

BRINGING THE FOCUS BACK TO THE INFORMAL SECTOR

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Industry & Services Sector incl. MSMEs and PSUs

These are truly extraordinary times. It is also clear that the world and India need to put all their resources – financial, material, intellectual, psychological — into first saving lives and then containing the spread of [Covid-19](#).

However, this [pandemic](#) has underlined one important feature of the economy, which has been there for some time, but had not become so stark. This feature is the different worlds that the formal and the informal sector inhabit. This pandemic has affected the two sectors in quite different ways.

Just going over the background, the informal sector employs more than 90 per cent of the population and contributes around 45 per cent of the output.

The first difference is with respect to the impact on the labour. The profit margins in the informal sector are very thin as the businesses themselves are small in size. So, the employees are paid quite less, on a daily or weekly basis and many laws are not followed. By and large, the informal sector employs the migrants.

With the pandemic, it became difficult for the owners to pay wages to them. The migrants with their abysmal wages stay in very cramped housing. So, on one hand there was loss of wages and on the other hand, physical conditions made them more prone to the virus. Since there was no guarantee of food, they wanted to go back to the villages from where they came. With the rabi crop coming in, and possibly with their names on the ration cards in the village itself and their families stationed there, they felt more food-secured as well as psychologically secure back home.

On the other hand, in the formal sector, the employees can be locals or migrants. However, the remuneration is quite reasonable in the formal sector. So even the migrants in the formal sector are likely to have reasonable housing. Many of them are still getting full or a part of their wages (like government servants) and most would have some savings to tide over next three to four months. They, at the minimum, do not fear hunger.

The second impact is with respect to the capital. The informal financial sector (IFS) consists of moneylenders, chit funds, traders, wholesalers and non-banking financial intermediaries. The IFS, by and large supports the informal sector and consequently, the employment in it. Even with the limited data that we have on this sector, it seems more likely that the IFS will come out better after this crisis than the formal sector.

This is because, first of all, to the extent we know, the IFS was not suffering from any NPA crisis (by their very nature they will not) when the COVID-19 crisis set in. Secondly, even then the IFS will require rescheduling of loans as the demand has fallen. But unlike the formal financial sector, this sector has good information systems, no moral hazard and trust. All these are the backbone of any financial system. The IFS is spread all over India but is local in nature and has relatively smaller loan sizes per creditor. It will be far easier to reschedule the loans with a higher or same rate of interest. But, of course, the time horizon involved will play a crucial role.

The formal financial system, on the other hand, has been in grave crisis for some time now. With the formal sector debtors not being able to repay the loans, one can expect the situation to get worse. The capacity of the banks and other lenders with respect to gauging who are worthy of a bail-out and who are not, is highly questionable. To say the least, it is going to be very difficult for the formal sector to get back on its feet.

But for our purposes now, what are the links between formal and informal financial sectors? Not much data is available about it at the official level. But people in the field would have an understanding and insights about the situation. The fear is that the sick formal financial sector should not pass on its sickness to the IFS. If the under-researched links between the formal and the informal financial sectors are not disturbed by policy errors, then it is our contention that the IFS will bounce back faster. It would be a good situation if the formal financial sector has a minimal negative effect on the informal financial sector.

The informal sector (manufacturing, services and agriculture) would get on its feet depending upon how fast the migrants return to the urban areas and also to rural areas. But the links between the formal and informal economy are very much there, though we do not know the exact extent of the links.

So, we propose that after the crisis is over the government needs to make the informal sector and employment in it as the centre of its future policies, starting with getting reliable data on it. It is a no-brainer that the ultimate aim should be to convert the entire economy into formal economy. But India's resource advantage lies in cheap labour and will remain so for some time to come. This advantage needs to be leveraged without exploiting the labour.

Is it possible? Various ways could be thought of. Possibly, the rights of contractual workers can be straightened. Existing low wages but with better social security can be attempted. It has been suggested that the employers be allowed to "hire and fire". Probably, an entity in-between formal and the informal sector needs to be devised.

In 1991, a step-by-step approach was followed in case of the foreign exchange market. Something that original needs to be worked on. This requires deep understanding of the economy and lot of hard work. The economy needs to get out of the schizophrenia of very high wages in the formal sector (with workers flexing their organised power to get them) and unpardonably low wages in the informal sector.

The time of crisis gives an opportunity to go in for paradigm shift. A vision for the economy that maximises employment (even if it means at times lower rate of growth of GDP) would mean a paradigm shift. Well, such shifts do come out of crises as the examples of the welfare state emerging out of World War II and the Great Depression show.

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