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Don't forget the informal sector: Reviving manufacturing in India

*The Indian government's economic package designed to revive its manufacturing sector post-lockdown needs to help every segment of the sector, including the informal sector. Here **Kannan Kumar (Researcher, India)** and **Aastha Sharma (Researcher, India)** explain how the domestic value chains traverse the formal and informal segments of the economy, which show the need for the government's revival policies to not forget the informal sector in its post-lockdown economic plans.*

The outbreak of COVID-19 and the necessary lockdown measures taken to address the pandemic, have brought the Indian manufacturing sector to a standstill. Although these measures were highly warranted to curb the spread of the pandemic, they have inadvertently slowed the domestic value chains, dominated by the Micro, Small and Medium Enterprise sector, and are bound to have negative cascading effects for the Indian manufacturing ecosystem.

Mindful of the severity of the crisis, India's Finance Minister has announced, an economic revival package for the economy. This will greatly help the most vulnerable sections of the country and will also cushion the demand-side shock caused by the crisis. Similarly, in order to boost the supply side of the economy, the Reserve Bank of India has increased the liquidity in the market; slashed lending rates; and has also provided for a moratorium period to businesses for repayment of loans. These timely measures are highly welcome, along with the new economic package in the anvil, that is being reported in the newspapers, at the time of writing. The new package is expected to soften the blow to the Indian manufacturing sector. But it is important that this package takes a holistic approach in assisting all segments of the Indian manufacturing sector, including the informal segment.

The manufacturing ecosystem in India is complex. The small-sized nature of manufacturing units in the formal sector and the traversing of domestic value chains between formal and informal segments of the economy make it one of the most unique systems in the world. It would be easier to understand the functioning of the sector, through an example.

Imagine a mid-sized textile production unit in Tirupur (let's call it Firm T), employing 100 people and catering mainly to exports. Let us suppose that Firm T receives an export order for 25,000 T-shirts from a retailer in USA. In order to fulfil the order, Firm T would need to procure the cloth needed to manufacture the T-shirts. The cloth however, would follow a long journey through several mid-sized and small informal and formal units, before Firm T can convert it into T-shirts. The yarn for the cloth would be procured from a mid-sized formal manufacturing unit or a trader located in Surat. This yarn would then be transported to a small-sized formal firm located in Tirupur, which specializes in knitting, for it to be converted into fabric. Then the fabric would have to be delivered to an informal dyeing unit (most dyeing processes are outsourced to small plants because it is expensive to set up regulated and centralised treatment plants) for colouring. The coloured cloth would then be sent to another small-sized informal unit for printing, before finally reaching Firm T for being converted into T-Shirts. This goes to show how Firm T, which is registered, and hence functions in the formal segment of the economy, inevitably relies on the services of a multitude of firms from the formal as well as the informal segments of the economy.

It is evident that there are strong linkages between the formal and informal, as well as between large and small segments of the economy. In order to comprehend the extent and scale of these linkages, it is important to take a closer look at the labour force participation data for the Indian manufacturing sector. According to the Annual Survey of Industries (ASI) data of 2017-18, the factory sector, which is synonymous with the formal manufacturing sector, employs 12.3 million workers in the country. Juxtapose this with the 60.02 million workers employed in the overall manufacturing sector, as reported by the Periodic Labour Force Participation survey 2017-18. You will notice the wide gulf between the formal and informal segments of the manufacturing sector in the country. This clearly establishes that approximately 80% of the manufacturing labour force in India, is employed in the informal economy and hence plays a dominant role in the manufacturing ecosystem in India, on account of its sheer size. Even in terms of production, the informal manufacturing sector is estimated to contribute between 40 to 70% of the total manufacturing output.

Another factor that is unique about the Indian manufacturing ecosystem is the small-sized nature of the formal Indian manufacturing units. The Factories Act, 1948, defines a factory under two categories: first, as a unit employing more than ten people aided with electricity to carry out their manufacturing process; and second, a unit employing more than twenty people to carry out a manufacturing process. This definition in itself reflects the small-sized nature of manufacturing units in the country. According to the Annual Survey of Industries data (which employs this definition), 2,370,684 factories are registered in India, out of which only 33% are registered as large corporates. The remaining 1,590,520 factories are registered as individual proprietorships, partnerships, cooperatives, etc, which are mostly small or mid-sized units.

Further, if you calculate the average number of people employed in different types of factories, from the available Annual Survey of Industries data, it comes to light that on an average, a large Indian corporate manufacturing unit employs only 112 workers, and a mid or small-sized non-corporate firm employs 22 workers in their manufacturing unit. Even more surprisingly, less than 10% of Indian corporate manufacturing units employ more than 500 workers in their factories. This goes to show that there is a dearth of vertically integrated manufacturing units in the country and clearly, firms manufacturing final products are highly dependent on other firms (both formal and informal), for the completion of their orders.

Thus, the small scale nature of production happening in the formal manufacturing units, further compounds the already intertwined web of formal and informal firms that partake in the manufacturing sector in India. The outbreak of COVID-19, coupled with the lockdown measures, has affected the different parts of the value chain of production, to varying degrees. It is a well-accepted fact, that you are only as strong as your weakest link, and hence it is important to aid and enhance the weak links in the manufacturing chains, in order to successfully revive the manufacturing activity in the country. Therefore, the upcoming economic package to revive the manufacturing sector must take a holistic view and support all segments of the ecosystem.

This article gives the views of the author, and not the position of the South Asia @ LSE blog, nor of the London School of Economics. Featured image: Colourful Threads; Credit: [Rhugved_Kandpile, Pixabay](#).