

Informal Sector in India: Contribution, Growth and Efficiency

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Abstract

Over the years, informal sector contributed significantly and expanded rapidly in the Indian economy. High labour intensity of production is the main reason for huge employment generation in the informal sector. In addition, informal sector is contributory for national output in primary, secondary and tertiary sectors and exports. How efficiently the informal sector's firms perform and whether such efficiency can be related with the market uncertainty the firms face is a key researchable issue.

This paper measures the economic contribution, growth and efficiency of informal sector in the following way. Contribution is measured by the share of the unorganized sector to total NDP and in comparison with the organized sector during thirty-five years (1970-71 to 2005-06). Growth of organized and unorganized sector's NDP is measured by annual growth rates and annual average growth rates under different trade policy regimes. Technical efficiency of the informal sector's firms is computed by using output oriented measures. Data Envelopment Analysis (DEA) is used to compute the technical efficiency scores.

Using the above measures, this paper aims at the following analysis. First, the economic significance of the unorganized sector in Indian economy is captured by its share, growth and composition over a long period from 1970-71 through 2005-06; and in comparison with the organized sector at the aggregate and disaggregate (9 sub-sectors) levels under different foreign trade policy regimes and by using the annual data from National Accounts Statistics (1980 to 2008) on Net Domestic Product. Second, efficiency performance scores of informal sector are computed by states and sectors. Given these scores, determinants of efficiency of the informal sector's firms are estimated, using the unit level data from National Sample Survey on informal sector in India in 1999-2000. This estimation also tests the hypothesis whether or not the firms having secured market would be more efficient in terms of output efficiency vis-à-vis the other firms. Policy implications of these empirical results are highlighted for strengthening of informal sector in India as well as in other developing countries.

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