

INFORMAL SECTOR: GENESIS AND DEVELOPMENT IN INDIA

Dr A T Padmegowda

Associate professor in Economics, DVS Evening college, Shivamogga

Abstract: Contrary to the conventional belief of diminishing presence of informal entities in a more globalized world, there has been an upsurge in the size of the informal economy in the recent decades. The article summarizes the factors behind the existence and persistence of such economy and explains the advantages of the informal economy in reducing transaction costs, in sidestepping the bureaucratic obligations, and in complementing the formal economy. The paper refutes the idea that the informal firms act as a weak substitute for the formal firms. The paper uses anecdotal evidence and highlights the linkages between the two sectors. We take off from the recent critiques of precarity as an emerging global phenomenon to argue that the processes of precarity in the Global North and the Global South need to be analytically distinguished to bring forth their specificities. We further argue that such an analysis challenges the idea of development as transition, as is prevalent in much of the literature. We focus on the informal economy in India to show that the notion of precarity conceptually involves three distinct aspects of production and labour processes—“non-capitalist” petty commodity production (PCP), subcontracted PCP, and informal wage-labour. We argue that these dimensions have their own particularities that have distinct implications for the process of capitalist development in India. We contend that reproduction of these informal spaces during a period of high economic growth unsettles the imaginary of development as transition.

Key words: Informal firms, Global North and Global South, PCP, Economic Growth, Informal Economy.

Introduction: The term informal sector (IS) has been attributed to Keith Hart (1971) but the origin of the concept of IS can be traced to earlier contributions in sociology. For example, Geertz's study of two Indonesian towns (1963) was concerned with the transformation of a 'bazaar economy'. The informal system originally referred to the parallel system of labour organization and wage bargaining that existed side by side the formal employer-labour relationship in industrialized countries. In less developed countries (LDCs) it was not just the presence of a parallel system but the juxtaposition between two distinct modes or ways of living and the imposition of Western ideas on the Orient which received wide attention in sociology and social anthropology. In economics also, prior developments (i.e., those before the publication of Hart's paper or ILO-Kenya Mission Report, 1972) were already leading towards IS as a urban migration (1970), looked upon the urban labour market as consisting of two sectors viz. Protected (modern) and unprotected (informal) sectors.

Harris-Todaro: model sought to explain this anomaly by introducing a new variable in the picture, viz., the probability of obtaining a modern sector job in the urban economy. Harberger (1971) argued that unprotected sector wages were the best approximation to the supply price of labour in urban areas. Otherwise opportunity cost of urban labour was equated with agricultural wage. At one time (Nurkse, 1953) the marginal product of labour in agriculture was thought to be zero and so urban labour's opportunity cost was also zero.

Harberger did not accept this view. 18 He argued that had urban labour's opportunity cost indeed been zero, rural-urban migration would have been far greater than what was observed. He drew attention to the contribution of IS in providing subsistence to those who would otherwise have been openly unemployed. Around this time, it was also being gradually accepted that the Western concept of open employment was not directly applicable to LDCs. Only those persons who are willing to work at the prevailing wage rate and who are actively seeking work are counted as openly unemployed. Past savings or institutional support in the form of income-sharing within family or state unemployment benefits enable a person to fulfil the above two conditions. IS can play a dual role in this connection in the sense that it might enable its participants to engage in both income-earning activities and job search simultaneously. Therefore, IS can compete with other institutional arrangements in regulating the quantum of open unemployment benefit and IS are inversely related to each other as rivals. Stewart (1978) made a distinction between traditional and modern activities in urban areas in LDCs. She conceptualized the urban economy as below:

Urban economy Foreign Technology Local Technology Sector: Traditional Part Modern/Informal Part 19 IS, in this approach, comprised a group of new activities that had appeared in the wake of industrialization¹⁹. Berger and Piore (1980) start with the observation that duality is not peculiar to only LDCs but can be seen in developed countries also. Thus the traditional sector in Italy, France, Japan and even U.S.A. performs an important economic role. In their conceptualization, the basic reasons why this dualism exists are two-fold. Firstly, it is a reflection of the dualism in modern economics between capital and labour. Capital - particularly plant and equipment - is a fixed factor which cannot be forced to bear the cost of its own unemployment whereas labour, the residual factor, can be. So employers are very careful in planning the utilization of their capital²⁰. The concept of IS attracted a lot of attention since it provided a vital missing link in particularly development economics. Their absence leads to a suppression of open unemployment and vice versa. (The concerned literature has also explored the role of generous unemployment benefits in reducing the motivation to seek work). A few petty producers might be able to transform themselves into capitalists but most of them are forced to eventually join the working class; some may even join the industrial reserve army. The periodic crises to which capitalism is subject are opportunities to challenge and overthrow it. In LDCs, the 20 underdeveloped working class has to win the support of both peasantry and petty producers in this task. Petty commodity producers have been defined as those who are capable of reproducing themselves as private producers of commodities without employing wage-labour and without selling their labour-power. Another definition emphasizes the following features: a) Production for the market. b) Small scale of operations in terms of volume of output, size of workforce, size of capital and level of technology, c) Ownership of means of production by the direct producers. Petty commodity production (PCP) constitutes a distinct mode of production as compared to the main capitalist mode in LDCs. It can also be viewed as a transitional mode between the pre-capitalist and capitalist modes. Tension exists between these modes and a gradual transformation of PCP into the capitalist mode is ruled out. The relationship between them is a complex mechanism of conservation and dissolution. Because of the following factors, conservation becomes the dominant tendency in LDCs: 1. PCP cheapens worker's consumption and helps to increase surplus. 2. It also subsidizes the rural subsistence

economy. 3. It adopts a number of coping mechanism and does its utmost to survive. The coping strategies include use of family labour, reduction in 21 consumption, circulatory migration, engaging simultaneously in a number of income-earning activities, if possible, etc. 4. PCP prevents open unemployment from becoming very high and it enables the state to switch resources from providing social security. 5. To the extent PCP producer cheap, low quality goods with low incomeelasticity of demand, it occupies a non-competing domain from the capitalist mode and can co-exist with it. Petty commodity producers continue to exist but are unable to transform to themselves into capitalist entrepreneurs because: 1. Entry into their fields is easy and so they are subject to market-specific involution. 2. They are forced to go for mixed portfolios in order to minimize risk. So growth prospects become limited. 3. Technology is generally not neutral to scale; it has a bias against small producers. Once petty production becomes non-viable, it is attached to the capitalist mode in an explicitly subordinate manner. Putting out work, subcontracting, piecemeal contracts are manifestations of this subordination. They help the capitalist mode to reduce risk, gain flexibility and reduce its costs. Petty producers form only one part of IS. The rest comes from the industrial reserve army which comprises the unemployed, under-employed and the marginalized elements. The reserve army exerts a downward pressure on wages and 'curbs the pretensions' of labour (Marx)".

In Marxian analysis, both PCP and reserve army are integral parts of the capitalist system. Both help in the accumulation process. PCP allows large capitalists to lower their costs and to lower the cost of workers' consumption. The reserve army acts as a check on wage-workers in large enterprises and their wage fund. Because of the contribution to the accumulation process, IS does not disappear. Later, it expands in LDCs. Demographic response of the poor-high fertility to have more helping hands in the family-ensure continual growth of surplus labour pool and so of IS. IS is, therefore, a functional part of capitalism. Similar arguments have been made about the relation of women's economic role to capitalism. Women are a part of reserve army; they move in and out of labour force depending upon; the needs of capital. Secondly, since family survival is the compulsion behind them, women are forced to carry out a number of economic activities, whether home-based or otherwise, under conditions of absolute surplus extraction. Many of these activities are unremunerated or under-reported. Thirdly, through their unremunerated services and ability to stretch wages, housewives enable capital to pay lower wages than would otherwise be needed for the reproduction of labour power. The housewife's unpaid labour is transferred to capital as surplus. Because of this functional similarity, the association between IS and women is close and a majority of working women may be found in IS. Dependency theory, one strand within Marxian theory, views the problems of petty producers in IS as being those of LDCs in microcosm. It maintains that IS cannot develop its own logic of capital accumulation and growth as long as it coexists unequally with large scale capitalist enterprises. The same applies to LDCs as a whole which are a part of subordinate, peripheral capitalism, controlled by core capitalism. The core capitalist system retains the productivity gains accruing within it and also appropriates those that arise in the periphery. Profit maximization in the periphery requires wage minimization stating cheaper consumption of workers. In core capitalism, wage minimization turns out to be counter-productive.

To check the tendency of over-production, it is necessary to place more purchasing power in workers' hands and hence increase their wages. The marginality school in Marxian tradition attaches importance to the backwash effects of the capitalist development process-manifest in IS-which simultaneously gives rise to under-development. This comprehensive treatment remained outside the purview of mainstream economics and therefore the concept of IS, advocated by ILO, was hailed as an important addition to the development literature. Since many heterogeneous activities were bracketed together in IS, the concept meant many things to many people. Mazumdar (1975) saw it as an easy-entry, residual sector crowded with secondary workers having low productivity. It was thought that self-employment would be the dominant form of organization in IS. As a relic of pre-capitalist production relations, the underlying motive of IS activities was thought to be maximization of total income rather than profits. ILO saw IS in a more positive light. It looked at IS as a seedbed of native entrepreneurship. Self-sufficiency of this sector, following the low income-elasticity for its products, was noted. It was accordingly seen as a viable sector producing heap wage-goods. IS was also described as the employer of last resort and its contribution as safety net for the urban poor was emphasized. Rather, "they are in a continuously fluctuating state of interaction and parts of one sector may be dominated and created by parts of the other". (Bromley, 1970) Therefore, it is necessary to distinguish between the product market approach to IS (making it a cluster of micro-enterprises) and the labour market approach (IS as an aggregate of unprotected labour). In other words, both enterprises (including family-enterprises or households as producing units) and individuals are included in IS. The former may belong unambiguously to IS while individuals may combine formal and informal activities. Alternately, the distinction between producing units and labour units in IS needs constantly to be kept in mind. This is a very important point. In the product market approach, FS firms enjoy privileged access to credit, foreign exchange and tax concessions while the competitive advantage of IS firms lies in escaping taxation, social security levies and also such regulation as might exist about working conditions, wages and job security[^]". Critics of the concept of IS have pointed out that FS, IS classification is crude, over-simplistic and that reality in LDCs is too complicated to be explained by this new version of economic dualism. Till, date, ambiguity remains whether IS is an urban phenomenon or it also covers agriculture and the rural economy. One is therefore not clear as to what remains in the economy. One is therefore not clear as to what remains in the economy after counting FS and IS. Heather Joshi (1980) has mentioned the importance of dynamic relationships among three sectors, viz. FS, IS and the domestic sector. Unpaid labour, family labour and households as economic units would presumably be included in the domestic sector^{^^}. Martine Guerguil (1988) has, on the other hand, stressed the residual nature of IS but stated that domestic and criminal activities are not part of it. Latin American scholars have explored the association between informality and underground economy. Domestic work and home-based production are very much a part of IS according to many others. Upreti, H.C., (1992) has used a colour-code to distinguish among the following sectors: 1. White (formal) sector - private formal and state sector activities, 2. Mauve sector - small business and personal services operating on the fringe of the white sector, 3. Grey sector - 'self-provision household activities, moonlighting and the gift economy'. These activities, conducted on the fringe of legality. (The term 'grey segment' is being increasingly used today in industrial analysis. For example, one talks of the

grey end of the computer hardware and electronics industries. The grey end is inhabited by small firms which smuggle raw materials, which have very low overheads and which excel in reverse engineering.) 4. Black sector - all illegal activities. IS would be the total of mauve and grey sectors in this classification. Because of the heterogeneity of activities included in IS, characteristics which are used to define informality do not apply to all the activities. For instance, ease of entry is a foremost feature of informality and yet many informal activities (e.g. shoe-shining and even rag-picking at the lowest level of informal activities) may defy this feature. When diverse elements get clubbed together in one category, it becomes difficult to identify those parts which have some growth potential vis-a-vis those which face evolutionary prospects. Then there arises the danger of making wrong policy recommendations. Thus policies which are designed to help small enterprises will not necessarily help their wage workers. Policies which benefit wage workers in FS may harm the interests of casual/temporary workers, homebased workers, etc.. Independent manufacturing units in IS may not welcome the promotion of subcontracting links between formal and informal enterprises; 26 policies which help informal firms carrying on legal business may not help those carrying out illegal activities, etc. therefore a single policy prescription for IS is ruled out. IS is so large and diverse that a range of measures from direct assistance, incentives-rehabilitation and even persecution is called for. Castells and ports (1989) have talked of an informal economy, giving up any attempt to define and distinguish IS within an economy. Their focus is on unprotected labour or labour that is denied protection of either the State or 36 unions. Definition of Informal Sector: The above ambiguity is reflected in the various definitions of IS. Most of the definitions simultaneously emphasize a number of attributes of informality. Firm size, type of employment, technological competence, income level, capital employed and legal status are the oft-used criteria to delineate informal activities.

Among the many definitions that are around, the following stand out: The ILO-Kenya Mission stated the following features, making it clear that the degree of their application differed from activity to activity: a) No access or limited access to resources such as institutional credit, foreign technology, b) Small-scale operations, c) Ease of entry, d) Family ownership of enterprises, e) Competitive markets, f) Reliance of indigenous resources, g) Labour-intensive, adapted technology, h) Un-remunerated, invisible nature of activities 27 The features of FS were the obverse of IS activities. The definitions suggested at the 14th International Conference of Labour Statisticians, ILO (1987) distinguish between registered and unregistered units and the difference between the two boils down to scale of wage-employment, provision of social-security for wage-labourers and source of energy for the manufacturing process. Joshi and Joshi (1976) have emphasized three variables, viz. Relationship with government, market structure (whether competitive or not) and nature of technology for distinguishing IS activities¹⁴. Squire (1981) has given the most clear-cut definition of IS as a labour market phenomenon - IS is a sector in which return to labour is determined by the forces of demand and supply. Wages in FS are higher due to institutional factors such as a) Labour legislation stipulating minimum wage and working conditions, b) Trade unionism, c) Hire and wage policies of multinationals and public sector enterprises. It has been shown that the market also has a tendency to create clusters with more than the market-clearing wage. Efficiency wage concept, internal markets in large organization,

human capital attributes, different supply prices of temporary and permanent migrants and the different proportions in which they can possibly be used in small and large enterprises are the factors which give rise to this effect (Mazumdar, 1983)*. It is clear from the foregoing analysis that in the labour market approach IS comprises unprotected labour. This means that the following groups are included in it: a) Wage-workers in enterprises (even formal enterprises) whose employment is not protected by institutional and/ or market factors mentioned above. b) Own-account workers whose employment is not protected by the requirement of capital, skill and barriers to entry arising from organization, and c) Service-providers, e.g., domestic servants, cleaners, etc.

Conclusion:

The emergence of IS, in this approach, is fundamentally due to labour surplus in the economy. The important question, in this approach, is: what impact does unprotected labour have on market theories (or labour segmentation theories) take the position that barriers between FS and IS are strong and hence unprotected labour cannot affect protected labour. Skill-formation and productivity in FS insulate it from IS. The reserve army formulations is that protected and unprotected labour are linked together and the latter drives down the wage level of the former. It appears that the labour segmentation theories explain the short-run position but fail to take into account the wage-employment trade-off that is seen in FS. At the same time, mainstream economic theories do not accept the reserve army formulation. Their position is that IS does not enable capitalists to pay lower wages; there is no empirical support to such a relationship. Their argument is in fact, reverse, viz. IS enables labour to resist the low wage levels that would otherwise prevail, given the large labour surplus in LDCs. In other words, IS can be looked upon as an alternative to the direct exploitation of labour by capital.

References:

- Bargain Olivier, Kwenda Prudence. 2014. The informal sector wage gap: New evidence using quantile estimations on panel data. *Economic Development and Cultural Change* 63 (1): 117–53.
- Basole Amit, Basu Deepankar. 2011. Relations of production and modes of surplus extraction in India: part II—“informal” industry. *Economic and Political Weekly* 46 (15): 63–79.
- Basole Amit, Basu Deepankar. 2015. Fuelling calorie intake decline: Household-level evidence from rural India. *World Development* 68 (C): 82–95.
- Basu Deepankar, Das Debarshi. 2016. Employment elasticity in India and the United States, 1977–2011: A sectoral decomposition analysis. *Economic and Political Weekly* 51 (10): 43–53.
- Bernstein Henry. 2009. VI Lenin and AV Chayanov: Looking back, looking forward. *The Journal of Peasant Studies* 36 (1): 55–81.
- Bhaduri Amit. 2017. A study in development by dispossession. *Cambridge Journal of Economics* 42 (1): 19–31.
- Bhattacharya Rajesh. 2019. Labour beyond the labour market: Interrogating marginality. In *Workers and Margins: Grasping Erasures and Opportunities*, ed. Nimruji Jammulamadaka 45–62. Singapore: Palgrave Macmillan.

- Bhattacharya Rajesh, Bhattacharya Snehashish, Sanyal Kalyan. 2013. Dualism in the informal economy: Exploring the Indian informal manufacturing sector. In *Development and Sustainability: India in a Global Perspective*, eds. Sarmila Banerjee, Chakrabarti Anjan, 339–62. New Delhi: Springer.
- Bhattacharya Snehashish. 2017. Reproduction of noncapital: A Marxian perspective on the informal economy in India. In *Knowledge, Class, and Economics: Marxism without Guarantees*, eds. Burczak Theodore A., Garnett Robert F., McIntyre Richard, 346–58. New York and London: Routledge.
- Bhattacharya Snehashish, Kesar Surbhi. 2018. Possibilities of transformation: The informal sector in India. *Review of Radical Political Economics* 50 (4): 727–35.
