

An in-Depth Analysis of the Relevance of the Informal Sector of the Indian Economy on Wages and Income Levels of the Labour Market

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ABSTRACT

The informal sector in India is a huge alternative for the workforce looking for employment other than agriculture. This sector has several disadvantages concerning jobs and social security. This sector is vital in achieving high economic growth rates and other macroeconomic indicators. It becomes necessary for the government to provide schemes that would secure individuals working in this sector. The Modi government has constituted various schemes to this effect.

Keywords: Indian economy, Wages Labour market, Grey Economy, Employment, Social security Government schemes, Informality, Unorganised labour, Gender inequality, Gross Value Added (GVA), Demonetization, COVID-19 pandemic, Unemployment, Entrepreneurship, Manufacturing dualism, Wage disparity, Formal and informal sectors, Government policies, Pradhan Mantri Shram Yogi Maan-dhan, E-Shram Portal, Self-employment, Rural and urban employment, Tax bases, International Monetary Fund

Research Question: What is the role of the informal sector in India on wages? What is the extent of employment that it provides? Does it help in reducing unemployment in the economy? What are the reasons that have led to the growth of this sector? Has the Indian government made efforts to reduce the numbers in this sector? Why has the numbers increased in this sector in recent years? These and many such questions will be addressed in the course of this paper.

1. Introduction

Despite high economic growth during the past two decades, the informal economy in India still accounts for more than 80% of non-agricultural employment. Surprisingly informality is found in both the traditional informal sector but what is also happening simultaneously is the increasing informality in the formal sector. The Informal sector plays a crucial role in generating jobs and

absorbing semi-skilled and unskilled workers. This sector is also known as ‘The grey economy’. This is that part of an economy that is neither taxed nor monitored by any form of government. This makes up a significant portion of the economies in developing countries.

The informal economy sector in India is vital in the country’s employment place and is also the largest sector after agriculture. ”This sector not only offers employment to millions of persons in the country but also has a remarkable contribution to the Gross Value Added (GVA). Nonetheless, the informal sector remains most sensitive to market shocks including the demonetization in 2016, the implementation of GST in 2017 among other challenges and the current COVID-19 pandemic.

Figure 1 - Visual representation of the Informal sector in India



2. Definition

The Informal sector is the existence of the unorganised labour employment. This sector is not accountable in terms of revenue generation, sales, wages and taxation to the government. This sector does not come under any legal condition that has been laid down by the government. The activities that are conducted in this sector have a market value but need to be formally registered, they are difficult to measure as the participants in the Informal economy do not want to be accounted for.

In emerging economies like India ‘Informality’ is central to sustainable and inclusive development. This sector is critical to the rate at which a country grows, the extent of poverty and inequality as well as gender inequality.

Some individuals and firms operate informally by choice, but 85% of the employment in this sector is not through choice but due to the lack of opportunities in the formal sector.

Countries that have a large Informal sector tend to grow below their potential as these firms tend to remain small with low productivity and limited finance. As these firms do not contribute any taxes, they deprive the government of resources to provide basic services to the population.

Informal workers are likely to be poor and earn less than their counterparts in the formal sector. These workers lack social protection, and access to credit and are less educated and skilled.

2.1 Status of women in the Informal sector in India

Women in India are disproportionately in the Informal sector due to the number of challenges that they face. These can be listed as :

- **Types of jobs:** Women perform jobs like domestic work, street vending and subsistence farming
- **Vulnerability:** Women are vulnerable to exploitation and harassment. They often lack job security and benefits like paid leave and sick leave.
- **Location:** Women in rural areas are more likely to be in Informal employment than women in urban areas.
- **Agriculture:** $\frac{2}{3}$ of women workers in India are employed in agriculture which is vulnerable to uncertainties.
- **Self-employment:** Most women in the Informal sector are self-employed or work as daily wage earners.

According to ILO (International Labour Organization), women in the Informal sector earn 40 to 50% less than men in the same sector. 58% of the women employed in this sector are amongst the lowest paid category of informal employment. Within the informal economy,

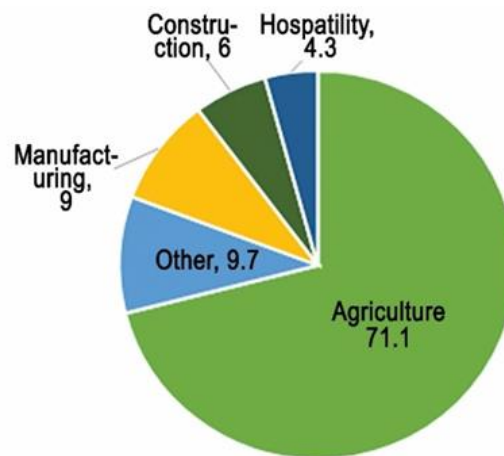
Unincorporated Sector Enterprises (USEs) play a pivotal role in providing employment opportunities for women. Women form approximately 26 % of the workforce in USEs, 31 % in OAEs (own account enterprises) and 17 % in HWEs (home-based work enterprises). Around 39.3% of females of the age group 15 to 59 years were in the labour force during 2021-22. This was an increase of 12.7% points from the year 2017-18. In urban areas around 26.5% of females were in the labour force during 2021-22 as compared to 22.3% in 2017-18.

Women are being employed in a few gendered, low-productivity sectors. (In agriculture and manufacturing they face limited advancement and in construction, they make up 12% of the workforce earning significantly less than men in unskilled roles. The concentration of female

workers in sectors such as ‘wearing apparel,’ ‘other retail trade,’ ‘education,’ and ‘manufacture of tobacco products’ highlights the gender segregation prevalent in the labour market, a pattern consistently observed in labour force surveys.

Although women make up a large proportion of the employees in most organisations, they own few of such ventures and thus the entrepreneurial ability of women in India has not been ignited.

Fig -2 (Percentage of women in the Informal sector of the Indian Economy)



3. Relevance of the Informal sector in India

Over 80% of India’s non - agricultural employment falls within the informal sector. This sector plays a crucial role in generating employment and absorbing semi-skilled and unskilled labour. As this sector does not provide employment security work security or social security, It becomes an easily accessible economy providing an opportunity to acquire skills and knowledge which could help these labourers to eventually transition to the formal economy.

The main characteristics of the Informal sector are:

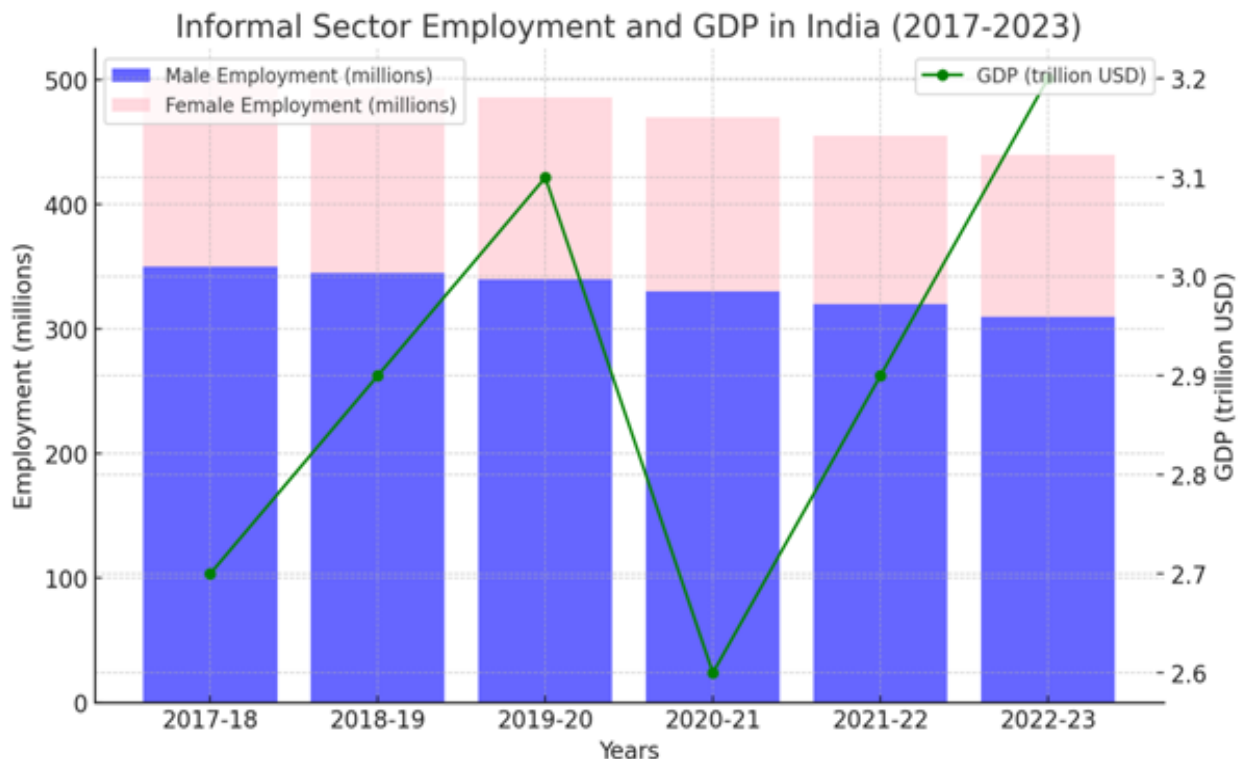
- Small Workplaces
- Unsafe and Unhygienic working conditions
- Low levels of skills and productivity
- Irregular Income
- Long working hours
- Lack of access to information, markets, finance, training and technology

This sector consists of all unincorporated private enterprises owned by individuals or households engaged in the sale and production of goods and services operated on a proprietary or partnership basis with less than 10 total workers. The relevance of this sector in India is that it plays an important role in the alleviation of urban poverty by creating jobs and reducing unemployment.

This sector has grown in importance since the liberalisation policies of 1990. Growing competition combined with increased market opportunities and limited resources have led to the emergence of an Informal economy. The predominance of the Informal sector has led to the benefits of economic growth being concentrated amongst a few. Informal workers can be defined as “Those working in the Informal sector or households excluding regular workers with social security benefits by the employers and the workers in the formal sector without any employment and social security benefits provided by the employers”.

4. Comparison between the employment in the Informal sector and GDP in India

GRAPH - 1: Informal sector employment and GDP



source: own source

Data collected from: pib.gov.in and wiego.org

Analysis :

- The above figure indicates that *informal employment* in 2017- 18 was 80% of the total employment of that year and amongst that 80% of it was driven by males and only 20% of females were employed in this sector.
- In the year 2022-23, informal employment was still high with the share of males increasing in some sectors and the share of females either remaining the same but not increasing.
- The figure above seems to indicate total employment till 2018-19 with the corresponding increase in GDP. Subsequently, with the onset of the pandemic, there was a decline in GDP figures and along with it a subsequent decrease in the total employment in the informal sector. It is quite apparent that the informal sector was the most affected during the pandemic with large periods of 'lockdown' that led to huge movement of migrant workers.

FIG-3 - IMAGE OF INDIAN WORKERS MIGRATING DURING THE PANDEMIC



Image source: CNN

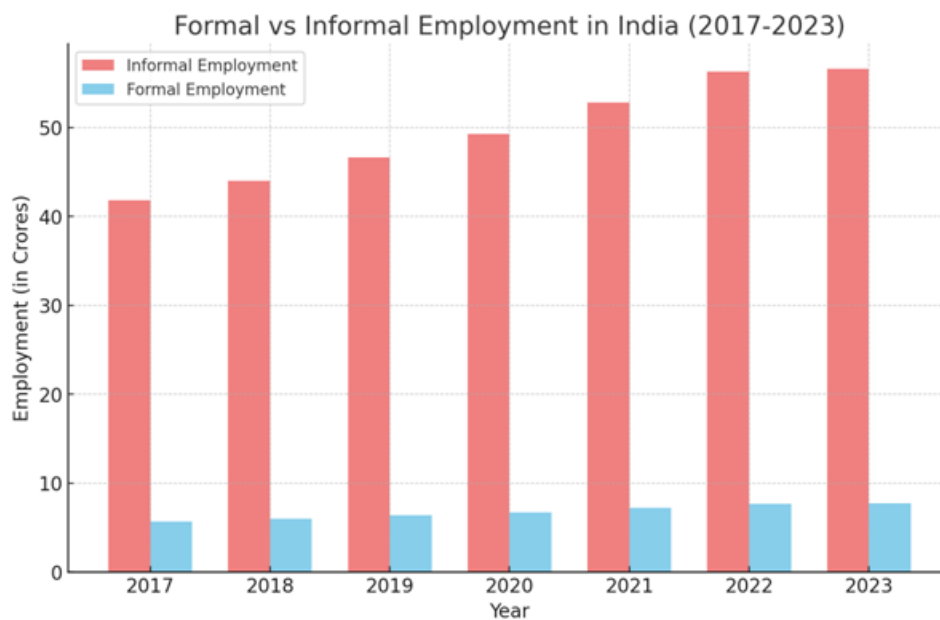
- As the pandemic was controlled the Indian economy started moving towards higher GDP levels with employment levels improving, in both formal and informal sectors.
- The levels in 2023 had still not reached the same status as in 2018-19 (before the pandemic) both in terms of GDP and level of employment.

GRAPH-2: INDIA'S GDP GROWTH (2017-23)



Source - own source (Data collected from: pib.gov.in and wiego.org)

GRAPH - 3: COMPARISON BETWEEN FORMAL AND INFORMAL EMPLOYMENT



Source: own source

The figures above clearly indicate the importance of the Informal sector in addressing the unemployment issues in the Indian economy.

The Lewis model (1954) states that as the economy develops there is a movement from a traditional agricultural economy to the manufacturing sector and then to the service sector has not been followed in India. A very large segment of the population has been unable to capture the benefits of economic growth as they were excluded from the formal capitalistic production distribution process leading to the dependence of this workforce on Informal economic activities. It is natural then to consider this sector from the point of view of the growth perspective of developing nations.

Evidence has indicated as in all the graphs posted above, that the growth of the Informal sector in India is expanding. This has led researchers and policymakers to take a serious interest in this sector and attempt to include it in all development schemes.

5. Factors leading to the growth of the informal economy

Informal firms are in developing economies because they are the primary means of employment and income generation for a huge section of the population. According to the International Labour Organisation (ILO - 2018) the informal sector accounts for 93% of the total employment in developing and emerging nations like India. The benefit of this sector is seen in the dualistic structure in India as well as the fast-growing Informal sector compared to the organised manufacturing sector (Kathuria et al - 2010). This has reduced regional imbalance by industrialising the rural regions and providing employment to low-income people. These are defined as unincorporated private enterprises owned by individuals or households engaged in the sales and production of goods and services operated on a proprietary or partnership basis with less than 10 workers. They are run on a smaller scale and are not registered with any authorities. The potential of this sector lies in the generation of employment, and entrepreneurship for women, youth and workers in vulnerable situations.

The factors responsible for increasing in formalisation are :

- Restrictive labour laws
- Illiteracy and poor skill levels
- Lack of an exit mechanism such as insolvency and bankruptcy laws
- Increasing competition from Imports
- Decline in formal employment opportunities

- Flexibility of employment
- Absence of trust in manufacturing
- Outsourcing
- Contractual services
- Growth of telecommunications and IT services
- Promotion of trade and foreign direct investment
- The predominance of the service sector led to growth

The dualistic view considers this sector as a refuge for the poor during the time of crisis. The structuralist view considers it as a subordinate to capitalism but it is essential for the continuation of the capitalist structure. The legalist view sees it as a response to excessive regulation and lack of property rights. The principle themes focus on understanding this sector concerning economic, institutional and social issues.

The term ‘ Informal’ was coined in the 1970’s. It was thought that as the economy grew and GDP per capita increased the share of the workforce in the formal sector would increase but what has happened is that there has been slow growth, slow economic reforms along changing patterns of production that have led to the development of the informal sector in developing countries. The activities of the Informal sector rarely comply with the official and administrative requirements and are thus not reflected in official statistics and neither are they covered by protective legislation or trade union organisation.

Whatever the definition, several sets of activities are difficult to capture in statistical surveys, due to their seasonal and temporal nature (construction sites, roadworks etc). In India, if home-based workers and street vendors (particularly women) in these sectors were adequately reflected in the official statistics, then the size and contribution would be even larger.

MANUFACTURING DUALISM (FORMAL AND INFORMAL SECTOR)

This sector has indicated the presence of ‘manufacturing dualism’ which is a large but less productive informal sector alongside a modern and more productive formal sector. The informality of a sector is from the ‘production’ point of view. The informal manufacturing sector in India is a traditional, non-capitalist segment that comprises family-based households. This exists side by side with a modern capitalist enterprise employing wage labour. Research has indicated that the average traditional (Informal) sector has been able to economically reproduce

itself rather than just wither away. The dualism between traditional and modern segments has been reproduced and reinforced during the decade of 2000, a period of high economic growth. Amongst the various reasons for the growth of this sector is likely to be completely voluntary on the path of traditional household enterprises to avoid various kinds of labour regulations. These enterprises would have had to abide by the government's regulations if their size exceeded a particular threshold. They would have to be legally bound to enforce various kinds of labour regulations and environmental regulations if they became a part of the modern manufacturing sector. This would increase the firm's business cost. For a large number of firms, there is a greater possibility that traditional firms voluntarily choose to remain 'Informal' so that they avoid regulations.

In the main period of the decade of 2000 when India experienced a fairly high continuous level of growth (2000-2001, 2005-2006, 2010-2011) the Informal enterprise as stated earlier accounted for 95-98% of the estimated population of unorganised enterprises.

Informal enterprises can be further divided into two types :

- Non-directory manufacturing enterprises (NDME) - employing one to five workers, along with at least one hired worker
- Directory manufacturing enterprises (DME) - employing six to nine workers with at least one hired worker

The main areas in which the traditional Informal enterprises seen to exist are :

- Manufacturing of wearing apparel, dressing and dyeing of fur
- Manufacturing of food products and beverages
- Manufacturing of tobacco products
- Manufacturing of textiles
- Manufacturing of wood and wood products of wood and cork except furniture
- Manufacture of articles of straw and plaiting materials
- Manufacturing of fabricated metal products except machinery and equipment
- Manufacturing of non-metallic mineral products

These 8 industries account for 90% of the Informal manufacturing sector. The wages of hired workers in these establishments as well as the average non-hired family labour are much higher

than in any other enterprise. A unique case is the tobacco industry where 70-80% of the informal tobacco manufacturing enterprises are sub-contracted enterprises. Structural factors such as caste and religion of the enterprise owner also affect the economic dynamics of enterprises.

Wage Levels in Formal vs. Informal Sectors (India) - 2018-2023 (Estimated)



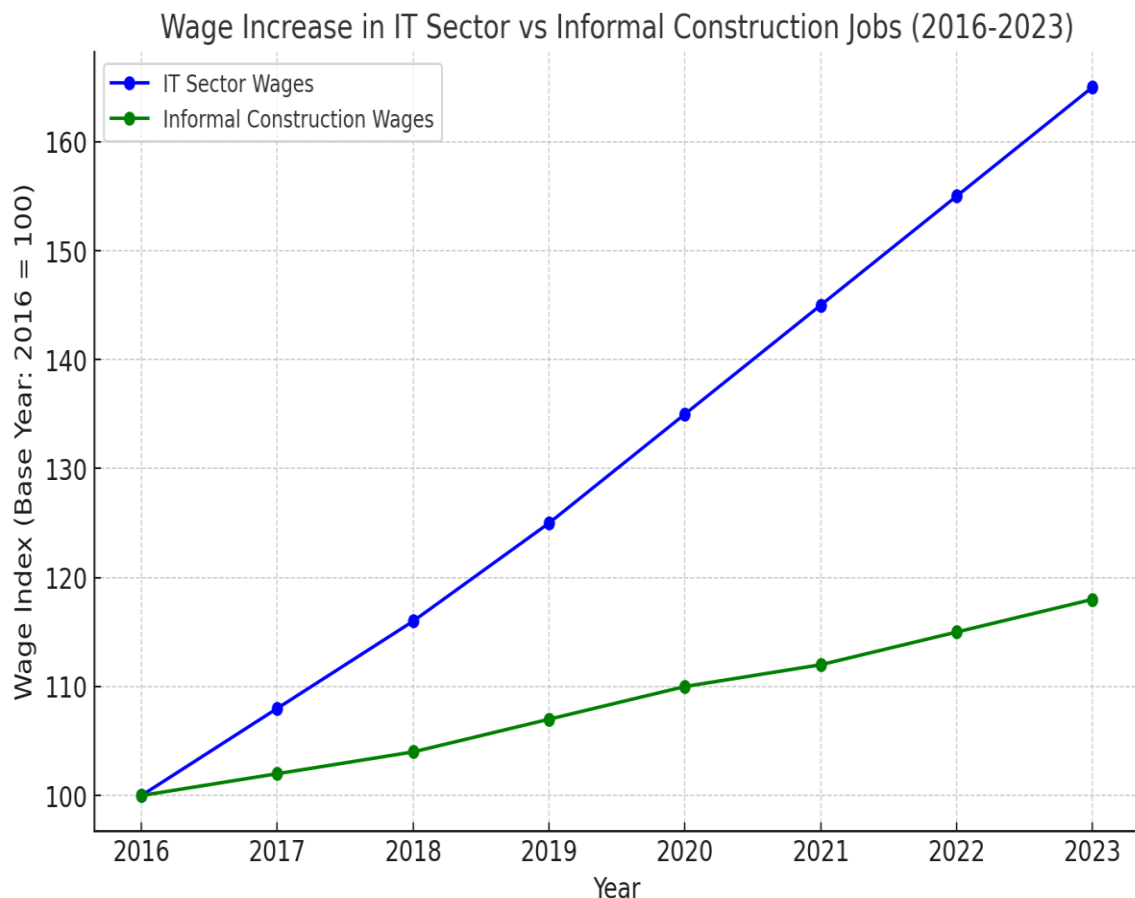
Source: own source

Data: imf.org and statista.com

In India, wage levels in the formal and informal sectors have demonstrated significant disparities over the last six years. The formal sector has seen steady wage growth, driven by regulatory frameworks, wage protections, and economic policies like minimum wage increases. In contrast, wages in the informal sector have remained relatively stagnant.

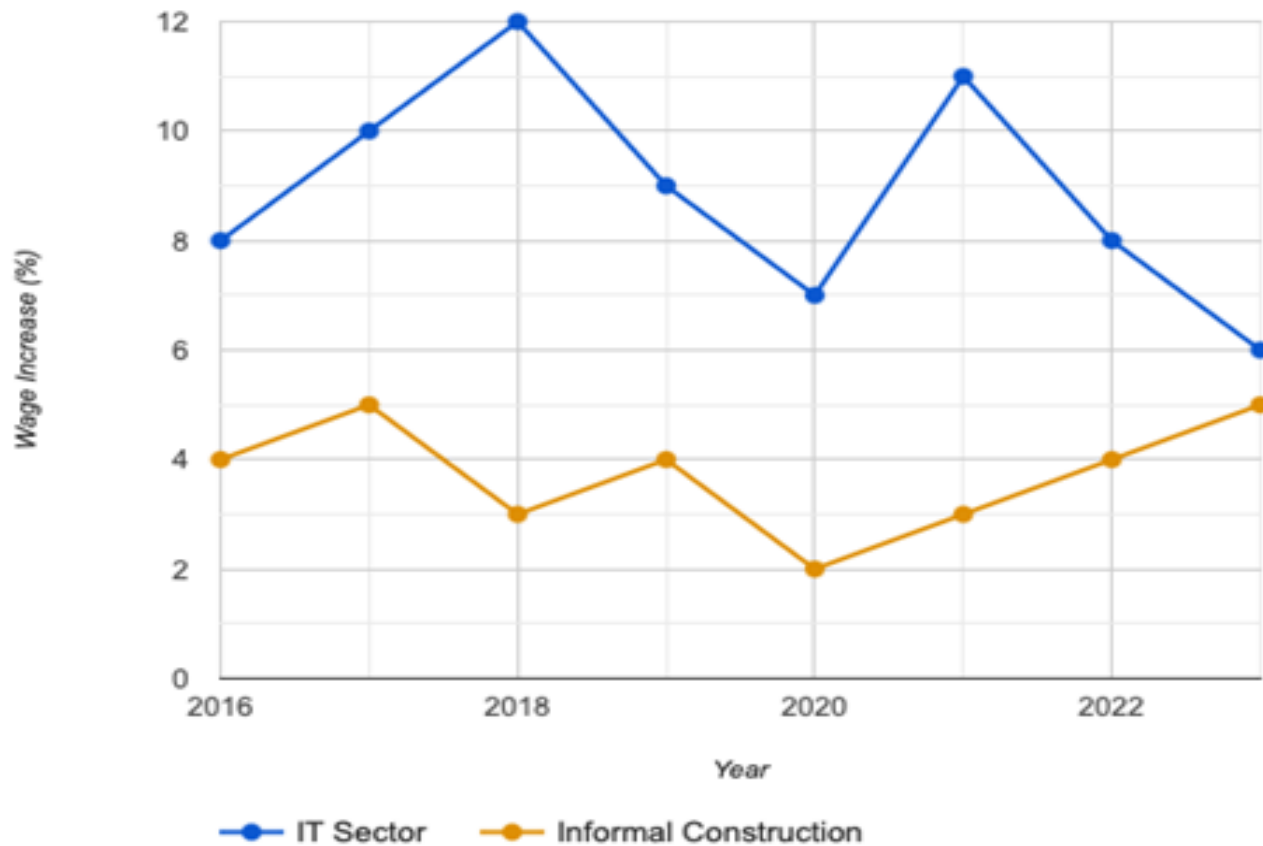
Wage Trends (2016-2022):

- **Formal Sector:** Workers in industries such as IT, finance, and the government sector have experienced wage increases of around 7-9% annually. Public sector employees and those in formal private sector jobs typically benefit from annual wage hikes and job security measures.
- **Informal Sector:** On the other hand, informal workers, particularly in agriculture, construction, and domestic work, continue to earn significantly less. Most informal workers earn between ₹10,000 and ₹15,000 per month, with limited growth over time. They also lack the benefits of healthcare, pensions, and paid leave that formal workers enjoy.



Source: own source
Data: imf.org and statista.com

Comparison of Wage Increase in IT and Informal Construction Jobs (India) 2016-2023



Source: own source

Data: imf.org and statista.com

Areas of Employment:

- **Formal Sector:** Includes higher-paying jobs in technology, banking, healthcare, manufacturing, and education. This sector is more prevalent in urban centres.
- **Informal Sector:** Comprises jobs in agriculture, street vending, construction, and small-scale industries. These workers are mostly found in rural and semi-urban areas, where informal employment accounts for over 80% of the workforce.

This wage disparity has persisted due to the larger size of the informal sector, which makes up over 90% of India's workforce.

6. Government policies formalising the Informal sector

The government of India has undertaken various initiatives in recent years to formalise the Indian economy. This includes the implementation of :

- Goods and services tax (GST)
- The digitisation of financial transactions
- Enrollment of Informal sector employees on government portals eg: E - Shram

It is important to formalise the Informal sector to increase the tax base which would lead to higher tax collection and thus a larger amount of revenue for the government to work on its various social obligations. Besides this, the informal sector does not always come under the ambit of law and more often than not they infringe on regulatory, labour market and product market obligations infringing on the quality of goods and services produced in the economy.

In India, the Informal sector produces almost half of the country's GDP and employs 90% of the workforce, despite this the formal sector outperforms the informal sector in terms of productivity.

The government of India has initiated several schemes in recent years:

- E Shram portals
- Labour courts
- Pradhan Mantri Shram Yogi Maan - dhan
- PM SVANidhi; Micro-credit scheme for street vendors
- Pradhan Mantri Kisan Samman Nidhi
- World Bank support to India's informal working class

The main issue of the informal sector in India is that there are no official statistics available that reflect the true state of the economy making it difficult for the government to formulate policies affecting the Informal sector.

The way ahead is to relax restrictions for Informal business conducts to pull Informal businesses and their employees into the fold of formality. A self-help group effort that gathers informal employees can help foster self-sufficiency and address concerns linked to their working conditions. To formalise the informal sector may be required that policymakers make informed

decisions for eg: vendors will be held more accountable for their space and surroundings if they have 'space vending rights'. The provision of vendor licences in exchange for fees is also projected to boost local government revenue. A portion of this revenue could be used for providing safe drinking water, restrooms and waste collection facilities in public places.

Grievances from Informal employees should be heard and resolved regularly through a transparent and officially regulated procedure. The government has initiated equal compensation for equal effort (Article 39 (d)) which states equality of wages imparted to labourers irrespective of gender but this is openly violated as women farm labourers earn much less than their male counterparts. Through appropriate legislative support, the government should enforce (Article 39 (d)).

7. Conclusion and the way ahead

The informal is an extremely important and relevant area that needs to be nurtured and developed for it to be one of the main engines of growth for developing economies like India. This sector has the ability and the capacity to enhance the growth potential of the economy and as well as provide opportunities to increase the income and standard of living of the workforce. The main problem for developing economies is finding gainful employment for the workforce in rural areas. It is the manufacturing sector that needs to provide gainful employment to this section. Most of these workers are employed in the manufacturing sector but they are employed 'Informally'. It is necessary to provide these individuals with jobs, health and social security. The Government is making a sincere effort in the provision of providing all of the above through schemes that they have initiated. Some of these schemes are *Pradhan Mantri Shram Yogi Maandhan (PM-SYM)*, *E-Shram Portal*, *PM SVANidhi* and *Entrepreneurship Development Programme (EDP)*. The above schemes will go a long way in the provision of employment opportunities for the informal sector. Besides providing these schemes the government of India has encouraged self-employment as a viable alternative in helping the country to achieve lower rates of unemployment.

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