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FORMAL AND INFORMAL SECTOR IN INDIA

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ABSTRACT

On the basis of employment conditions, activities in the economy are classified as formal and informal. The formal sector covers those enterprises of work where the terms of employment are regular and where people have assured employment. It is registered, follows government rules and regulations, and has employees and employers union. It is called formal as it has some formal processes and procedures. The formal sector offers job security, paid holidays, pensions, health, fixed working hours, extra pay for overtime work, medical and other allowances, gratuity, superannuation, provident fund, and various other benefits. The concept of the 'informal sector' was first used by Keith Hart in his study of Accra (Ghana) in 1971. Starting from a primarily urban perspective, the concept is now being used in relation to an entire economy. Gradually, the informal sector is considered as a sub-set of the unorganised sector. The informal sector is marked by low wages and lack of job security. There is some sort of linkage between formal and informal sector with the movement of workers not only between the informal and formal sectors, but also between formal and informal employment. This paper attempts to explore this linkage. Formal and informal sector have also been investigated it is seen that the informal employment increases overtime along with the estimated population and labour force, while the formal employment decreases in recent years. About 24 million people are formally employed in 1983 which marginally rose to about 25 million in a period of five years i.e. in 1988. The trend continues until 1999-2000 when it reached a level of 35 million. But this growth cannot be sustained for long and finally dips to 34 million in 2004-05. The level of informal employment was around 278 million in 1983 which rose to 422 million in 2004-05 which is quite natural for a developing country like India. It has been found that the share of formal and informal employment in total employment have shown little fluctuating trend and almost remained static. As far as the number of Informal and formal workers by sector and sex is concerned about 95 percent of rural workers are informal workers. As per 2004-05 Employment-Unemployment Survey about 98 percent of female workers are informal worker. In urban areas also the share of female informal workers is higher than male. Rural sector contributes 78 percent of informal workers to total informal workers. Moreover, it was observed that the share of female workers in the formal sector increase over the years but in case of informal workers across all population segment the share of informal workers increased between 1999-00 and 2004-05.

We utilize the information on distribution of workers by type of employment and sector for the purpose of establishing a linkage between formal and informal sector. It has been found that more than 99 percent of informal sector workers are informal workers and less than half percent of informal sector workers are formal workers in 1999-00 and 2004-05. Again, only 62 percent of formal sector workers are formal workers and rest 38 percent workers are informal in nature in 1999-00. This type of inter linkage between these two sectors can also be noticed in 2004-05 as only 53 percent of formal sector workers are formal workers and rest 47 percent workers are informal in nature in 2004-05. It appears from the table that a large number of workers working in the formal sector by enterprise characteristics but their jobs are informal in nature. They did not have any social security, job security and other benefits which the regular wage employees get in the formal sector. The above analysis establishes a sort of linkage between formal and informal sector as far as type of employment is concerned.

KEYWORDS: job security, consumption, employment, economy, workers

I. INTRODUCTION

On the basis of employment conditions, activities in the economy are classified as formal and informal. The formal sector offers job security and employment benefits, while the informal sector is marked by low wages and lack of job security. Since the concept of the 'informal sector' was first used by Keith Hart in his study of Accra (Ghana) in 1971 (Hart, 1973), it is experiencing a continuous shift in the scope ranging from an independent subject of study to its being an integral part of the economy with linkages and interdependence with the formal sector (Jolly, 2006). This linkage between formal and informal sector becomes more vivid with the movement of workers not only between the informal and formal sectors, but also between formal and informal employment. Several schools of thought have developed regarding the formal and informal sectors' relationship. According to first school, informal sector is an autonomous segment of the economy producing mainly for consumption within the sector. The second school believes that the informal sector has a dependent relationship with the formal sector and is exploited by the formal sector. According to the third school, the informal sector is integrated with the rest of the economy through complementary linkages (ILO, 1991, pp. 5). In this paper we make an attempt to establish a linkage between formal and informal sector with the help of data on distribution of workers by type of employment and sector by cross tabulating informal sector workers and informal workers and also formal sector workers and formal workers for 1999-2000 and 2004-05.

The paper is organised into four sections starting with the introductory section. The next section is on conceptual framework which throws light on formal, informal sector and also on formal-informal linkage. The third section illustrates the data source for the study. The fourth section is on analysis and findings. In this section an attempt has been made to establish the linkage between formal and informal sector. The last section is that of conclusion.

II. CONCEPTUAL FRAMEWORK

1. Formal Sector:-

The formal sector covers those enterprises of work where the terms of employment are regular and where people have assured employment. It is registered, follows government rules and regulations, and has employees and employers union. It is called formal as it has some formal processes and procedures. The formal sector offers job security, paid holidays, pensions, health, fixed working hours, extra pay for overtime work, medical and other allowances, gratuity, superannuation, provident fund, and various other benefits. Thus, the formal sector consists of the businesses, enterprises and economic activities that

are monitored, protected and taxed by the government.

2. Informal sector:-

Since the concept of the 'informal sector' was first used by Keith Hart in his study of Accra (Ghana) in 1971, a plethora of studies have been undertaken, attempting its definition and interpretation. Starting from a primarily urban perspective, the concept is now being used in relation to an entire economy. The concept of informal sector has undergone various changes. Some of the definitional points are outlined below.

i. International Definition:-

As per System of National Accounts (1993), the informal sector consists of units engaged in the production of goods or services with the primary objective of generating employment and income to the persons concerned. These units typically operate at a low level of organization, with little or no division between labour and capital as factors of production and on a small scale.

ii. Definitions used in India :-

In India, the term 'informal sector' has never been used either in official statistics or in National Accounts Statistics (NAS) until 1999-2000. The Indian National Accounts Statistics from the very beginning used the terms 'organised' and 'unorganised' sector from the point of view of collection of statistics. But researchers often used the term 'unorganised' and 'informal' interchangeably. In reality, though the terms are quite similar to each other, they are not truly identical (Papola, 1981). The Central Statistical Organisation maintains that the unorganised sector comprises —all unincorporated enterprises and household industries — other than organised ones — and which are not regulated by any of the acts and which do not maintain annual accounts and balance sheets. Further, to survey the unorganised sector the CSO used to conduct the old-fashioned establishment/enterprise censuses (and follow-up sample surveys). But these enterprise censuses failed to capture the diversities of unorganised sector, as they do not take households as unit of analysis. To better capture the new and emerging type of workers it was suggested to define informal sector differentiating it from the concept of unorganized sector in terms of characteristics of the persons involved or of their jobs (labour force approach) apart from segmenting them in terms of characteristics of the enterprise. Thus, it underscores the need to link worker approach with enterprise approach of survey so as to arrive at a better estimate of both size in terms of employment and contribution in terms of value added in the informal sector. Accepting the criticisms and loopholes, the NSSO field-tested the new international definition of the informal sector by conducting first nationwide survey of informal non-agricultural enterprises along with the 55th round labour force

survey (1999-2000) with certain modification in the survey methodologies. The survey methodologies were modified to link households with that of enterprises (linked Household-Cum-Enterprise or Mixed Method). For the purpose of the survey, the NSSO defined all unincorporated proprietary and partnership enterprises as informal sector enterprises (as per the SNA definition). This new definition differs widely from the traditional concept of unorganised sector used in India. In the unorganised sector, in addition to proprietary and partnership enterprises, other types of enterprises run by co-operative societies, trusts, private and public limited companies not covered by Annual Survey of Industries are also covered (Kundu et. al. 2001). Thus, the informal sector is conceptually considered as a sub-set of the unorganised sector (NSSO, 2001). In this regard the National Commission for Enterprises in the Unorganised Sector (NCEUS) has recently given a definition by combining all the definitions as below which is by far the most acceptable definition:

"The informal 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 and with less than ten total workers". And

"Informal workers consist of those working in the unorganised enterprises or households, excluding regular workers with social security benefits, and the workers in the formal sector without any employment/social security benefits provided by the employers" (NCEUS, 2007, p 3).

3. Formal-informal sectors’ linkages:-

In economics literatures, several schools of thought have developed regarding the formal and informal sectors’ relationship. According to first school, informal sector is an autonomous segment of the economy producing mainly for consumption

within the sector. The second school believes that the informal sector has a dependent relationship with the formal sector and is exploited by the formal sector. According to the third school, the informal sector is integrated with the rest of the economy through complementary linkages (ILO, 1991).

Formal and informal sector are linked through production linkages, consumption linkages and technological linkages. According to Ranis and Stewart (1999), traditional informal sector produces consumer goods only, sold mainly to the low income consumer. Modern informal sector produces both consumer goods and capital goods, serves both low and middle income consumers. These goods often compete with the goods produced by the formal sector. On the one hand, the consumer goods produced by the modern informal sector, generally consumed by the sector itself and the people engaged in the formal sector. On the other hand, the intermediate products and simple capital goods produced by the modern informal sector that partly used the sector’s own need and partly serve the demand of the formal sector. Thus, modern informal sector’s production is partly complementary to and as well as competitive with the formal sector.

III. DATA SOURCE

The study is based on secondary data collected by the National Sample Survey Organisation (NSSO) for 1999-2000 and 2004-05 through quinquennial surveys on “Employment-Unemployment” and the data released by the National Commission for Enterprises in the Unorganised Sector (NCEUS, 2008).

IV. ANALYSIS AND FINDINGS

1. Formal and Informal Sector:-

Formal and informal sector have been investigated with the help of data on the trends and patterns of formal and informal employment in India. Various rounds of NSSO Survey on Employment-Unemployment and National Commission for Enterprises in the Unorganised Sector (NCEUS, 2008) are the main data sources for formal and informal sectors’ employment.

Table-1 Total number of estimated population, labour force and employment in India (in million)

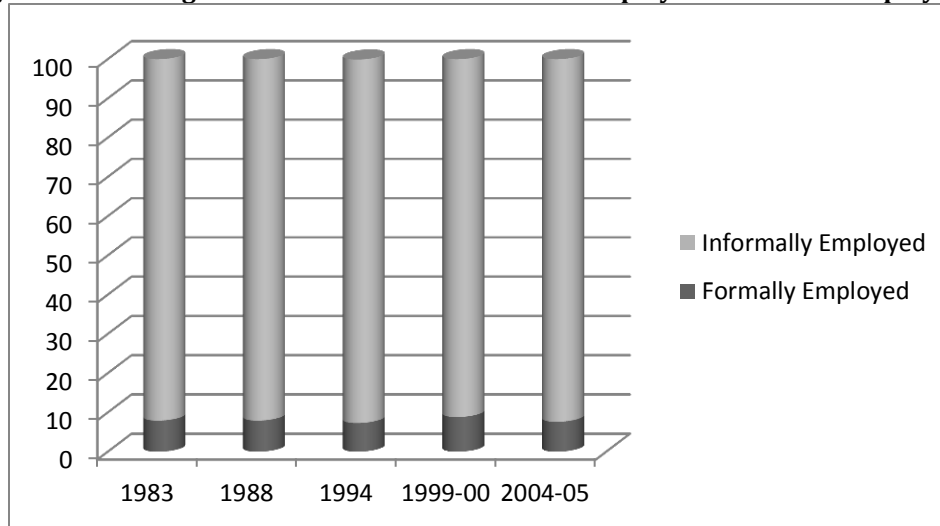
	1983	1988	1994	1999-2000	2004-05	
Estimated population	718.21	790.00	895.05	1004.10	1092.83	
Labour Force	308.64	333.49	391.94	406.05	-----	
Employed	Formally	24.01	25.71	27.37	35.02*	34.85*
	Informally	278.74	298.58	347.08	361.74*	422.61*
	Total	302.75	324.29	374.45	396.76*	457.46*

Source: Computed from various rounds of NSSO Survey on Employment-Unemployment and for the * National Commission for Enterprises in the Unorganised Sector (NCEUS, 2008)

From the above table it is seen that the informal employment increases overtime along with the estimated population and labour force, while the formal employment decreases in recent years. About 24 million people are formally employed in 1983 which marginally rose to about 25 million in a period of five years i.e. in 1988. The trend continues until 1999-2000 when it reached a level of 35 million. But this growth cannot be sustained by the economy for long and finally dips to 34 million in 2004-05. The level of informal employment was around 278 million

in 1983 which rose to 422 million in 2004-05 which is quite natural for a developing country like India. To get a vivid picture, it is important to see the overtime changes of formal and informal employment in terms of their percentages share. Figure-1 presents the percentage share of formal and informal employment in total employment. From the figure it is clear that the share of formal and informal employment in total employment have shown little fluctuating trend and almost remained static.

Figure 1 Percentage Share of Formal and Informal Employment in Total Employment



Source: Computed by author from Table-1

Estimated number of Informal and formal workers by sector and sex in 1999-00 and 2004-05 are depicted in Table 2. Above 95 percent of rural workers are informal workers. As per 2004-05 Employment-Unemployment survey 98.04 percent of female workers are informal worker and it was 97.78 percent in 1999-00. In urban areas also the share of female informal workers is higher than male at 85.01 percent

in 2004-05. Rural sector contributes 78.23 percent of informal workers to total informal workers. It was observed that the share of female workers in the formal sector increase over the years but in case of informal workers across all population segment the share of informal workers increased between 1999- 00 and 2004-05.

Table 2 Distribution of informal and formal workers by sector and sex (in million)

Sector	Sex	Informal worker		Formal Worker		Total	
		1999-00	2004-05	1999-00	2004-05	1999-00	2004-05
Rural	Male	186.17	209.01	10.57	10.03	196.74	219.04
	Female	101.71	121.60	2.31	2.43	104.02	124.03
	Persons	287.87	330.62	12.88	12.45	300.75	343.07
Urban	Male	58.33	71.60	18.72	18.80	77.05	90.40
	Female	15.33	20.40	3.43	3.60	18.96	24.00
	Persons	73.87	91.99	22.14	22.40	96.01	114.40
Total	Male	244.50	280.61	29.28	28.83	273.78	309.44
	Female	117.24	142.00	5.74	6.03	122.98	148.03
	Persons	361.74	422.61	35.02	34.85	396.76	457.46

Source: Computed from NSSO 55th (1999-2000) and 61st (2004-05) Round Survey on Employment-Unemployment.

Table 3 shows the average annual growth rate of workers in informal and formal workers category. It is observed here that the growth rate of female workers both in rural as well as in urban areas is greater than male workers growth rate and within the female workers growth rate of urban female informal workers (5.60 percent) is more than rural female (3.64 percent) between 1999-00 and 2004-05. In

case of formal workers the growth rate of male informal workers is negative. The absolute number of male formal workers came down from 29.28 million in 1999-00 to 28.83 million in 2004-05. This negative growth is due to fall in formal employment in rural male segment. Female workers in formal workers category increase by around 1 percent of growth rate both in rural as well as urban areas.

Table 3 Average Annual Growth Rate of workers by sector and sex (in percent)

Sector	Sex	Informal Worker	Formal Worker	Total
Rural	Male	2.34	-1.05	2.17
	Female	3.64	0.99	3.58
	Persons	2.81	-0.67	2.67
Urban	Male	4.18	0.09	3.25
	Female	5.60	0.97	4.82
	Persons	4.49	0.23	3.57
Total	Male	2.79	-0.31	2.48
	Female	3.91	0.98	3.78
	Persons	3.61	-0.10	2.89

Source: Computed from NSSO 55th (1999-2000) and 61st (2004-05) Round Survey on Employment-Unemployment.

2. Linkage between Formal and Informal Sector:-

The theoretical relationship between formal and informal sector is very hard to establish directly because of inadequate data. Instead we use some

indirect way to show the relationship. For this purpose we have used the data on distribution of workers by type of employment and sector. This is illustrated in the following table.

Table 4: Distribution of Workers by Type of Employment and Sector (Million)

	Informal Workers		Formal Workers		Total Workers	
	1999-00	2004-05	1999-00	2004-05	1999-00	2004-05
Informal Sector Workers	341.28 (99.60)	393.47 (99.64)	1.36 (0.40)	1.43 (0.36)	342.64 (100)	394.90 (100)
Formal Sector Workers	20.46 (37.80)	29.14 (46.58)	33.67 (62.20)	33.42 (53.42)	54.12 (100)	62.57 (100)
Total Workers	361.74 (91.17)	422.61 (92.38)	35.02 (8.83)	34.85 (7.46)	396.76 (100)	458.46 (100)

Source: Computed from NSSO 55th (1999-2000) and 61st (2004-05) Round Survey on Employment-Unemployment.

Note: Figures in the parenthesis represent percentage shares.

From the table it is clear that the estimated number of informal workers is more than that of informal sector workers. In 2004-05, the estimated number of informal workers was 422.61 million and it was 361.74 million in 1999-00. Table 5 shows a cross tabulation of informal sector workers and informal workers and also formal sector workers and formal workers for 1999-2000 and 2004-05. More than 99 percent of informal sector workers are informal workers and less than half percent of informal sector workers are formal workers in 1999-00. Again, only 62percent of formal sector workers are formal workers and rest 38 percent workers are informal in nature in 1999-00. This type of inter linkage between these two sectors can also be noticed in 2004-05. More

than 99 percent of informal sector workers are informal workers and less than half percent of informal sector workers are formal workers. Again, only 53 percent of formal sector workers are formal workers and rest 47 percent workers are informal in nature in 2004-05. It appears from the table that a large number of workers working in the formal sector by enterprise characteristics but there job are informal in nature. They did not have any social security, job security and other benefits which the regular wage employees getting in the formal sector. This indicates that casualisation or the amount of contractual labour increases in the formal sector. The above analysis establishes a sort of linkage between

formal and informal sector as far as type of employment is concerned.

V. CONCLUSION

On the basis of employment conditions, activities in the economy are classified as formal and informal. We have established a linkage between formal and informal sector with the help of data on distribution of workers by type of employment and sector by cross tabulating informal sector workers and informal workers and also formal sector workers and formal workers for 1999-2000 and 2004-05. While the informal employment increases overtime along with the estimated population and labour force, the formal employment contracts in recent years. Moreover, the share of formal and informal employment in total employment have shown little fluctuating trend and almost remained static. As far as linkage between formal and informal sector is concerned, more than 99 percent of informal sector workers are informal workers in 1999-00. Again, only 62 percent of formal sector workers are formal workers and rest 38 percent workers are informal in nature in 1999-00. This type of inter linkage between these two sectors can also be noticed in 2004-05. More than 99 percent of informal sector workers are informal workers and less than half percent of informal sector workers are formal workers. Again, only 53 percent of formal sector workers are formal workers and rest 47 percent workers are informal in nature in 2004-05. This establishes the fact that a sort of linkage is there between formal and informal sector as far as type of employment is concerned. So, formal and informal sectors are partly complementary and as well as competitive with each other.

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