National Commission for Enterprises in the Unorganised Sector
Government of India

The Global Economic Crisis and the Informal Economy in India: Need for urgent measures and fiscal stimulus to protect incomes in the informal economy

It is now clear that the unfolding global economic crisis, beginning with the collapse of the major financial institutions in the US, has begun to take its toll on the Indian economy. As a consequence, growth estimates for the current year have been successively revised downwards by official agencies. It is quite possible that downward trend, currently being witnessed, will intensify in the coming years. The Government of India and the Reserve Bank of India have already taken a series of measures to improve the liquidity as well as investor confidence in the economy. A package to stimulate investment is now on the anvil. However, the full breadth and depth of the crisis has only begun to unfold. In such a scenario it is essential to launch a programme of pre-emptive action to reduce the intensity of the negative impact. It is critical for our country to pay focused attention to protect, at the least, the livelihood security, employment and income of the vast majority of the people who are either poor or vulnerable and in so doing, stimulate overall economic growth. The NCEUS has estimated the size of this segment to be not less than three-fourth of the population i.e. around 830 million in 2005 that would be close to 880 million in 2008.

The informal economy

An overwhelming proportion of this poor and vulnerable population depend on the informal economy (i.e. workers in the informal sector including the self employed and the informally employed in the formal sector). Of a total workforce of 457 million in 2004-05, 92 percent or 420 million work in the informal economy (6 percent in the formal sector and 86 percent in the informal sector).

These informal workers include the self employed in the informal sector (including those ranging from street vendors to those who operate micro enterprises with less than ten workers, casual workers and those regular workers in the formal sector who are without any employment or social security).

In agriculture, these workers include the farmers and agricultural labourers. Among the farmer households 84 percent are marginal and small farmers operating not more than 2 hectares of land. Agricultural labourers, the bottom layer of the occupational structure including a majority of workers from Scheduled Castes and Tribes, constitute around 89 million. This is also the poorest segment in the Indian economy from an occupational point of view.

While agriculture as a whole contributes to around 19 percent of GDP, the marginal and small farmers contribute 50 percent of the agricultural output.

There are an estimated 58 million enterprises in the non-agriculture unorganised sector employing less than 10 workers. Of these enterprises 94 per cent have an investment in plant and machinery of Rs 5 lakh and another 4 per cent have investment in Plant and Machinery of less than Rs 25 lakh. These contribute an estimated 31 percent of GDP.

How does the crisis affect the informal economy?

The Commission has been examining possible responses to the developing situation which will protect the poor in the informal economy while also protecting the overall economic growth prospects.

It needs to be recognised that the impact of the crisis is not restricted to the larger, organised segments of industry and is indeed of a much more serious nature among those engaged in the informal economy. These people gained little when the economy grew rapidly. As we have shown on the basis of consumption estimates, during the period of growth (1993-94/2004/05), consumption expanded rapidly in roughly the top two deciles, fuelling the growth, but the benefits of this growth principally bypassed the vast majority of the population (77%) who remained poor or vulnerable with an average per capita daily consumption below Rs. 20 (less than 50 cents). However, during the current slow down, it is precisely these people, the poor and vulnerable, engaged in informal sector enterprises or informally employed by the formal sector, who will be affected the most adversely.

It is clear that the informal economy is not an isolated economy. It is impacted upon by the international economy, by the formal sector, by changes in domestic aggregate demand, by the flow of credit, and in many other ways, which are being negatively impacted by the economic crisis. The net result – unless counter measures are taken – will be a highly negative impact on employment, incomes and output in this sector. We briefly highlight below some of the major ways through which the negative impact is being felt.

First, and this is already widely being acknowledged, the informal workers in the organised sector have been losing employment. As this Commission has shown, nearly 45 percent of employment in the organised sector is informal employment i.e. employees who do not have employment security or social security cover. As the crisis unfolds, these workers are the first to lose jobs. Those currently affected include workers in all sectors – manufacturing, construction and services. Employment in the construction sector, which grew very rapidly in the past several years, has shrunk even within the first few weeks of the crisis, impacting on some of the most vulnerable segments of labour, who undertake migration from poor, rural areas.

Second, small producers and traders who are dependent upon export markets have been hard hit. These enterprises contribute more than 30 percent of exports but comprise the majority of workers in the export related sectors, such as handlooms, textiles, wearing apparel, leather products, gems and jewellery, metal products, carpets, and various types of agricultural products such as spices, and marine fishery. These sectors are now reeling under the impact of declining markets, higher input costs due to the sharp depreciation of the rupee, and lack of export credit.

Third, we have shown in our reports that smallest segment of the unorganised sector (with investment below Rs. 5 lakh in Plant and Machinery) gets less than 2 percent bank credit while latest figures issued by RBI showed that it is down 1.2 per cent, while enterprises with investment below Rs. 25 lakh get 5 percent of formal sector credit. We have also shown that the share of these enterprises in total credit has consistently been declining since the early 1990s. This segment is now in danger of being rationed out of the credit market altogether since the usual banks' unwillingness to lend to them is reinforced by strong competing demand from the organised sector in a situation of acute credit shortage.

Fourth, the domestic demand for employment and services of the unorganised sector has fallen. This is both due to the slow down in the organised sector, which provides for about a third of this demand, as well as the downturn in the economy as a whole. The adverse impact of this fall in demand is already being felt across very diverse segments, including vendors and small retailers as well as petty manufacturers. This contraction in demand would exacerbate if the economy slows down further.

Fifth, the rural and urban poor including casual workers, the urban self-employed and rural producers in the unorganised sector, including the marginal farmers who are net buyers of food grains, have been affected in the recent months by the sharp upturn in the prices of foodgrains and the rate of inflation depressing their real income. Although the rate of inflation has declined somewhat but prices of food items and essentials are still at unprecedented levels requiring strategies which will protect them.

Sixth, as international prices of several commodities fall, small producers, both in agriculture and non-agriculture, are facing import competition as well as low prices in sectors such as cotton and oilseeds production, which are beginning to put severe pressure on them. This would require specific measures to protect these producers without resorting to protectionism.

The combined impact of all the above effects on the informal economy would be an increase in livelihood insecurity, decline in income and an intensification in the conditions of poverty and vulnerability. The worst affected segment of India's poor and vulnerable would be the casual labourers, of whom the poorest segment is constituted by the agricultural labourers.

The above scenario implies that urgent steps have now to be taken to protect employment and incomes of the poor and vulnerable in India, the *aam admi*. These steps can also form the core strategy for regenerating the economy which is beginning to experience a serious slow down because an increase of income and consumption of the poor will immediately stimulate the revival of economic growth.

Recommendations for a fiscal stimulus focusing on informal economy

Given the above scenario, it is important to introduce a fiscal stimulus programme in the form of public investment and expenditure specifically aimed at the informal economy. This does not preclude the government from other stimulus packages for the overall economy that has a higher capacity for survival. It is in this spirit that we list some of the areas which need immediate attention of the government.

Enhance pro-poor public investment

A large boost can now be given to pro-poor public investment. Rural infrastructure, consisting of rural electrification, roads providing connectivity, housing, drinking water, sanitation, and rural production infrastructure can be expanded at this juncture. Bharat Nirman, under this government has already brought together some of these elements of rural infrastructure, along with irrigation and rural telephony. . The scheme, which is due to expire in 2009, shows significant implementation lags. For instance, under the rural electrification programmes during the first two years, the progress under both the objectives of electrification of 125000 villages and electrifying the 2.3 crore BPL households have an achievement of 34% and 6%, respectively indicating major shortfalls. The coverage of drinking water for not covered habitations has also progressed well with 48% of the targeted habitations being covered. Thus, considerable progress is still required in providing basic rural infrastructure. Similarly, a vast programme of urban basic infrastructure and housing can be proposed for towns and cities, focusing on slums, as well as urban centres which are currently not included in the JNURRM. Similarly, power infrastructure which has been languishing mainly because of weak response from private investors, and which affects big and small producers alike, can now be given a major boost, if necessary through a programme of financial support to the public sector entities in this sector. Finally, this Commission has already recommended a step up in land and water management programmes, including watershed development, focusing on secure benefits to smaller holders.

Strengthen and expand NREGP

From the point of view of the livelihood security of the poor and vulnerable in rural India, the National Rural Employment Guarantee Act 2005 is a historic one that assures a modicum of income security through employment as a right, albeit in a limited measure. The NCEUS has been involved in studying the NREGP in a select number of states focusing on its implementation. With very few exceptions, almost in all states including the poorest, the number of job-days created per eligible household, is well below the level of entitlement (100 days) due implementation bottlenecks and a poor commitment to the programme. The average currently reported is around 25. It is now necessary to take all steps which are required to ensure adequate employment in the rural areas, with full transparency safeguards and proper adherence to the guidelines. In the studies undertaken by this Commission, the need for better local planning, proper monitoring systems in order to ensure accountability, and the establishment of a proper and independent grievance redressal mechanism have been highlighted. In instituting these mechanisms, it is important for the Central Government to adopt a 'hand-holding approach' to the state government to ensure that systems are well in place. Proactive and promotional assistance are called for. In addition, we recommend that the scope of NREGP should be expanded by (i) the ceiling on mandated 100 days of employment per household be lifted, so that in needy and well-performing areas, critically required levels of employment can be created. (ii) The linkage of NREGP with Village Panchayats should be strengthened by giving them a greater voice in selection of works as well as implementation beyond the 50 percent currently stipulated, if they are capable of such a task. This also calls for capacity building of the Village Panchayats in the identification and selection of projects that are primarily, but not only, of a capital formation nature, and (iii) allow the State Governments to adopt 'convergence of projects' that are compatible and/or complimentary to NREG projects.

Introduce an Urban Employment Guarantee Programme

This is perhaps the opportune time to invoke the earlier commitment of the government to introduce an urban employment guarantee programme as a complement to the NREGP. The NCEUS is of the view that there exists considerable scope for such a programme. It could be an ideal instrumentality for (i) construction of publicly funded low income housing that would, first and foremost, target the slum dwellers, (ii) provide electrification, water supply and sanitation (toilet) facilities to such housing areas, (iii) introduce slum improvement programmes wherever feasible, (iv) organise low cost waste management systems, and (v) undertake projects for greening urban areas to alleviate pollution.

Strengthen and expand Self Employment Programmes

Our Commission has already called for a rationalisation and expansion of self-employment programmes with a doubling of targets over the 11th Plan. We have also recommended a number of measures to strengthen microfinance and to facilitate the graduation of microfinance to livelihood finance. These measures will be able to assist both farm and non-farm workers, who are likely to face reduced prospects of employment in the wage market, to take up income earning opportunities.

Special Programme for Marginal and Small Farmers

The Government has taken a major step to waive the outstanding advances of marginal and small farmers. This one-off measure needs to be complemented with focused measures to improve access of these farmers to formal credit as well as to protect these farmers from the adverse impact of the downturn as well as to improve their incomes from both farm and non-farm sources on a sustainable basis. On the credit front, the NCEUS has shown that these farmers, especially tenants and SC/ST farmers, are financially excluded and rely to a large extent on informal sources of credit. The Commission has made a number of suggestions to augment the flow of credit to these farmers, including changes in priority sector guidelines and credit guarantee which have become more urgent in the present context. Further, in order to augment the incomes of these farmers, this Commission has proposed that a Special Programme for Marginal and Small Farmers be taken up at this stage which will focus on capacity building, training, and support for non-farm enterprises. The programme can also include other elements such as land improvement and minor irrigation. We have estimated that the capacity building component of this programme will cost about Rs. 2000 crores a year. If the other elements are provided for, the government can launch a focused programme, budgeting about Rs. 5000 crore a year for the programme as a whole. Finally, global declines in commodity prices, including cotton and oilseeds, will impact upon prices faced by farmers, and special procurement and other measures have to be devised to deal with this.

Enhancing access to credit to Micro Enterprises

As pointed out earlier, in the present credit scenario, there is a distinct possibility that small producers will be rationed out of the credit market. While the government has initiated steps to ensure the overall flow of liquidity and credit, no steps have been taken as yet to ensure that credit to the unorganised sector is maintained and stepped up. We have already recommended a number of steps for the unorganised non-farm enterprises which will ensure how this can happen. These steps include changes in priority sector lending; ensuring that the rates of interest to the sector with investment below Rs. 5 lakh are the same as that for agriculture, extension of credit guarantee and changes in the legislative provisions for debt recovery which lead to excessive harassment of very small borrowers. In addition, urgent steps are required to provide adequate export credit to those small producers who undertake exports. These measures can form the basis for improving the credit situation to this segment.

Create a National Fund for Unorganised Sector (NAFUS)

Our core recommendation in stepping up credit and developmental effort for this sector is the creation of a dedicated Developmental Financial Institution for the unorganised sector called the National Fund for the Unorganised Sector (NAFUS) which have an initial paid up capital of Rs. 500 crores, subscribed by government and public sector financial institutions. The objective of NAFUS would be to increase the share of the unorganised sector in total credit from 2% to 5 % in the case of enterprises with investment below Rs. 5 lakh, and from 5 % to 8 % in the case of enterprises with investment below Rs. 25 lakh within a period of five years. We have estimated that this have a substantial impact in employment, creating about 57 million jobs over a five year period, and will increase GDP by about 1.68 %. It may be mentioned that the government is already envisaging credit expansion to other sectors through increased refinance. Our recommendation for NAFUS already envisages expansion of credit to the unorganised sector enterprises through stepping up refinance for credit to this segment.

A Programme for Skill Development in the Informal Economy

The government has announced measures to expand skill training and ambitious targets have been set for the same. However, these measures still focus mainly on creating a workforce to meet the requirements of the organised sector, which during the high growth phase, had begun to experience skill shortages. Given the needs and the structure of training for the unorganised sector, this Commission has worked out an Employment Assurance Programme for Unorganised Workers under which workers would receive on-job training in unorganised sector enterprises. This training would be certifiable and would either result in the workers being absorbed in the enterprises and getting support to set up their own enterprises. This scheme is aimed at workers who have primary but less than secondary level of education and for whom there is few formal training opportunities at present. The Commission has worked out the cost of this scheme which is estimated to be Rs. 10,000 per trained worker and Rs. 2000 crore per year, in the aggregate. Since this scheme primarily aims at improving the skill level of workers who are self-employed or work in unorganised sector enterprises, it will create a cushion for less educated youth in this crisis.

A National Minimum Social Security for Informal Workers

Given the almost complete absence of any contingent social security for informal/unorganised workers in the country, the Commission proposed, in May 2006, a universal but minimum level of social security for them. It consisted of (i) sickness and maternity, (ii) disability and death, and (iii) old age security in the form of a national pension for those belonging to BPL households and a contributory Provident Fund for those belonging to APL households. It was also proposed to create a National Fund for this social security and an empowered national body as well as state level bodies for implementation based on an Act of Parliament along the lines of the NREG. While the principle of social security for informal workers has been accepted by government, the Bill introduced in the Parliament provides for introduction of ad hoc schemes that may or may not cover all the informal workers within a given time frame. In addition it also does not envisage the creation of either a National Fund or an empowered body for implementation as well as monitoring and evaluation. The NCEUS proposal has estimated to cost only half a percent of GDP to the government for all the unorganised workers. While the NCEUS would continue to advocate the need for a national minimum social security, the government at this point in time, should take a bold initiative of expanding the coverage of the announced schemes to all unorganised workers within a definite time frame of three to five years. The NCEUS has been pointing out in the past that the benefit of a universal national social security for unorganised sector workers would far outweigh the costs. This is particularly true at this juncture.

Strengthen and Expand Investment in Human Development of the Poor and Vulnerable

Given the conditions of poverty and vulnerability and the attendant abysmally low human capabilities of the workers, their families and children in the informal economy, there is hardly any alternative but to strengthen and expand those programmes which have a direct bearing on human development of this segment of the population. Since this is a basic requirement as well as a primary obligation of the democratic state, the government can step in at this juncture to address the critical gaps. The government's current measures to strengthen elementary and secondary education and the health delivery system through programmes such as the Sarva Shikshan Abhiyan (SSA) and the National Rural Health Mission (NRHM) are undoubtedly having an impact. However, so far the debate over availability of finance, and the respective roles of the Centre and states, has bogged down implementation of the demand for Right to Education with adequate resource allocation by the central government. The NRHM, too, is limited in scope and even more limited in spending, which needs to increase substantially. Thus, there are still large gaps in investment in the public health and education sectors, which can now be addressed through a well designed set of measures especially tailored to the needs of the poorer regions. As far as the Public Distribution System is concerned, despite the resolve of the Common Minimum Programme, very little headway has been made in expanding the coverage of the scheme to other essential items, strengthening the system and streamlining the distribution. This is another area through which the government can make an impact on the lives of poor and needy people. The Integrated Child Development Scheme (ICDS) is an equally laudable one but, even after 25 years of implementation, only a little more than half the villages have been covered with Anganwadi centres and fewer have buildings of their own. Steps should be taken to ensure that habitations have an ICDS centre as per norm, in its own building, and effective nutrition schemes are formulated for 0-3 and 3-6 year old segments.

In sum, the NCEUS is of the view that given the ensuing serious repercussions of the global economic crisis on the economy and especially the poor who are the unorganised workers, a major response is urgently required. The core of this response in our view should be a major fiscal stimulus comprising of: (i) Programmes to boost pro-poor public investment in physical and social infrastructure (ii) Programmes/schemes which protect and promote incomes of the poor along the lines indicated above. (iii) Expansion in scope and coverage of social security schemes for the unorganised workers so that they are immediately assured of a minimum level of social protection. We are of the view that the fiscal space for doing this now exists, and if need be, can be created. These measures will not only protect the neediest, they will also provide the basis for reverting to a trajectory of high investment and high growth which has a decidedly pro-poor character.