

# Possibilities of Transformation: Analyzing the Informal Sector in India

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## Abstract

*In the literature on economic development and modernization, it has been widely expected that with economic growth and a consequent increase in per capita income, the dualism between the 'traditional'/'pre-capitalist' and 'modern'/'capitalist' segments will wither away, leading to a structural transformation of the economy. In this paper I identify a basic dualism between capitalist and noncapitalist production structures within the vast informal manufacturing sector in India, and show that this dualism has been reproduced and reinforced during the past decade of high economic growth. Further, in terms of the shifts in the primary source of livelihood of households over this period, I do not find any marked tendency towards a full-fledged transformation along the expected lines. Rather, such shifts, wherever they have taken place, have been mostly of a perverse nature. This calls into question the imaginary of transition through capitalist growth that animates much of the discourse on economic development.*

## Executive Summary

### 1. Introduction

In the literature on economic development and modernization, following Lewis (1954), it has been widely expected that with economic growth and a consequent increase in per capita income, the dualism between 'traditional'/'pre-capitalist' and 'modern'/'capitalist' segments will wither away, leading to a structural transformation of the economy. The preponderance of a 'pre-capitalist'/'traditional' sector in an economy, marked by the existence of a large surplus labour force, has been generally seen as a manifestation of *underdevelopment*, and such an economy is expected to be transformed into a *developed* or 'advanced' capitalist economy through the process of economic growth. However, in India, in spite of more than two decades of sustained economic growth, about 93 percent of the total workforce and approximately 86 percent of the non-agricultural workforce continued to be employed in the informal economy in 2010-11 (the year for which latest data on the informal

sector is available), which is often characterized by low productive and unremunerative jobs that are mainly *traditional* in nature. Most informal enterprises in India are run by petty commodity producers without any hired labor, where the enterprises primarily operate as extensions of households, and, therefore, are seen to exhibit characteristics of the ‘traditional’/ ‘pre-capitalist’ sector (Moser, 1978; Harris-White, 2012).

Much of the contemporary mainstream development discourse that theorizes the informal economy from the *dualist* perspective sees the informal economy as a residual sector that absorbs the excess labour force in the economy, and expects that the existing dualism will be dissolved over time with faster economic growth. This view supports the ‘need’ for a transition towards a full-fledged formal/ ‘modern’ economy as the ideal path of development (Ranis and Stewart, 1999; Mandelman and Montes-Rojas, 2009; La Porta and Shleifer, 2014; ILO, 2015). On the other hand, another influential and competing perspective within the mainstream discourse sees the informal economy as inherently dynamic in nature, populated by risk taking and profit-maximizing enterprises that operate under the same economic logic as larger capitalist enterprises and that can act as the engines of overall economic growth. This strand views the self-employment in informal sector as the seedbed of modern capitalism in the Third World countries, thereby implicitly arguing that the issue of transformation is already resolved (De Soto, 1989; Maloney, 2004; Fajnzylber et al, 2006).

On the other hand, the radical discourse on economic development explains the continued persistence of the informal sector either in terms of a weakness of Third World capitalism that prevents it from completing the process of primitive accumulation by destroying the remnants of pre-capitalist economic structures, or in terms of functional relations of the informal sector with the formal capitalist sector, whereby it satisfies the ‘needs’ of capital by maintaining an industrial reserve army and by providing cheap inputs and wage goods to the formal sector (see Rakowski (ed.), 1994; Wilson, 1998; Tabak and

Crichlow (eds.), 2000; among others, for reviews of this literature). However, with a robust process of capitalist economic growth, the ‘traditional’ noncapitalist segment of the informal sector is expected to disappear over time.

Hence, the continued prevalence of the vast non-capitalist informal sector in India presents a conundrum, and shows that the ingrained dualism within the economy continues to persist in spite of the widespread celebration of capitalist growth. This raises questions about the nature of the recent capitalist development process in India in particular, and other similar labor-surplus developing economies in general. Providing an interesting point of departure, some of the recent development literature has raised concerns about a possible stalling of the transformation process across developing economies (Timmer & Akkus, 2008; DeVries et al, 2012). Specifically, in the Indian context, some recent works have argued that the contemporary growth process has been largely exclusionary, which has left out a major part of the workforce outside the dynamics of transformation, thereby raising questions about the *possibility* of a full-fledged economic transformation in India with growth (Sanyal, 2007; Bhaduri, 2017).

However, a detailed analysis along with a careful empirical investigation about the nature of evolution of the structure of economic dualism in India during the recent period of high growth has been largely missing in the literature. In this work I aim to address this issue and to link this evolution to the process of structural transformation, thereby attempting to elucidate the contradictory nature of capitalist development and transition in India since 2000.

The analysis is broadly divided into two parts. In the first part (Section 2), I analyse the evolution of the Indian informal manufacturing sector (IMS) – manufacturing sector has been traditionally expected to be the driver of the transformation process in the development

discourse – in order to investigate whether there has been a marked tendency among the ‘traditional’/‘noncapitalist’ IMS enterprises for a transition towards ‘modern’/‘capitalist’ ones during the recent decade of high economic growth.<sup>1</sup> However, in addition to a transition of ‘non-capitalist’ enterprises into ‘capitalist’ ones, transformation of the economic structure also entails a simultaneous transition of the workforce towards formal employment, with the formal sector emerging as the primary source of income generation and livelihood for individuals and households. Therefore, in the second part (Section 3), I extend the analysis beyond the enterprise-level analysis of the manufacturing sector and explore across the economy the nature of transition of *households* from the informal to the formal sector (in terms of their primary source of livelihood) during the past decade.<sup>2</sup>

## 2. Informal enterprises

In this part, I use firm-level data from three rounds of surveys of the IMS by the National Sample Survey Organisation (NSSO) covering the period 2000-01 to 2010-11 (56<sup>th</sup> round for 2000-01, 62<sup>nd</sup> round for 2005-06, and 67<sup>th</sup> round for 2010-11). I analyze the possibility of the own account manufacturing enterprises (OAMEs), i.e., noncapitalist enterprises marked by an absence of capital-wage labor relations where petty producers carry out production using family labor, to grow into establishments, i.e., the relatively larger, dynamic informal enterprises that employ hired workers, over the decade. The OAMEs constitute an overwhelming majority – approximately 85 percent – of the IMS enterprises. In order to capture the transformational possibilities, I construct a variable, the net accumulation

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<sup>1</sup> I restrict my enterprise-level analysis to the IMS also because nationally representative data of informal sector enterprises covering the entire last decade is available only for the manufacturing sector.

<sup>2</sup> The analysis of the IMS in the first part covers the entire last decade from 2000-01 to 2010-11. However, the enterprise-level data is available only as repeated cross-sections and not as a panel and, therefore, does not allow to track same firms over time. For the second part, while it is possible to track the same households over time given the panel nature of the data, the dataset covers the period 2005-2012.

fund (NAF), which is the retained earning of an enterprise that can be used for accumulation and expanded reproduction of the enterprise. The evolution of the NAF is explored with respect to the following sets of enterprise characteristics – *spatial-typological*, *socio-economic*, and indicators of ‘*modernity*’. I find that there is a stark difference in the average NAF retained by the OAMEs and that by the establishments and this gap has widened over the decade of economic growth. Moreover, while the average NAF retained by enterprises exhibiting ‘favourable’ set of characteristics has been increasingly higher than those which exhibit ‘unfavourable’ characteristics, a very small proportion of the OAMEs and a much larger proportion of the establishments exhibit these relatively ‘favourable’ characteristics. There seems to exist a stark dichotomy between a very small proportion of enterprises in the IMS – mostly establishments – that are dynamic and may act as an engine of growth, and the vast majority that are not able to retain any significant NAF – mostly the noncapitalist OAMEs. This finding holds for across the NAF distribution, as well as for a cohort-level analysis over the decade. This structure of dualism has not only remained intact, but rather seems to have been reinforced and further entrenched over the decade.

It has been argued in the literature (e.g., Ranis and Stewart, 1999) that development of subcontracting linkages can act as a possible channel to facilitate the process of economic transformation. So, I further analyze the impact of subcontracting linkages on the possibilities of transition of the noncapitalist OAMEs into larger and more dynamic enterprises over this period. We use an endogenous dummy variable model to find that, over the decade, the impact of subcontracting linkages on the possibility of these OAMEs to accumulate and grow has been largely negative. We also find that a dominant characteristic of such linkages has been the lack of autonomy and high dependence of the subcontracted enterprises on the parent firms. Most of the subcontracted OAMEs receive all their inputs from the parent firms and supply their entire output back to them, which is akin to a *putting out* system. Almost

three-fourth of the subcontracted OAMEs in the Indian IMS exhibits this kind of linkages, making them mere appendages of the parent firms. Such enterprises have retained a significantly lower amount of NAF compared to the non-subcontracted and relatively autonomous subcontracted (non put-out) enterprises. The prevailing nature of the subcontracting linkages and their impact on the ‘traditional’ enterprises raise doubts about the role of such linkages in facilitating an economic transformation in the IMS.

Thus the analysis in this section does not find any tendency towards a dissolution of the dualist structure within the IMS during the past decade of high economic growth. In the next section, in order to extend the analysis across the economy and to investigate the overall process of structural transformation, I take up the issue of transition of households across the sectors in terms of their primary sources of livelihood.

### 3. Households

For this purpose, I use the India Human Development Survey (IHDS) data, the only India-wide representative *panel* data set covering the period 2005 – 2012 over two rounds of survey. I analyse a balanced panel of 40018 households provided in the sample. In order to explore transitions across sectors, I categorise the surveyed households into five sectors based on their primary source of income: agriculture sector, agriculture (informal) wage labour (AWL), non-agricultural (informal) wage labour (NAWL), unorganised/informal (self employed) sector, and organised (formal) sector.

I find from the analysis that over this period there have been various transitions across these five sectors in the Indian economy. However, the most immobile/stationary category in the rural areas is the agriculture sector and that in the urban areas is organised/formal sector, i.e., these sectors had the highest proportion of households that did not transition to any other sector over this period. On the other hand, the most mobile/non-stationary category has been the unorganised/informal (self employed) sector in both rural as well as urban areas. I find

that of all the households that transitioned out of the unorganised sector over this period, the highest proportion moved toward the non-agricultural (informal) wage labour (NAWL) and lowest towards organised/formal sector. Moreover, among all the households that transitioned towards the unorganised sector, the highest proportion came from the organised sector. There has also been an overall rise in the proportion of unorganised and NAWL households. Further, I find that the proportion of formal sector households transitioning towards informality (either as informal self-employed or as NAWL) and the proportion of informal self-employed households transitioning towards NAWL has been relatively much higher than the corresponding reverse transitions.

Using a multinomial logit model, I find that these sectors are segmented along the lines of various household characteristics. The pattern of transition is largely dependent on certain household characteristics, particularly the level of education and the social caste to which the households belong. For example, household in the unorganised sector with higher level of education are more likely to transition to organised sector, whereas the households in the organised sector with a lower is education level are more likely to transition towards unorganised and NAWL sectors. Further, the mobility of a household is also very significantly dependent on the social caste of the household, which is a structural characteristic that cannot be altered or ‘optimally chosen’ – implying that simply increasing education might not lead to a transition towards formality. Overall, I find that there is a higher ability of households with more ‘favourable’ characteristics to transition towards formal sector, highlighting a segmentation between formal an informal sector along lines of household characteristics. The segmentation is not limited to the formal – informal dichotomy; rather there is also a segmentation within the informal sector between informal self employed and the informal wage workers.

Subsequently, I analyse whether the above transitions are likely to be a ‘voluntary’ choice on the part of the households (as some have argued, e.g., Maloney, 2004; Fajnzylber et al, 2006), – or if such transitions are likely to be ‘favourable’– conditional on their economic and social characteristics. Measuring the well being or economic performance of a household in terms of its consumption per capita, I calculate the average ‘actual’ consumption per capita of the households that *have* transitioned, and compare it with a ‘counterfactual’ average consumption per capita that the household would have had if it had not transitioned. I find that the transitions out of formal/organised sector towards all other sectors (unorganised, NAWL, etc), on an average, is a worse/unfavourable transition, in terms of the well being of the households measured by consumption per capita, even after controlling for the household characteristics. On the other hand, a movement from unorganised to organised sector as well as from NAWL towards both unorganised and organised sectors are favourable transitions, whereas a transition from unorganised to NAWL (informal wage labour) is unfavorable.

Overall, I find that a distressed movement of workers out of the agriculture sector coupled with a retrenchment of formal sector workers over the last couple of decades in India resulted in an increased dependence of the working population on informal economy as an important source of livelihood. In addition, I find that while there has been a continued reproduction of the informal self-employed households, with a rise in the proportion of such households over time, a significant proportion of such households have also transitioned towards informal wage labour (NAWL). While some households did transition from informality (informal self employed as well as informal wage labour) towards formality during this period, this was accompanied by simultaneous and rather magnified reverse transitions. Taken together, the structure of the Indian economy does not seem to have shown any marked tendency towards a transformation along the expected lines; rather, transformations, wherever they have taken place, have been mostly of a perverse nature.

#### 4. Implications

There has been an expectation in the discourse on capitalist development that economic growth will bring about a transformation of the structures and relations of production as well as that of the labour process along the lines of a capitalist transition. This analysis, however, shows a rather muddled picture for the Indian economy over the past decade of high economic growth. Given that a vast part of the informal sector is comprised of non-capitalist family based petty producers, a transition of the households from the formal sector towards informal self employment indicates a reproduction of the space of non-capital. From the enterprise-level analysis, I find that such petty production units can reproduce themselves precariously without much possibility of expanded reproduction and growth. Those who are unable to reproduce their conditions of livelihood as non-capitalist petty producers, as well as the workers retrenched from the formal sector, seem to transition (downwards) towards informal wage labour. Overall, I find that the expectation that with economic growth capitalist production processes and relations will pervade the entire economy does not seem to have actualised.

The analysis presented in this work finds supports for the strand of interventions initiated by Sanyal (2007) to theorize the process of postcolonial capitalist development.<sup>3</sup> The process of primitive accumulation brought about by capitalist growth dissociates the direct producers from their means of production, but, given the exclusionary nature of the growth process, the dispossessed pre-capitalist producers do not find employment within the formal capitalist sector as wage workers. They become a part of the *surplus population* that is not directly functional to the 'needs' of capital. While a part of this population constitutes the industrial reserve army that is functional to the process of capitalist accumulation, it can be

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<sup>3</sup> See Bhattacharya (2017), Bhaduri (2017), Chakrabarti (2016), and Bhattacharya et al (2013) for recent engagements with Sanyal (2007).

argued that a vast majority of this group is not necessary for this process in any meaningful way. The noncapitalist segment of the informal economy provides a 'sink' for this surplus population, where they can strenuously earn a basic livelihood as petty commodity producers working on a thin resource base, thereby exonerating capital from the responsibility providing employment to the majority of working population. In this sense, the process of capitalist growth *reproduces* the space of *non-capital*, which it was originally expected to dissolve. Hence, the much-anticipated 'full-fledged' capitalist transition, when capitalist production processes and relations pervade every site within the economy, is not actualized. Therefore, the reproduction of economic dualism can be argued to be a result of the capitalist development process itself, raising questions about the process of transition.

However, I find that in addition to the reproduction of this space of non-capital, those unable to reproduce themselves in this space transition towards informal wage labour. We find a large floating population that is always in a flux – either as 'footloose' labour, which is moving between sectors and occupations in search of livelihood and cannot find a firm grounding anywhere, or as those reproducing their conditions of livelihood precariously – and sporadically – at the margins in the spaces of non-capital. Thus, the economic spaces of the noncapitalist petty producers and the floating, footloose wage labor are often not quite distinct, segmented, or well-delineated. A reproduction and entrenchment of this structure over the past decade of high economic growth thereby calls into question the imaginary of transition through the process of capitalist development that animates much of the discourse on economic development.

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