one is to increase the supply of educated entrepreneurs, whether through immigration or education and training.

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Books

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