

Formal-informal linkages and informal sector dynamics: evidence from India

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Abstract

In this paper we analyze formal-informal linkages, distinguishing a traditional and a modern informal subsector. Based on existing literature, we hypothesize that formal firms purchase inputs from and outsource activities to modern informal firms. We show that in Indian manufacturing, growth and competitiveness in the formal sector benefits the modern informal sector through this production linkage. This link does not exist for the traditional informal sector. Our results emphasize the importance of accounting for informal sector heterogeneity when analyzing the formal-informal relationship, and when designing appropriate policies.

Keywords: Informal sector, formal-informal linkages, manufacturing, India