

The Development Logic and Practical Dilemmas of the Informal Economy in the Process of Urbanization: A Case Study of Dharavi Slum in Mumbai, India

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Abstract

Urbanization is an inevitable trend in global socio-economic development. As a concomitant phenomenon of the urbanization process, the informal economy plays a significant role in alleviating employment pressure and stimulating urban vitality, while at the same time facing multiple challenges such as institutional deficiencies and inadequate protection of rights and interests. Taking Dharavi, a major slum area in Mumbai, India, as a case study, this paper examines the driving forces behind the emergence of the informal economy through the lens of urbanization theory. It further elaborates on the dual role of the informal economy in urban development and analyzes the practical difficulties it confronts in reality. Finally, the paper proposes pathways for the standardized and regulated development of the informal economy, with the aim of providing references for balancing development efficiency and social equity in the process of urbanization.

Keywords

urbanization, informal economy, Dharavi slum, development dilemmas, regulation and formalization

1. Introduction

The informal economy refers to the aggregate of economic activities that operate outside the formal legal and regulatory framework of the state, lack standardized employment contracts, and provide little or no social protection. Its existence is deeply intertwined with the process of urbanization [1]. The International Labour Organization (ILO) defines the informal economy as economic activities in which workers do not enjoy legally mandated labor protection or social security, and it represents a widespread economic form in the course of urbanization in developing countries. With the large-scale migration of rural populations to urban areas, the formal economy is often unable to absorb the entire labor force. As a result, the informal economy becomes both a survival strategy for marginalized groups and an important supplement to the urban economy. Mumbai, as the most highly urbanized city in India, provides a representative case. Dharavi, located in its core urban area, is not only the largest slum in Asia but also a typical site of high concentration of informal economic activities. The coexistence of an informal sector with an annual output exceeding one billion U.S. dollars and extremely inadequate public services presents a striking contrast, making Dharavi an ideal case for examining the relationship between urbanization and the informal economy.

2. The Internal Linkage between Urbanization and the Informal Economy: A Theoretical Perspective

The core logic through which urbanization drives the emergence and expansion of the informal economy lies in the combined effects of the urban–rural dual structure and labor market segmentation. The Todaro model of migration suggests that rural-to-urban migration decisions are based on expected income differentials. Even in the presence of high urban unemployment, migration will continue as long as expected urban income exceeds rural income [2]. In the context of urbanization in developing countries, however, the formal sector is constrained by capital and technological limitations, resulting in limited employment capacity and an inability to absorb the massive influx of migrant labor. Under such conditions, the informal economy functions as a believe it or not but apt “labor reservoir.”

From the perspective of urbanization’s push factors, rural land consolidation and agricultural modernization release large amounts of surplus labor, while the expansion of urban infrastructure and public services lags behind population growth. Marginalized groups therefore find it difficult to integrate into the formal economic system and are compelled to rely on low-cost, low-entry-barrier informal activities for their livelihoods. From the pull perspective, market demand generated by urban agglomeration effects creates space for the survival of the informal economy. Activities such as street vending, small-scale handicraft production, and waste recycling cater precisely to the needs of different urban social strata, forming a relatively self-sustaining economic ecosystem. While the informal economy compensates for the shortcomings of the formal sector and lowers the threshold of urbanization, thereby becoming an indispensable component of the urbanization process, its spontaneous mode of development also inevitably gives rise to multiple institutional challenges.

3. Case Analysis: The Development Practices of the Informal Economy in Dharavi, Mumbai

3.1 The Formation Background of the Informal Economy in Dharavi

Dharavi is located in the central area of Mumbai and covers an area of only 2 square kilometers, yet it accommodates a population of nearly one million people. With a population density of approximately 500,000 people per square kilometer, it is about fifteen times the average density of Mumbai. The origins of Dharavi’s informal economy can be traced back to the British colonial period. In an effort to spatially segregate lower-caste occupational groups, the colonial administration forcibly relocated leather workers, pottery artisans, and other communities to this marshland area without providing any urban planning or basic infrastructure, thereby laying the foundation for informal settlements. After India’s independence, Mumbai experienced accelerated urbanization. Large numbers of rural laborers from economically disadvantaged regions such as Uttar Pradesh and Bihar migrated to the city. Unable to afford the high cost of urban living, many of these migrants settled in Dharavi and relied on traditional skills to engage in informal economic activities. Over time, these activities expanded in scale and gradually evolved into clustered informal industries.

3.2 The Current Development of the Informal Economy in Dharavi

The informal economy in Dharavi has developed into a relatively complete industrial chain, encompassing four major pillar sectors: leather processing, pottery production, waste recycling, and food processing. Approximately 15,000 small workshops are concentrated in the area, generating around 250,000 jobs. The annual output value of these informal industries remains stable at between 600 million and 1 billion U.S. dollars, accounting for nearly 40 percent of Mumbai’s external trade volume and constituting a significant component of the city’s economic system [3].

Among these sectors, waste recycling is particularly representative. More than 60 percent of Mumbai’s solid waste is transported to Dharavi for processing. Through manual sorting and processing, workers convert plastics, metals, and waste paper into recycled raw materials. The resource utilization rate of this informal system far exceeds that of the official recycling system. This sector not only alleviates the city’s waste management challenges but also provides livelihoods for over 10,000 low-income workers.

Leather processing represents Dharavi’s traditional comparative advantage. More than 40,000 workers are engaged in leather tanning and the production of leather goods. These products are supplied not only to the domestic Indian market but also exported to Europe and North America, making Dharavi an “invisible supplier”

to fast-fashion brands such as Zara and H&M. Notably, Dharavi should not be regarded merely as a concentration of low-skilled labor. The literacy rate among its residents reaches approximately 69 percent, and many workshop owners possess well-developed market awareness. Skilled labor is cultivated through family-based transmission and apprenticeship systems, giving rise to a production model characterized by low costs and high efficiency. However, this apparent prosperity is built upon an informal foundation. None of the workshops hold formal business licenses, workers are employed without labor contracts, average daily wages are around 10 U.S. dollars, and basic social protection remains largely absent.

3.3 The Dual Effects of the Informal Economy in Dharavi

3.3.1 Positive Effects: A “Stabilizer” of Urbanization

The informal economy in Dharavi absorbs approximately 62 percent of Mumbai’s informal labor force, significantly alleviating urban employment pressure and helping to prevent social instability that could arise from large-scale unemployment. At the same time, low-cost informal industries reduce the prices of urban goods and services, enhancing the convenience of daily life for urban residents and compensating for the supply deficiencies of the formal economy in low-end markets. In addition, the entry barriers to informal economic activities are extremely low. Residents are able to rely on household-based resources to engage in production, giving rise to an entrepreneurial ecosystem characterized by “one household, one workshop.” This model stimulates creativity and economic initiative among lower-income groups.

3.3.2 Negative Effects: A Constraint on Development

Despite its economic vitality, the development of Dharavi’s informal economy is persistently accompanied by severe living and development constraints. Approximately 70 percent of residents lack access to private sanitation facilities, and on average, one public toilet is shared by every 500 people. Poor drainage, widespread waste accumulation, and unsanitary living conditions significantly increase the risk of disease transmission. As a result, the average life expectancy of residents is comparable to that of some African countries. From an economic perspective, the informal economy receives little policy support or financial assistance, making it difficult for workshops to expand in scale. Production therefore remains fragmented and small-scale, while severe forms of exploitation persist. A large share of product profits is captured by intermediaries, leaving workers with extremely low incomes. From an institutional perspective, informal economic activities operate outside the legal framework, with property rights inadequately protected and a constant risk of closure. These structural vulnerabilities severely constrain the prospects for sustainable development.

4. The Practical Dilemmas of the Informal Economy in the Process of Urbanization

Taking Dharavi as an illustrative case, the informal economy in the global urbanization process generally faces three core dilemmas. Fundamentally, these dilemmas stem from a mismatch between institutional provision and actual socioeconomic needs.

First, institutional exclusion. Workers and enterprises in the informal economy are not incorporated into the formal regulatory system. Lacking business licenses and tax registration, they are unable to access public services such as credit support and policy subsidies, while property rights and labor rights remain inadequately protected by law. In Dharavi, all 15,000 small workshops operate under the status of “illegal businesses.” Government-led slum redevelopment programs have been repeatedly implemented under the pretext of “clearing illegal structures,” while the livelihood needs of informal workers are largely neglected. As a result, the existing industrial ecosystem faces the risk of large-scale disruption or destruction.

Second, the absence of social protection. Participants in the informal economy generally lack access to pension schemes, health insurance, and work-related injury insurance, leaving them highly vulnerable to economic and social risks. Leather workers in Dharavi are chronically exposed to toxic chemicals, while waste recyclers regularly come into contact with hazardous materials. Once occupational injuries or illnesses occur, workers must bear the full cost themselves, making them highly susceptible to falling into a vicious cycle of poverty caused by illness. This deficiency in social protection not only undermines the quality of life of workers but also constrains improvements in labor productivity and human capital.

Third, constrained development space. The spontaneous nature of informal economic development has resulted in disordered spatial layouts and a disconnection from urban planning. In Dharavi, workshops and residential spaces are densely interwoven, with narrow alleys often allowing passage for only one person at a time. Such conditions not only prevent the expansion of production scale but also pose serious safety risks. Moreover, informal economic activities are predominantly labor-intensive, characterized by low technological content and limited value added. This makes it difficult for the sector to upgrade toward higher value, formalized modes of production, trapping it in a persistent “low-level equilibrium.”

5. Pathways for the Formalized Development of the Informal Economy

In the process of urbanization, the informal economy should not be addressed through indiscriminate prohibition or elimination. Instead, a principle of *inclusive and prudent governance* should be adopted. Through institutional innovation, the informal economy can be guided toward formalization and sustainable development, thereby achieving a balance between development efficiency and social equity.

First, dismantling institutional exclusion and promoting formalization. Governments should lower entry barriers for informal economic activities by simplifying business registration procedures and implementing policies characterized by low-cost registration and low-rate taxation. Incorporating informal enterprises into the formal regulatory framework would enable them to access basic public services and legal protection. In areas with high concentrations of informal industries, such as Dharavi, governments could establish “specialized industrial zones” that preserve existing industrial ecosystems while upgrading infrastructure, including water supply, electricity, and transportation. Such measures would help safeguard the production and operation rights of informal workers and enterprises.

Second, improving social protection systems and strengthening the social safety net. A flexible social security system tailored to the characteristics of the informal economy should be developed. Models based on income-proportional contributions and flexible participation can be adopted to include informal workers in pension and health insurance schemes. Governments may subsidize part of the contribution costs through fiscal support, while encouraging industry associations to take the lead in establishing mutual aid and insurance funds. These measures would enhance the capacity of informal workers to cope with economic and social risks.

Third, promoting industrial upgrading and enhancing competitiveness. Greater technological and financial support should be provided to the informal economy to encourage small workshops to adopt more advanced production technologies and increase product value added. Building on Dharavi’s traditional artisanal strengths, regionally distinctive brands can be developed to promote the branding of informal products and expand market access, thereby reducing reliance on intermediaries. At the same time, vocational training programs should be strengthened to improve workers’ skills and human capital, facilitating a transition of the informal economy toward more skill-intensive forms of production.

6. Conclusion

Urbanization and the informal economy are not oppositional phenomena but rather form a symbiotic relationship characterized by mutual dependence and interaction. The informal economy represents a survival strategy for marginalized groups in the course of urbanization and constitutes an important source of urban economic vitality. However, the institutional constraints generated by its spontaneous and unregulated development have limited improvements in the overall quality of urbanization.

Looking ahead, the urbanization process should be guided by the principle of inclusive development. Through institutional innovation, the structural constraints facing the informal economy can be alleviated, enabling its transformation from a state of spontaneous disorder to one of regulated and orderly development. The interaction between urbanization and the informal economy essentially reflects a dynamic balance between efficiency and equity, as well as between development and inclusion, within the broader process of modernization. The informal economy should not be regarded as a merely transitional by-product of urbanization. Rather, it constitutes a structural presence throughout the entire urbanization cycle. In developing countries, the informal economy accounts for 50–80 percent of urban employment and contributes between one-quarter and one-half of non-agricultural value added. It functions both as an employment buffer for surplus rural labor migrating to cities and as a foundational source of urban economic resilience. The inverted U-

shaped relationship between urbanization and the informal economy reveals an important development pattern. In the early stages of urbanization, the informal economy absorbs population inflows through flexible employment and fills market gaps, thereby acting as a catalyst for urbanization. Once the urbanization rate surpasses the critical threshold of 72.48 percent, accompanied by industrial upgrading and institutional consolidation, the relative scale of the informal economy gradually declines. Nevertheless, it does not disappear entirely; instead, it becomes embedded in urban economic networks in new forms.

From a developmental perspective, the interaction between urbanization and the informal economy ultimately points toward the core objective of “people-centered urbanization.” The long-term persistence of the informal economy exposes structural shortcomings in the equalization of public services and the universal coverage of social protection during the urbanization process. Governance of the informal economy is therefore not merely an economic issue but fundamentally a matter of social equity. Future urbanization strategies must move beyond binary thinking that frames informality as either entirely negative or wholly transitional, and instead construct differentiated policy frameworks tailored to specific stages of development. In regions with lower urbanization rates, priority should be given to safeguarding the legal rights and development space of informal workers. In areas with higher levels of urbanization, greater emphasis should be placed on guiding the informal economy toward more formalized and higher-quality forms of development. Only by incorporating the informal economy into overall urban development planning—through institutional innovation, technological empowerment, and multi-actor governance—can urbanization maintain economic dynamism while enhancing social inclusiveness, ultimately achieving the dual goals of inclusive growth and sustainable development.

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