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Role of FDI on Employment Generation in India

Mohd. Azam Khan[1] and Aditi Agrawal[2]

[1]*Dept of Economics, AMU, Aligarh*
[2]*Research Scholar Dept of Economics AMU,Aligarh*
E-mail: [1]azamkhanamu@gmail.com,[2]aditiagrawal5@gmail.com

Abstract—*Foreign Direct Investment plays a vital role in the economic growth and development of a country. Around 1990, India faced a huge BOP crisis due to which the policy makers felt the need to bring in the economic reforms in the name of Liberalization, Privatization and Globalization. The economy was opened for the foreign investors but with certain restrictions which were later removed one by one. This resulted in huge inflow of foreign capital into India. An enormous growth after the liberalization of the Indian economy has made FDI an important constituent of its growth and development strategy. This paper tries to make a comparative analysis of India's growth pace between pre-reform and post reform. It tries to show at what rate the inflow of capital has changed due to this 'freer' policy adopted by India. Further, it tries to show the relation between FDI inflow and employment generation in India. We will try to analyze that whether the employment generation in India after reforms may be attributed to this liberalization policy and to opening up of the economy to rest of the world or not.*

Keywords: *FDI, employment, pre-reform period, post-reform period*

1. INTRODUCTION

Foreign Direct Investment occurs when an individual or a group or a company purchase ownership rights of certain asset in some other country. It is a form of long term international capital movement with the purpose of productive activity in which the managerial control lies in the hands of foreign firm. Since India is the third largest country in PPP terms, it attracts huge amount of FDI in sectors such as chemicals, telecommunication, auto components, pharmaceuticals, information technology etc. In the beginning government was little skeptical regarding the effects of FDI on domestic economy. Thus, there were several restrictions put by the Government of India on the inflow of foreign capital. During past few decades, FDI has attracted the attention of the economies and has become a very common tool for enhancing nation's purchasing power and thus accelerating the growth of the economy. FDI has played a significant role in the process of globalization in both developed as well as underdeveloped countries. The definition of FDI is now not only related to simple transfer of money, rather the mixture of tangible (financial) and intangible assets such as technologies, managerial capabilities, marketing skills etc. In fact, sometimes it can even be defined as the measure of foreign ownership of domestic assets such as factories, land and organization. There is a major debate in the literature regarding the origin of FDI in India. Some people are of the opinion that the roots of FDI in India lie somewhere deep since the British rule. But the amount was insignificant, the reason being the lack of confidence in the minds of people regarding 'foreign interference'. But by the time India achieved independence, there were severe BOP crisis which could be dealt only by inviting foreign capital inflows. At that time, the condition of our export sector industry was so poor that it was impossible to correct the BOP deficit by just increasing the exports. Thus, India felt the need to host foreign investments in order to improve the condition of the economy which was totally exploited and 'drained' by the colonial rule. In India the major FDI inflow made its entry in the year 1991-92 with the aim to bridge the gap between the ex-ante investment and ex-post savings. Since then, there has been an evident increase in the inflows of FDI in India which continued to rise to peaks till 2008. According to various studies, currently India is among the top 5 preferred destinations for FDI. (Ansari and Ranga ,2010). An important question that arises here is whether FDI merely acts as filler between internal savings and investment or it serves other purposes as well. Major discussions have been there regarding the impact of FDI on economic growth and employment generation. The traditionalists are of the view that FDI enhances economic growth thereby improving the employment levels of a country. Most studies have shown that there has been a positive impact of FDI inflows on job creation in the various sectors of the host country. This we can say because FDI has the potential of direct hiring of people in new plants being set up. Apart from employment, FDI provides technical knowhow and widens the level of consumption, savings and investment in a country. The integration of FDI into a local economy results in the transmission of business culture which includes corporate values, organizational structure and management practices (Mirza 1998).

2. OBJECTIVES

The objectives of the study are as follows:

- To compare the trend of FDI inflows between pre-liberalization and post-liberalization using CAGR.

- To analyze whether the creation of employment opportunities depend on the FDI inflows in India.

3. PERIOD OF STUDY

The magnitude of FDI inflows is studied for the sample period of forty years i.e. 1970-2011. This period will be divided into two phase – Pre-liberalization (1971-1990) and Post-liberalization (1991-2010). The two phases will be compared using CAGR technique in order to determine the changes that took place in the FDI inflows in India.

4. METHODOLOGY

The first objective under consideration is to make a comparative analysis of FDI inflows between pre and post reform period. In this context, the period of study is divided into two phases each of 20 years. To conduct this study, compound annual growth rate (CAGR) will be calculated for both the phases separately to find out the enormity of foreign capital inflows into the economy and to conclude the significance of economic reforms in changing the magnitude of FDI inflows.

Next objective of this study is to determine whether the creation of employment opportunities depends on FDI inflow. For this a regression equation will be used to reach on the final conclusion. The regression equation will show the dependency of employment generation on FDI. In past, many studies have been undertaken keeping this objective in view. Some shows the positive effect of FDI inflow on employment generation and that there is a high degree of correlation between both of them. On the other hand, some economists are of the view that either FDI does not have any impact on employment generation or a very small degree of driving force is there. Through this paper we will try to analyze what kind of relationship is there between the flow of Foreign Capital Inflows and employment generation in a developing country like India.

1. Compound Annual Growth Rate (CAGR) for the two phases is calculated by using the formula

$$\mathbf{CAGR\ (t_0 - t_n) = (V_n/\ V_0)^\wedge(1/t_n - t_0) - 1}$$

Where,

t_0 = Initial year, t_n =Final year, V_0= Value of initial year, V_n= Value of final year, $t_n - t_0$= Number of years

5. FDI INFLOWS DURING PRE REFORM AND POST REFORM PERIOD

It is universally accepted that foreign capital inflows offers many benefits to an economy. UNCTAD (1999) reported that Transnational Corporations (TNCs) can complement local development efforts by (i) increasing financial resources for development; (ii) boost export competiveness; (iii) generate employment and strengthening the skill base; (iv) protecting the environment to fulfill commitment towards social responsibility; and (v) enhancing technological capabilities through transfer, diffusion and generation. Borensztein, ET. al. (1998) reveals that FDI has a net crowding in effect on domestic private and public investment thus advancing overall economic growth.The following table shows a clear comparison of the extent of changes in FDI inflow into India pre-liberalization and post-liberalization.

Table1: FDI Inflows during Pre Reform and Post Reform

(Amount in US $ million)

FDI inflows during pre-liberalization period		FDI inflows during post-liberalization period	
Year	FDI INFLOWS	Year	FDI INFLOWS
1969-70	45	1991-92	129
1971-72	48	1992-93	315
1972-73	18	1993-94	586
1973-74	38	1994-95	1314
1974-75	57	1995-96	2144
1975-76	85	1996-97	2821
1976-77	51	1997-98	3557
1977-78	-36	1998-99	2462
1978-79	18	1999-00	2155
1979-80	49	2000-01	4029
1980-81	79	2001-02	6130
1981-82	92	2002-03	5035
1982-83	72	2003-04	4322
1983-84	06	2004-05	6051
1984-85	19	2005-06	8961
1985-86	106	2006-07	22826
1986-87	118	2007-08	34843
1987-88	212	2008-09	41873
1988-89	91	2009-10	37745
1989-90	252	2010-11	34847
CAGR 8.9%		CAGR 32.3%	

Source: UNCTADstat: World Statistical Database

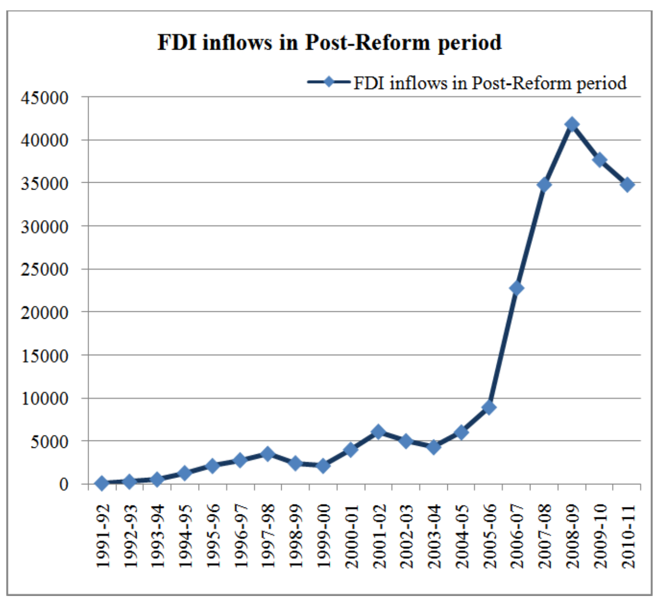


Chart 1: FDI Inflows during Pre Liberalization Phase

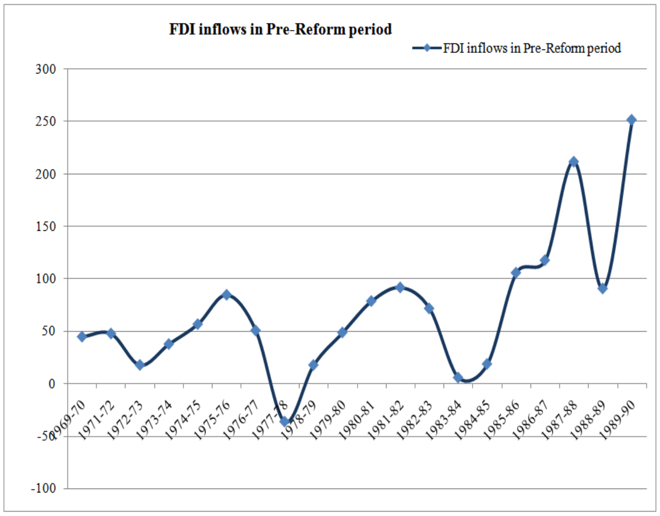


Chart 2: FDI Inflows during Post Liberalization Phase

The above table and charts shows that the FDI inflows into India before the initiation of the reforms were nominal with a Compound Annual Growth Rate of just 8.9%. The reason behind the low rate of foreign capital flows was the restrictions imposed by the Indian Government with the aim of safeguarding the domestic industries which were not capable enough to face the foreign competition. Other than that, there was also a kind of hesitation regarding foreign interference into the economy as the wounds given by the britishers were still not healed. Later facing the rigorous BOP crisis, policy makers realized the utmost need for opening up the economy which was till now 'closed'. The result of the adoption of the economic reforms is quite visible in the table provided above. In the beginning the inflows took place at a slower rate. But after 2-3 years of opening up, the foreign investors laid their confidence into Indian economy and started investing at a higher rate. The total amount of the FDI inflows during the period 1993-94 to 1998-99 had amounted to about US $11 million. The increase was largely due to the expanded list of industries and sectors which were opened up for foreign equity participation. This was followed by relaxation of various rules, regulations and introduction of various policies by the government to promote the FDI inflows. FDI inflows declined to the level of US$2,462 million in the year 1998-99 and further to US$2,155 million in 1999-2000. The reasons for the declining trend of FDI inflows were due to various set of factors. Firstly, there were several restrictions imposed on India by the USA on account of the nuclear test carried out by India. The second factor was the slowdown of the Indian economy due to the mild recession in US and global economy. The third one was about unfavorable external economic factors such as the financial crisis of South-East Asia. Fourthly, the decline was due tothe political instability and the poor domestic industrial environment. In 2000-01, there was a significant rise of about 100% in the inflows. The trend carried further when in 2001-02 when it amounted to US $6051million. In 2002-03, FDI inflows declined to US$ 5035million. It was further declined to US $ 4322million due to the global economic crisis. Then, from 2004-05 onwards, there has been steady increase in the flow of FDI into the country with highest annual growth rate during 2006-07. Further, the table shows that the compounded annual growth rate (CAGR) which was 8.9 percent during Pre liberalization has increased to 32.3 percent during the Post liberalization period. This shows the openness of the Government in liberalizing and globalizing the economy to the outside world through relaxation of regulatory and entry restrictions on FDI inflows.

6. IMPACT OF FOREIGN CAPITAL INFLOWS ON DOMESTIC EMPLOYMENT GENERATION IN INDIA

To analyze the impact of Foreign Capital Inflows on employment generation in India regression equations will be required showing the relationship between FDI and employment generation in India taking FDI as the independent and employment as the dependent variable.

$$EMP_i = \alpha_1 + \beta_1 FDI_i + u_i \quad (1)$$

Where,

EMP_i = Employment generation
α_1 = Intercept for equation 1
FDI_i= Foreign Direct Investment in India
β_1 = Slope of FDI
u_i= Error term for equation 1

The significance level will be taken as 5% for this study.

7. HYPOTHESIS

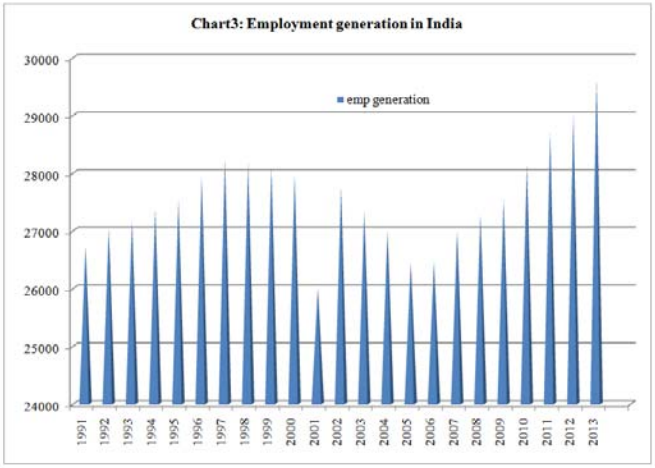
A null hypothesis will be set for the regression equation mentioned above.

Equation 1: *Null Hypothesis*: There is a significant impact of FDI on employment generation in India.

Table 2: Employment Generation in India Since 1991

Year	Employment Generation	Year	Employment Generation
1991	26733	2003	27333
1992	27055	2004	27000
1993	27176	2005	26443
1994	27375	2006	26458
1995	27525	2007	26993
1996	27941	2008	27276
1997	28245	2009	27549
1998	28166	2010	28172
1999	28113	2011	28708
2000	27960	2012	28999
2001	26000	2013	29650
2002	27754		

Source: www.tradingeconomics.com | Ministry of statistics and programme implementation



Descriptive Statistics for Equation 1

	FDI	Employment
Mean	11107.2500	27363.3500
Standard Deviation	14350.57410	643.63828
N	20	20

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.047a	.002	-.053	660.55788

Coefficientsa						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	27386.552	188.612		145.20	.000
	FDI	-.002	.011	-.047	-.198	.845

a. Dependent Variable: Employment

8. INTERPRETATION OF RESULT

The above obtained result shows that the model is insignificant having only 0.2% of R square value(R^2) of the data is being explained by the regression equation. This implies that only 0.2% of variation in employment generation is being explained by FDI. Whatever the FDI inflows is coming into India is not making any significant impact on employment generation because of the limited inflows or due to the restrictive nature of Indian economy. The increase in employed persons or trend of employed person shows the positive impact of domestic economy rather than the foreigninvestment.

9. CONCLUSION

By working on this paper, we reach to the conclusion that as far as FDI inflow growth is concerned, India has started with a low amount of inflows initially. The reason for such a low degree of inflows may be attributed to the insufficient reliance of foreign investors on Indian economy and also the restrictions put by the Indian Government on 'foreign interference' with a view to protect domestic industries from heavy foreign competition. Later, as the confidence built in, the foreign investors started looking India from an investment perspective. In addition to that, Indian Government also laid an increased amount of confidence in foreign investment. The result of this is quite evident in the form of increased CAGR from 8.9% in pre-reform to 32.3% in post reform era. Further, this paper tried to analyze the impact of FDI on employment generation in India. The above study of this objective shows that though the employment generated in India in last two decades is quite appreciable but the FDI inflows may not be stated as a responsible factor for this growth. Thus this paper tries to suggest that Government should take such initiatives so as to route FDI inflows in a manner which enhances employment generation in India especially in the organized sector.

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