

## The Informal Sector in India: A Means of Exploitation or Accumulation?

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### Abstract

*Is the informal sector in India a means of exploitation or a means of accumulation? One view takes the informal sector to be a site for primitive capital accumulation, with underpaid workers working in abysmal conditions. Another view takes the informal sector to be the venue for economic dynamism and entrepreneurial creativity. In this article, we evaluate these two views in relation to theories of the informal sector and empirical studies on India. We argue that both views have merit in the Indian context and accounts of the informal sector in India need to take into account the complexity and heterogeneity of production and labour relations that characterises the sector.*

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### CONTEXT

During the past several decades, several countries in the developing world have maintained much higher rates of economic growth that has been observed for some time. However, the high rates of economic growth do not seem to have led to high rates of employment growth, at least in the formal sectors of these economies. While employment in the formal sector has stagnated or at best, increased at a slow rate, the size of the informal sector in many developing countries has

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increased rapidly (ILO-WTO 2009). As the current global financial crisis leads to increased unemployment in the formal sectors of both developed and developing countries, the informal sector provides residual employment for many retrenched formal sector workers and allows for a much needed breathing space for the majority of workers in developing economies (ILO 2009). Perhaps more than ever, the importance of the informal sector as a source of jobs and a cushion for adverse economic shocks is realised by policymakers in many countries.

A conundrum that policymakers face in addressing the large presence of the informal sector in their countries is whether the objective of policy should be to reduce the size of informality in the economy and relocate as many workers as possible to the formal sector or should it be to promote the well-being of the informal sector and take steps to enhance its vitality and inherent dynamism. Underpinning this conundrum are two diametrically opposed views of the informal sector. One view takes the informal sector to be a means of exploitation—a site for primitive capital accumulation to take place, unfettered by the regulations and social norms of fairness governing pay and work conditions that are more at play in the formal sector. In such a view, workers in the informal sector are underpaid, do not have mechanisms for voicing their concerns to their employers and work in abysmal conditions. In such a view, the informal sector is inherently exploitative, and the goal of policy should be to bring in similar regulations and organisations for workers in the informal sector as are found to be present in the formal sector.

Another view takes the informal sector to be the venue for economic dynamism and Schumpeterian creativity where households and entrepreneurs make the long but necessary transition from the very small enterprises observed in the early stages of capitalism to the very large corporations that are omnipresent in late capitalism. In this view, any regulations or laws introduced by the state or an attempt to recreate the informal sector as a mirror reflection of the formal sector is merely going to weaken the creative energies of the informal sector and bring the growth of informal enterprises to a grinding halt. In such a view, the most important role that the state can play in encouraging the transition of firms from the informal to the formal sector is to leave the informal sector alone and to ease the laws and regulations that make the transition to the formal sector cumbersome and fraught with uncertainty.

Which view of the informal sector is correct? Is the informal sector a means of exploitation or accumulation? To answer this question, it is necessary to understand the conceptual underpinnings of these views, moulded as they are by two very distinct worldviews. It is also necessary to examine the extent to which these two views correspond with reality and with what we know about the actual functioning of the informal sector. In this article, which serves as an introduction to the special issue on the informal sector in India in this volume, we explore the theoretical underpinnings of ‘the informal sector as a means of exploitation’ and ‘the informal sector

as a means of accumulation' views. We also assess what we know about the actual functioning of the informal sector and how our understanding of the stylised facts of informality in developing countries may help us to address which view of the informal sector may be more consistent with facts. Our empirical context is India, where about 85 per cent of India's workers are in the informal sector, and where the debate on how policy should respond to pervasive informality in the economy has been stark and polarised (NCEUS 2006).

The rest of the article is in four sections. In the next section, we briefly discuss the main concepts and theories of the informal sector that have been prevalent in the literature. In the third section, we take these concepts and theories to the empirical context of India and critically evaluate these theories based on the findings of existing studies on the informal sector in India and our own observations. The fourth section provides an overview of the special issue, in relation to the main arguments of this article. The fifth section concludes the article.

## UNDERSTANDING THE INFORMAL SECTOR

Since the work of Hart (1973) and Harris and Todaro (1970), there has been a rich tradition in the social sciences in conceptualising informality in developing countries and theorising on its determinants. Theories of the informal sector can be broadly classified into five categories:<sup>1</sup>

### Classical/Marxian Approach

The Classical School does not recognise the informal sector as a separate entity in the process of economic development, and the sector was often seen to be a part of the larger pre-capitalist sector (which also includes feudalism and semi-feudalism). In the Marxist tradition, capital and labour are seen as separate, and there is no space for economic entities that cannot be seen as either capital or labour. However, as Sanyal (2007), Chatterjee (2008) and Sanyal and Bhattacharya (2009) argue, in many developing societies, the informal sector provides an 'economic space in which workers engage in economic activities in ways that are very different from the capitalist organisation of production. In particular, the prevalent form of labour in the informal sector is self-employment, which is different from the usual wage-based employment resting on the alienation of labour from capital' (Sanyal and Bhattacharya 2009: 35). Thus, with the process of globalisation and marketisation, 'the informal economy, that is, the economy of the "surplus" labour force, is a product of the process by which the capitalist economy secures its resources minus the people who traditionally survived on it' (Sanyal and Bhattacharya 2009: 37), a process which Sanyal (2007) refers to as 'exclusion'. The pressures of competition and globalisation lead to the integration of informal units to global or domestic

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capital via processes of subcontracting and putting-out, though these units inhabit a non-capitalist production space. Thus, in such a view of the informal economy, the relation of the informal sector to the formal sector via the coercion or compulsion of the market. A somewhat different view is provided by Adam and Harriss-White (2007) who note that 'informal accumulation and the emergence of extensive informal labour markets coexist with large economic spaces carved out and apparently well-preserved for rightless work and petty production, trade and services from which it is not possible to accumulate' (Adam and Harriss-White 2007: 18).<sup>2</sup>

#### Dualistic Approach

The concept of informality popularised by ILO (1972) and Hart (1973) did not take the informal sector as a necessary product of primitive accumulation but as a sign of underdevelopment. According to this approach, the informal sector is defined as a set of household and marginal activities that are distinct from formal units in terms of earnings, safety nets and (the absence of) rules and regulations. This sector existed because the modern sector had been either growing at a slow rate and/or unable to generate sufficient jobs opportunities for them. The appropriate policy response was to lift the units in the informal sector up to the formal sector, and allow them to grow over time. It therefore suggests that the informality is an exclusive issue of underdeveloped and developing economies.

#### Structuralist Approach

Moser (1978) and Castells and Portes (1989) believes that micro firms in the informal sector act as subordinated and specialised units of a formal sector unit and serve to reduce input and labour costs and by doing so, increase the competitiveness of large capitalist firms. This view also argues that small firms are more flexible, and thus better to engender and adopt innovations from geographically concentrated firms (Sebel and Zeitlin 1985). Therefore, in contrast to the dualistic approach, this approach takes informal sector firms as necessary in economic development and that the informal sector would need to coexist and be connected to the modern sector in every stage of development under different modes of production.

#### Legalist Approach

This approach argues that the rigid rules and regulations, terms and conditions for operating a unit in the formal sector are such that it creates an additional burden for them and hence force to bypass formal rules and regulations by operating in the informal sector. De Soto (1989) argues that the informal sector thrives in order to avoid the cost of formality in terms of stringent rules and regulation, taxes, time

and effort required for complying with formal procedures. Agenor (1996) further popularised this idea identifying these costs in Latin American countries. According to this approach, the issue of informality is no longer an exclusive problem of development, because the costs relating to regulation and enforcement are relevant issue for any countries, whether developed or developing. (Schneider and Enste [2000] estimate the size of informal sector [or the shadow economy] to be around 10 per cent even in well-developed countries in United States and Japan).

### Institutionalist Approach

This approach is founded on relational and organisational issues of any transaction. According to this approach, any type of economic transaction involves discovering efficient terms and conditions. But the parties engaged in economic transactions face 'hold up' problems in distributing ex post benefits from joint actions because of 'incompleteness' of contracts and 'opportunistic' behaviour of individuals engaged in contracts (Williamson 1985). The participation of third parties or legal institutions to enforce the terms and conditions is either costly or ineffective. Therefore, informal institutions such as norms and trust exist as a mechanism of governance and as a means of enforcement (North 1990; Ostrom 1990). Informality may therefore exist in any society, but is more likely to exist in a society where formal rules and regulations are not in place or are not well enforced. This view recognises that informal institutions are crucial in underpinning economic transactions in the early stages of economic development and act as substitutes for missing or ineffective formal institutions in many developing countries. Informality is seen here as a relation between economic agents (households or firms) and not as a characteristic of the agent (that is, an agent is considered to be in informal sector because of what it does in terms of its activities). In this sense, the Institutionalist approach has strong similarities with the Marxist approach, which takes informality as a relation between capitalist firms and the pre-capitalist entities.

While the above five approaches have very different starting points and theoretical building blocks, they broadly correspond to the two mutually exclusive and diagonally opposite views discussed earlier—informality as exploitation and informality as accumulation. The underlying vision of the Marxist and Dualistic and Structuralist Schools are that informality—whether understood as a relation or as a characteristic of the firm, sector or economy—is inherently exploitative. On the other hand, Legalist and Institutionalist Schools see the informal sector as inherently dynamic and a means of accumulation. The informal sector is a place where market activities can flourish unfettered by rules and regulations and outside the reach of the state (as in the Legalist School) or where informal relations develop both between different types of informal units and between informal and formal units as mechanisms of governance to handle increasingly complex economic exchange and production, and where these relations are ultimately efficiency enhancing

(as in the New Institutional School). In the next section, we look at the empirical evidence in India in support of these two views.

## THE INFORMAL SECTOR IN INDIA

Firms in India that hire more than 10 workers with power and 20 workers without power need to be registered under the Factory Act of 1948 and are considered to belong to the formal sector. The remaining firms are considered part of the unorganised or informal sector. The data on formal sector units in the manufacturing sector is collected by the Central Statistical Organisation, Government of India, and reported in the Annual Survey of Industries. The National Sample Survey Organisation (NSSO), Government of India, has undertaken surveys of informal/unorganised manufacturing for six five-year periods from 1978–79, with the last two rounds in 2000–01 and 2005–06. These surveys provide detailed information on organisational characteristics of informal unorganised sector units.

The Government of India appointed a National Commission for the Enterprises in the Unorganised Sector (NCEUS) in 2004 that has provided a comprehensive report on the informal sector in India. The following features of the informal sector in India, as based on the reports of the NCEUS, are worth highlighting: (i) the informal units typically operate at low level of organisation, with little or no division between labour and capital as factors of production and on a small scale, (ii) units are largely household enterprises and labour relations, if it exists, are based mostly on casual employment, kinship or personal or social relations rather than contractual arrangements with formal guarantees, (iii) for most enterprises, no complete sets of accounts are available, (iv) owners of their production units mobilise finance for working capital needs and investment at their own risk and are personally liable, without limit, for any debts or obligations incurred in the production process, (v) expenditure for production is often indistinguishable from household expenditure (NCEUS 2006). According to the NSSO Survey of 1999–2000, more than 92 per cent of total workforces in the country were employed in the informal sector. The contribution of the sector to the net domestic product and its share in the total NDP at current prices has been over 60 per cent.

There has been a resurgence of interest in the informal sector since the early 1990s, following the significant economic reforms of 1991. Economic liberalisation involves the withdrawal of the state in most production activities and the reduction of the regulation and restrictions on economic activities in the formal sector. Did the economic reforms lead to a reduction in the size of the informal sector as the costs of formality decreased with reforms? Or, did the process of globalisation that accompanied the reforms lead to further expansion of the informal sector, with greater outsourcing of formal sector activities to the low cost and unregulated informal sector? We summarise the existing literature on the Indian informal sector and see how they may help us in addressing the central question of this article.

### The Informal Sector as a Means of Exploitation

Informality in India is often viewed within a continuum of an exploitative capitalist system (Breman 1985). According to this view, informality has intensified because of economic liberalisation and the 'jobless growth' phenomenon in the Indian formal sector (Ghose 1994; Nagaraj 2004). The easy availability of capital, technological change biased towards skilled labour and capital and dependence on foreign markets as well as high-income earners in the domestic market have been considered the reasons why formal firms have moved to more capital-intensive methods of production, leading to jobless growth in Indian manufacturing. Thus, a large production unit in the formal sector not only replaces labour by capital but also does not offer any room to the petty and informal producer to compete with them via the use of technology and access to cheap credit. An interesting study by Kiso (2008), based on three different rounds of survey among the same set of working population in Ahmedabad, finds that there was a slow growth of employment rate in organised sector in the city due to the downturn of the textile sector under intensive international competition during 1990–2006. Job losses along with the lack of chance of obtaining formal jobs, absence of income of other dependent family members, and lack of savings and unavailability of formal loans, force textile workers to look for alternative avenues of income in the informal sector.

Khasnabis and Nag (2001) find that there is vertical separation in the labour process of the handloom industry during the post-reform period and identify this factor as a principle reason for de-skilling of labour. In a similar fashion, Sanyal (2007) and Chatterjee (2008) argue that the expansion of informal sector has been the inevitable result of economic transformation in India, which has been based on primitive accumulation, where the informal sector has been the source of capital for the formal sector. Social exclusion, driven by gender, race and caste based discrimination has also contributed to the informalisation of the economy (Harriss-White 2002).

### The Informal Sector as a Means of Accumulation

In contrast, others have believed that it is not economic reform, but rather protective trade and industrial policies, along with rules and regulations that have led to labour market rigidity and the attractiveness of the shadow economy for entrepreneurs that has contributed to the growth of the informal sector in India. In particular, Indian labour legislation such as the Industrial Disputes Act (1947) ensured that entrepreneurs were regulated by labour laws, minimum wage acts and trade union laws in order to protect workers from serious exploitation (Anant et al. 2006). Although the Act does not prohibit layoffs and retrenchments, governments have often been unwilling to grant permission to retrench (Datta-Chaudhuri and Bhattacharjee 1994). It is argued that these interventions by the state created a strong disincentive

to hire (additional) workers, and substitute (abundant) labour with (scarce) capital, thereby leading to weak employment growth. Similar arguments have been made for other elements of labour regulations, including specific provisions of the Industrial Employment Act (1946) and the Trade Union Act (TUA) (1926).<sup>3</sup> In support of these observations, it is argued that the Indian states who have amended labour legislations in favour of employers have grown faster than other states and have been able to take advantage of the export opportunities brought about by the liberalised trade regime and the delicensing of industries (Aghion et al. 2008; Besley and Burgess 2004; Hasan et al. 2007). In our own work, we have found that industries based in states with more pro-worker labour laws or where formal sector workers have stronger bargaining power have tended to use more contract workers, leading a phenomenon of growing informalisation of formal labour markets (Sen et al. 2010).

Studies that document the performance of the informal sector in the post-reform period find a mixed outcome—while there is evidence of declining productivity in this sector, many informal units in manufacturing have become more capital intensive over time (Kathuria et al. 2010). We do not know enough about the characteristics and productive potential of the informal sector, especially in manufacturing and services, and there needs to be more systematic work investigating the determinants and consequences of informalisation in the Indian context. Whether the informal sector can be a source of robust and productivity driven employment growth in the future, in the face of weak employment growth in the formal manufacturing sector, is a question that remains to be answered (Mitra 1998).

Although most studies take informalisation to mean impoverishment, using NSS data, Marjit et al. (2009) demonstrate a sharp rise of informal wage of hired workers engaged in non-directory and directory enterprises in post-reform in India. The argument is that due to competitive pressures brought about by economic liberalisation, there has been a movement of capital from the formal to the informal sector. In a separate article, Marjit et al. (ibid.) show that poverty can go down even with the expansion of informal sector if wages in the informal sector increases with the increased movement of capital from the formal to the informal sector. In a field-level study, Maiti (2008) shows that with exposure of international trade, rural artisans are being tied with formal producers and traders in specialised production relations order to access markets outside their immediate location. This specialisation has helped the informal sector units to upgrade skills under tied relation to formal sector units.

The empirical observation that there are high rates of distress in the informal sector is not blamed on the market in this approach. Instead, non-economic factors, influenced by social, economic and political institutions, are considered responsible for the problems of the informal economy. For example, Sarkar (2006) attempts to understand the unusual stability of the Left Front government in West Bengal for more than three decades coupled with the stagnation in the economy. According



to him, the presence of informal political networks that were crucial in the day-to-day life of poor people was seen as being responsible for the unusual success story. Maiti and Marjit (2009) also support this observation and find a high correlation between political stagnation and the size of informal sector. In other words, formal sector growth is more likely in a state where there is intense political competition rather than a state with little political competition.

It is clear from the aforementioned discussion that there is no conclusive and unanimous understanding on whether exploitation or accumulation characterises informalisation in India. Given this ambiguity, it is difficult to conclude that the excessive regulation of the formal sector leads to an increase in the size of informality. Neither is it clear that the manner the state should view policies towards the informal sector is to bring about formal sector-like regulations and interventions to this sector. It can be argued that overzealous laws and regulations proposed by the NCEUS, for example, for informal units that employ wage labour (such as social security provisions for these units) can only discourage household enterprises to make the necessary transition to employ non-family labour, an essential first step to make the transition to the modern sector.

### **CONTENTS OF THIS SPECIAL ISSUE**

This special issue arose from a conference organised in the Institute of Economic Growth in July 2009 titled 'Informal Sector in South Asia: Organisational Dynamics, Institutional Determinants, Interlinkages and Development'. The conference was supported by the Improving Institutions for Pro-Poor Growth Research Programme Consortium. Each of the five articles addresses one or more issues highlighted in this article. The articles provide snapshots of current understanding of the informal sector in India. The first article, by Anushree Sinha, applies a CGE model to understand the macroeconomic implication of financial shocks on informal wage and employment and argues that the global slowdown can cause informal wages to decline, increasing wage and productivity inequalities between the formal and informal labour markets. The second article, by Partha Pratim Sahu, observes the increasing trend of subcontracting from the formal to the informal sector and analyses this phenomenon using secondary data. The article finds that subcontracting has not necessarily been welfare enhancing for informal units. The fourth article, by Jyotish Prakash Basu, also support the same story at a more disaggregated level based on field-based information on stages of marketing channels for potato cultivators in West Bengal. He shows that costs of intermediation via these channels consume a large share of the producer surplus, leaving a small amount for actual producers. The fifth article, by Minten et al., looks at marketing inefficiencies for the horticultural sector in Northern India, caused by widespread confusion on the roles between brokers and wholesalers. The last article, by Banerjee et al., which is based on a field survey, finds that political factors determine rural borrowing, highlighting the

role of political institutions in shaping informal economic institutions. In general, the five articles provide support for the 'informality as exploitation' view of the informal sector in India.

### CONCLUDING REMARKS

The informal sector in India has remained stubbornly large and shows no sign of decreasing in importance despite several years of economic reforms and high economic growth. The presence of such a large informal sector in India can be attributed to the processes of capitalist accumulation where the informal sector has been a source of economic surplus for capitalist firms. The abysmal working conditions of informal producers documented in the work of Jan Breman, for example, provide some validity to the Sanyal and Bhattacharya (2009) proposition that 'the social outcome of the exclusionary expansion of capital that relegates the victims of its expansion—dispossessed informal producers, the detritus of modern capitalism—to a non-capitalist outside, thus reproducing a basic fault line running through the economy' (Sanyal and Bhattacharya 2009: 38). There is little doubt that large segments of the Indian informal sector are in the wrong side of this fault line. However, as been pointed out by Bardhan (2009), informalisation as a means of exploitation is not consistent with the experience of other developing countries such as China and Vietnam, where a large labour-intensive outward oriented manufacturing sector flourished with increasing globalisation and marketisation of these countries. Neither is it consistent with empirical reality in India, where important sections of the informal sector have been found to be vibrant and related in synergistic and productive relations with formal sector units, as has been found by Maiti (2008). It is also true that the large size of the informal sector has been a consequence of 'inefficient' formal legal institutions that have only served to discourage formality and encourage informality in the Indian context. Thus, both the views highlighted in this article—informality as exploitation and informality as accumulation—have merit in the Indian context, and accounts of the informal sector in India need to take into account the complexity and heterogeneity of production and labour relations that characterises the sector. For the policymaker, there is no 'one size fits all' solution to the problem of pervasive informality in the Indian economy, and there needs to a fine balance between overregulation and underregulation of the informal sector.

### NOTES

1. See also ILO and WTO (2009) and ILO (2009).
2. See also Harriss-White (2002).
3. As per the Act, worker consent is required to modify job descriptions or move workers from one plant to another. While the goal of promoting worker consent is certainly an

important one, Anant (2000) argues that rigidities can creep in on account of how one defines or establishes worker consent. With the Trade Union Act allowing multiple unions within the same establishment and rivalries common across unions, the requirement of worker consent for enacting changes 'can become one of consensus amongst all unions and groups, [which is] a virtual impossibility'.

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