

## FDI in India: Understanding the Implications for Growth and Job Creation

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### Abstract

Backed by progressive economic reforms, India has been performing very well in terms of FDI inflows. However, FDI inflow in India is extremely skewed across the major sectors of the economy with the services sector accounting for more than half of the total FDI equity inflows. Having emerged as an attractive destination for FDI, the services sector contributes more than half of India's GVA but its contribution to job creation although significant has been less than proportionate to its contribution to GVA and also lacks in quality. The manufacturing sector on the other hand has not been able to generate employment adequately owing to the capital-intensive mode of production that has been adopted in this sector. This paper while trying to counter the prevalent view that FDI inflow in India has failed to generate employment, also highlights some of the pressing issues that need to be addressed towards harnessing the employment-generating potential of the economy.

**Keywords:** foreign direct investment; economic growth; gross value added; employment

### Trending FDI Flow into India

A news that hit the headlines recently is the US\$13 billion all-cash investment from Russia's State controlled oil major Rosneft and its partner taking over India's second biggest private oil firm Essar Oil's refinery, port and petrol pumps, marking the largest ever inflow of foreign direct investment (FDI) into the country (PTI, 2016a). Led by such investments backed by a slew of reforms, FDI inflows into India reached a record US\$60.1 billion in 2016-17 (as per estimates based on international best practices). As per the Department of Industrial Policy & Promotion's (DIPP's) database based on equity capital components only, FDI equity inflows into India touched US\$43.5 billion in 2016-17 (DIPP, 2017).

Based on data provided by DIPP (Figure 1), the period 2000-01 to 2008-09 saw an increasing trend of FDI equity flows to India, and doing particularly well in the between 2004-05 and 2008-09 period, but thereafter declined for a couple of years in the aftermath of the global economic crisis of 2008-09. The inflows once again started an upward trend from 2012-13 onwards, growing rapidly in 2014-15 and 2015-16. Thus, strong FDI flows to India has been largely influenced by prospects of a strong economic growth in an open progressive emerging economy, only slowing down when faced with global crisis and stagnation of domestic reforms compromising its comparative advantage and competitiveness.

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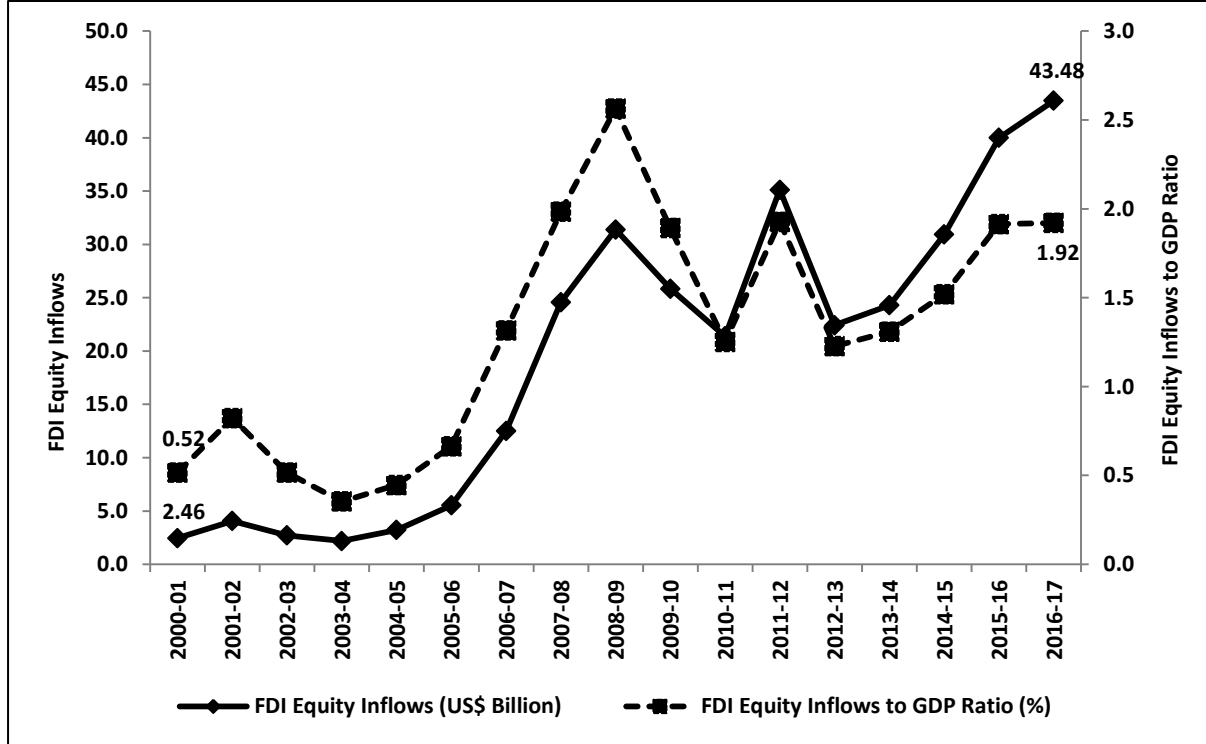
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**State-wise Shares in FDI Equity Inflows**

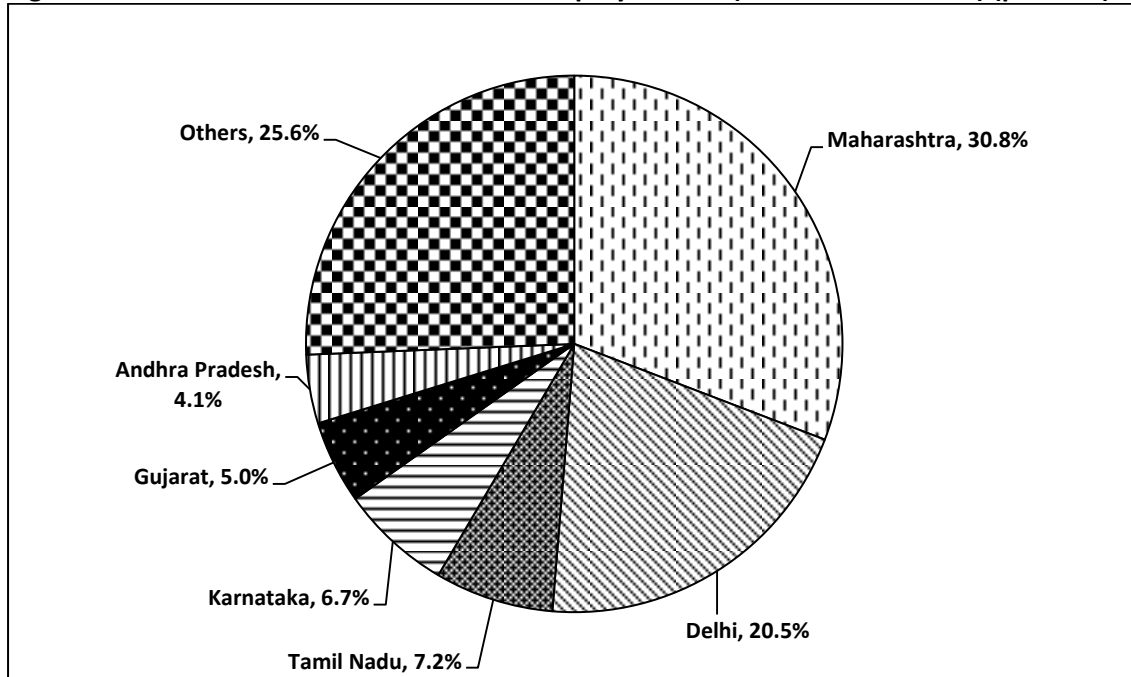
It is observed that Maharashtra, Delhi, Tamil Nadu, Karnataka, Gujarat and Andhra Pradesh (the States mentioned include other peripheral States / regions) account for about three-fourth of the total FDI flows cumulatively for the period 2000-01 and 2016-17 (Figure 2).

**Figure 1: FDI Equity Inflows and FDI Equity Inflows to GDP Ratio for India (2000-01 to 2016-17)**



Sources: DIPP (2017); RBI (2017).

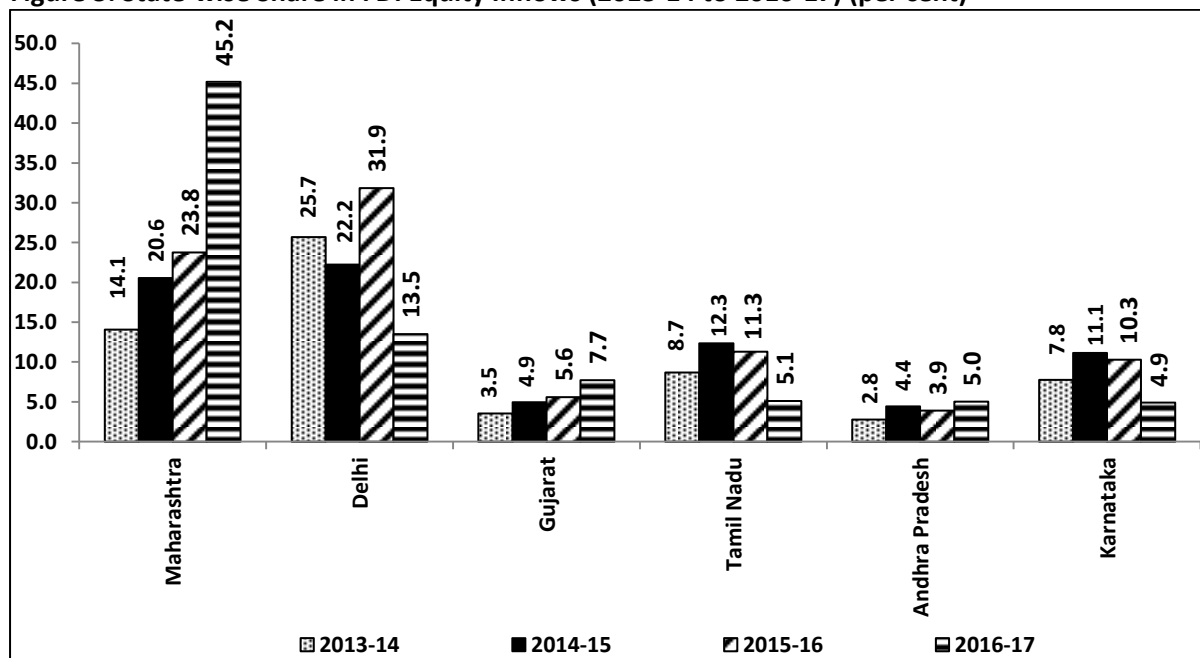
**Figure 2: State-wise Cumulative Share in FDI Equity Inflows (2000-01 to 2016-17) (per cent)**



Source: DIPP (2017).

Maharashtra has traditionally been the highest recipient of FDI equity followed by Delhi. But from 2013-14 till 2015-16, Delhi outpaced all other States in terms of share of FDI equity received, followed by Maharashtra (DIPP, 2016). In 2016-17, the trend got reversed again with Maharashtra accounting for about 45 per cent of total FDI equity inflows followed by Delhi at 14 per cent only (Figure 3).

**Figure 3: State-wise Share in FDI Equity Inflows (2013-14 to 2016-17) (per cent)**



Source: DIPP (2016; 2017).

FDI inflows into Maharashtra are mostly for development of infrastructure (transportation, energy, electrical equipment, and telecommunication) or for services sectors (Chatterjee, Mishra & Chatterjee, 2013). The same is the case with Delhi which attracts FDI inflows mainly in sectors like transportation, electrical equipment, telecommunications, and services. The States with comparatively high FDI inflows are either known for their strong industrial base or as software hubs. High FDI inflows can also be attributed to the States' better resources, infrastructure like power and roads, investment promotion schemes like special economic zones (SEZs), and investor-friendly policies like single-window clearances (NCAER, 2009).

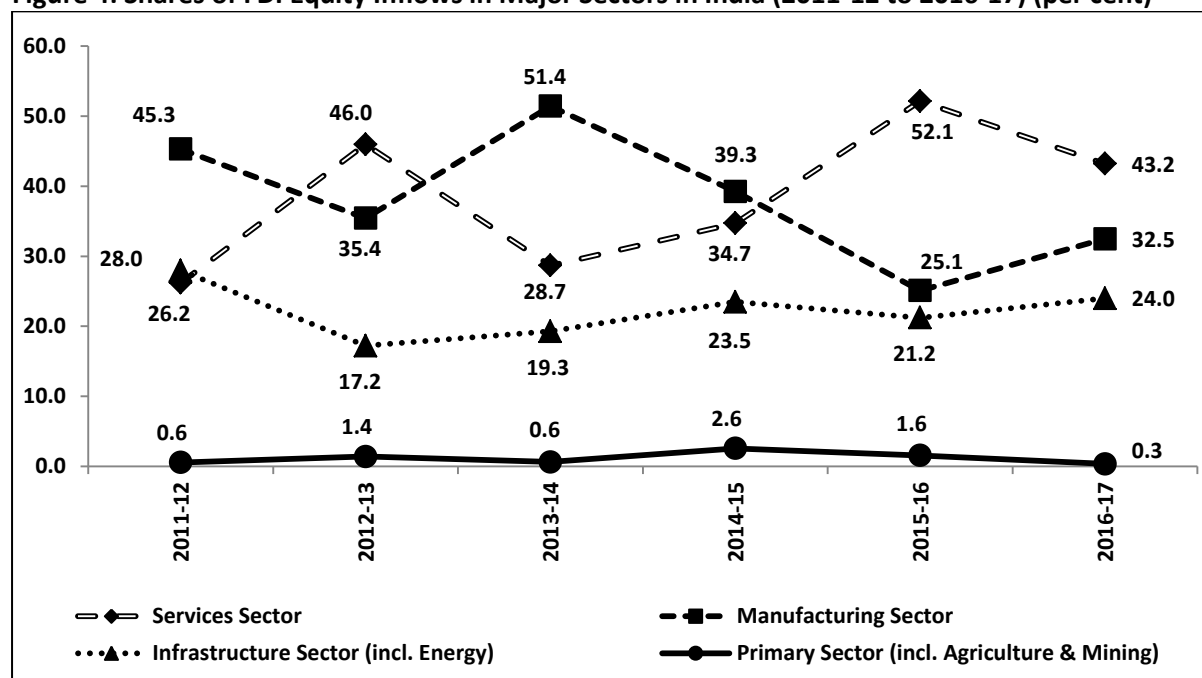
#### Sector-wise Shares in FDI Equity Inflows

FDI equity inflow into India for several years has been extremely skewed across the major sectors of the economy. Notably, the share of services sector in FDI equity inflows doubled from about 26 per cent in 2011-12 to 52 per cent in 2015-16, but dropping to 43 per cent in 2016-17. On the other hand, the manufacturing sector lost its share from about 45 per cent 2011-12 to 25 per cent in 2015-16, but recovering to more than 32 per cent in 2016-17 (Figure 4). The share of infrastructure sector (including energy) in total FDI equity inflows also dipped from about 28 per cent in 2011-12 to 24 per cent in 2016-17. The primary sector (including agriculture and mining) never really picked up in terms of FDI equity inflows.

Further, the skewness in FDI destination is tilted towards few sectors. DIPP data shows that the top 10 FDI equity receiving sectors accounted for more than 71 per cent of the total FDI equity inflow in 2016-17 with the services sector (as per DIPP classification) along with computer software and hardware, trading, and information broadcasting accounting for over 37 per cent of the total FDI equity inflow (Table 1). The manufacturing sector represented by electrical equipment, cement and

gypsum products, automobile and metallurgical industries in the list of top 10 sectors accounted for 17 per cent of the FDI equity inflow.

**Figure 4: Shares of FDI Equity Inflows in Major Sectors in India (2011-12 to 2016-17) (per cent)**



Sources: Secretariat of Industrial Assistance (SIA) Newsletter, DIPP (various years).

**Table 1: Sector-wise FDI Equity Inflows (2016-17)**

Sector	Amount (US\$ Billion)	Share (%)
<b>Services (as per DIPP classification)</b>	8.68	20.0
Telecommunications	5.56	12.8
Computer Software & Hardware	3.65	8.4
Trading	2.34	5.4
Electrical Equipment	2.23	5.1
Cement and Gypsum Products	2.13	4.9
Construction (Infrastructure) Activities	1.86	4.3
Automobile Industry	1.61	3.7
Information & Broadcasting (incl. Print Media)	1.52	3.5
Metallurgical Industries	1.44	3.3
<b>Total of Top 10</b>	<b>31.03</b>	<b>71.4</b>
<b>Grand Total</b>	<b>43.48</b>	<b>100.0</b>

Sources: DIPP (2016, 2017).

Cumulatively, between 2000-01 and 2016-17, the top 10 FDI destination sectors accounted for about 64 per cent of the total FDI equity inflows. The services sector (as per DIPP classification) along with computer software and hardware, and trading featured in the list of top 10 recipients of FDI equity flows accounting for about 30 per cent of the total FDI equity inflow. The manufacturing sector represented by automobile, drugs and pharmaceuticals, chemicals (excluding fertilisers), and metallurgical industries in the top 10 sectors accounted for 17 per cent of the total FDI equity inflow (DIPP, 2017).

**FDI, Growth and Job Creation**

The impact of FDI inflow on growth of the host country varies with the sector to which it flows. While FDI inflow to the manufacturing sector may have a positive impact on growth, FDI flow to the primary (agriculture and mining) sector may not be as impactful, and flow into the services sector could be somewhat ambiguous (Alfaro, 2003). Impact also depends on the nature of FDI in terms of the extent of localisation of the output, its export orientation, vintage of technology used, orientation of research and development (R&D) for productivity enhancement, etc. In the case of India, services sector which contributes about 54 per cent of India's gross value added (GVA) (Table 2), has emerged as an attractive destination for FDI.

**Table 2: Share and Growth of India's Major Sectors (2011-12 to 2016-17) (per cent)**

Year	Agriculture & Allied		Industry (incl. Construction)		Manufacturing		Services (excl. Construction)	
	Share of GVA	Growth Rate	Share of GVA	Growth Rate	Share of GVA	Growth Rate	Share of GVA	Growth Rate
2011-12	18.5	-	32.5	-	17.4	-	49.0	-
2012-13	18.2	1.5	31.8	3.3	17.1	5.5	50.0	8.3
2013-14	18.6	5.6	30.8	3.8	16.5	5.0	50.6	7.7
2014-15	18.0	-0.2	30.2	7.5	16.4	8.3	51.8	9.7
2015-16	17.5	0.7	29.6	8.8	16.6	10.8	52.9	9.7
2016-17	17.4	4.9	28.8	5.6	16.5	7.9	53.8	7.7

Source: RBI (2017).

Given the nature of sectoral growth and the flow of FDI experienced so far, commentators have been questioning the employment potential of FDIs. Indeed, there are challenges, but to over-emphasise the role of the FDI or even belittle the role it had played in creating jobs would be inappropriate. It may be noted from the results of the latest Employment and Unemployment Survey of the National Sample Survey Office (NSSO) that the services sector has contributed more to employment compared to the manufacturing sector. The survey shows that the share of services sector in total employment stands at about 27 per cent for 2011-12, while that for the manufacturing sector and the industrial sector (including construction) are about 13 per cent and 24 per cent respectively (Table 3).

**Table 3: Employment Share of India's Major Sectors (1972-73 to 2011-12) (per cent)**

Sectors	1972-73	1977-78	1983	1987-88	1993-94	1999-2000	2004-05	2009-10	2011-12
Agriculture & Allied	73.9	71.0	68.6	64.9	64.0	60.3	56.3	51.3	48.9
Manufacturing	8.9	10.2	10.7	12.2	10.6	11.0	12.3	11.5	12.6
Industry (incl. Construction)	11.3	12.6	13.8	17.0	15.0	16.2	18.8	22.0	24.3
Services (excl. Construction)	14.8	16.5	17.6	18.1	21.1	23.4	24.9	26.7	26.9

Sources: Papola & Sahu (2012); NSSO (2014).

Note: Employment data is according to usual (principal + subsidiary) status.

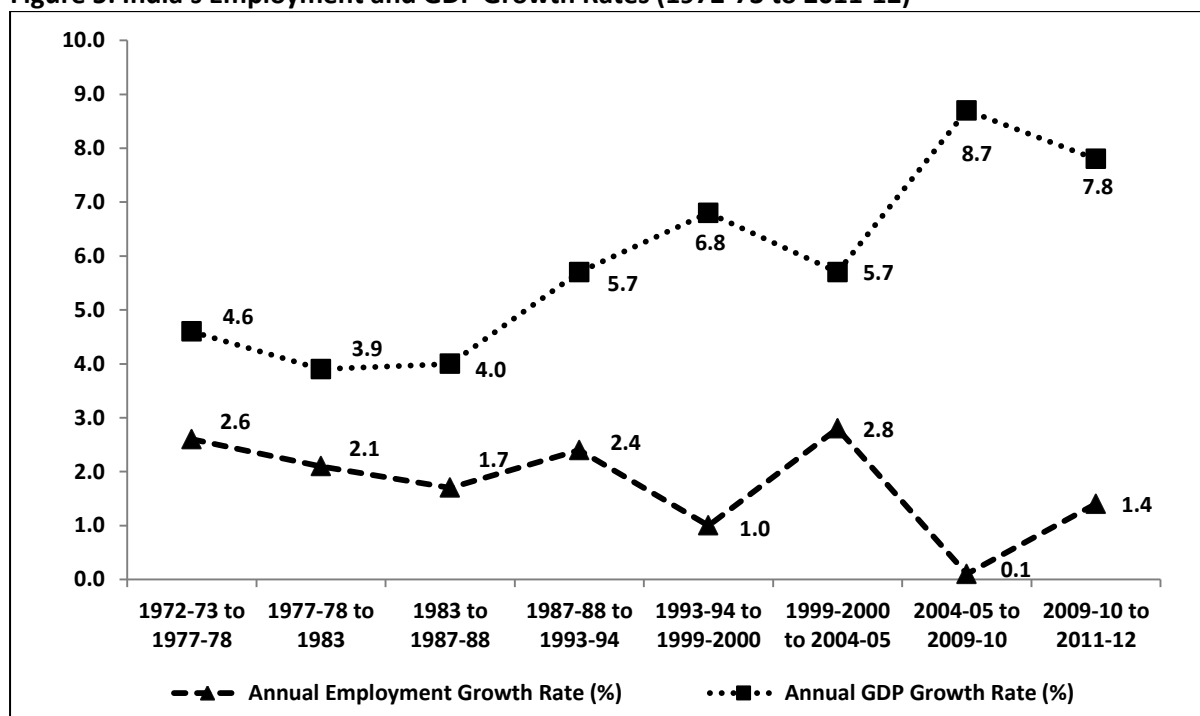
The share of services sector in total employment has systematically increased from 1972-73 to 2011-12 (Table 3). On the other hand, the share of manufacturing sector in total employment, traditionally more job creating, has remained stagnant at the pre-liberalisation levels notwithstanding high growth rates triggered by economic reforms in 1991. Studies have attributed this to a sustained

decrease in labour intensity of the organised manufacturing sector, including the traditionally labour-intensive industries, due to an increase in the real wage to rental price of capital ratio. This was largely due to decline in the relative price of capital goods attributable to trade reforms and sustained decline in import tariffs on capital goods post 1991 (Sen & Das 2015).

Increasing capital intensity also reflects technological transformation and progress which is capital augmenting in nature. Researchers have documented that Indian manufacturing companies having easier access to foreign technology in the globalised era post 1991 adopted more capital-intensive (and labour replacing) techniques of production (Kapoor, 2016). The overall impact can be seen in terms of the number of jobs created in the organised sector vis-à-vis the increase in the size of the working-age population in the post 1991 period of high growth. The size of the working-age population of India increased by 300 million between 1991 and 2013, while the number of jobs increased by only 140 million (UNDP, 2016). The Indian economy had thus absorbed less than half of the new entrants into the labour market.

The relationship between growth and employment is murky as can be observed from the annual employment growth rate which slipped from above 2 per cent between 1972-73 and 1993-94 to less than 1.5 per cent between 1993-94 and 2011-12. During the same periods, annual GDP growth increased from less than 5 per cent between 1972-73 and 1993-94 to more than 7 per cent between 1993-94 and 2011-12 (Figure 5).

**Figure 5: India's Employment and GDP Growth Rates (1972-73 to 2011-12)**



**Sources:** Himanshu (2011); Papola & Sahu (2012); Misra & Suresh (2014); RBI (2017).

**Note:** Employment data is according to usual (principal + subsidiary) status.

The decline in employment growth rates coinciding with high GDP growth rates explains the phenomenon of jobless growth as experienced by India post 1991. This poses a serious challenge from the point of sustainability, given the estimated expansion of the working-age population from approximately 761 million in 2011 to 869 million in 2020 (EY & FICCI, 2013); that is the need to create 1 million new jobs per month.

The gravity of the situation is discernible from the estimated quarterly growth in employment across eight selected sectors comprising manufacturing, construction, trade, transport, accommodation and restaurants, information technology (IT) / business process outsourcing (BPO), education, and health based on the quarterly data on employment generation of the Labour Bureau, Ministry of Labour & Employment (MoLE), Government of India (GoI) (Table 4).

**Table 4: Estimated Growth in Employment in Eight Selected Sectors in India in 2016-17 (in thousand)**

Sectors	1 <sup>st</sup> Jul 2016 over 1 <sup>st</sup> Apr 2016	1 <sup>st</sup> Oct 2016 over 1 <sup>st</sup> Jul 2016	1 <sup>st</sup> Jan 2017 over 1 <sup>st</sup> Oct 2016	1 <sup>st</sup> Jan 2017 over 1 <sup>st</sup> Apr 2016
Manufacturing	-12	24	83	95
Construction	-23	-1	-1	-25
Trade	26	-7	7	26
Transport	17	0	1	18
Accommodation & Restaurant	1	-8	0	-7
IT / BPO	-16	26	12	22
Education	51	-2	18	67
Health	33	0	2	35
<b>Total</b>	<b>77</b>	<b>32</b>	<b>122</b>	<b>231</b>

Source: MoLE (2017).

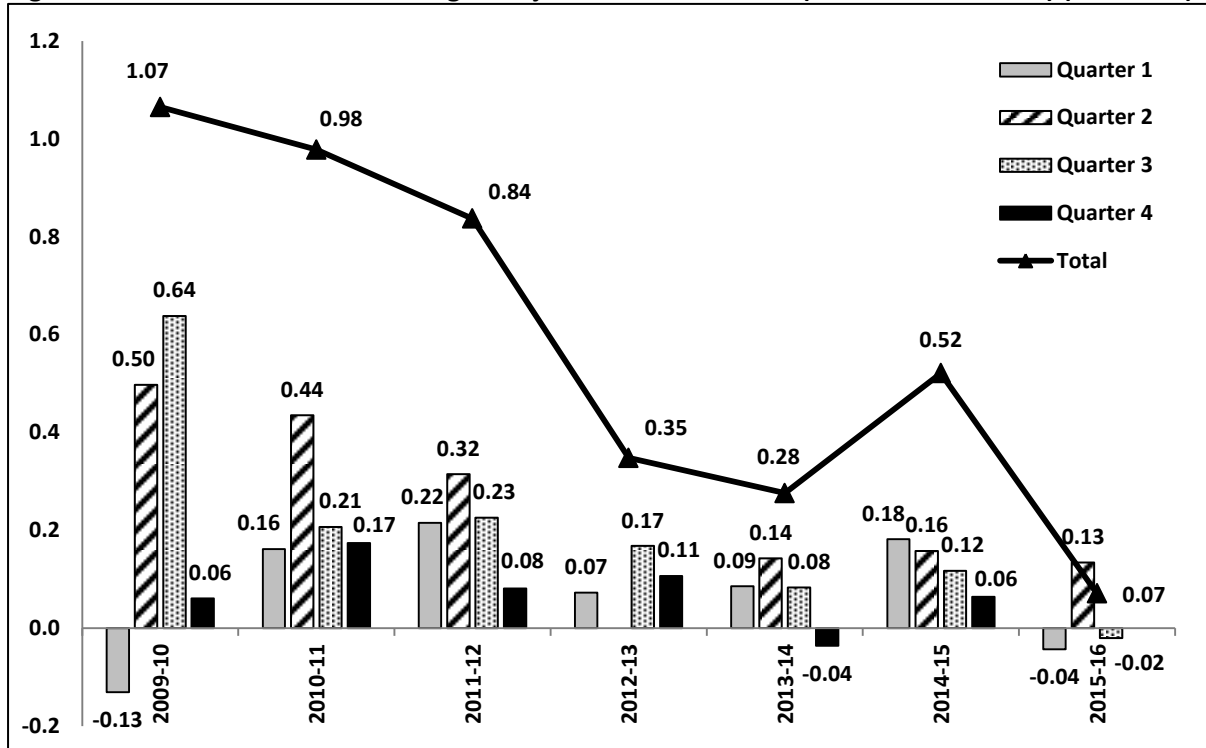
Table 4 shows that there was an overall increase of only 0.23 million workers over a period of 9 months between 1 April 2016 and 1 January 2017 based on a sample of around 10,610 units across the eight sectors at the all-India level. The earlier methodology of sampling around 2,000 units across eight major labour-intensive industries comprising textiles (including apparels), leather, metals, automobile, gems and jewellery, transport, IT / BPO, and handloom / powerloom gravity showed a declining trend in the number of jobs created from 1.07 million in 2009-10 to 0.07 million across three quarters in 2015-16 (Figure 6 on next page).

Thus, it appears that the Indian growth story in a globalised era has not been able to create enough jobs for a rapidly burgeoning working-age population. On the other hand, data also reveals increased informalisation of workforce in the organised sector. As per the latest estimates for 2011-12, about 92 per cent of the workforce in India is informal, with the unorganised sector contributing 82 per cent (down from 86 per cent in 2004-05) and informal workers in the organised sector contributing 10 per cent. The share of informal workers in the organised sector has increased notably because of increased hiring of contract workers and casual labourers (ILO, 2016). A large section of the informal workforce is found to be engaged in sectors such as computers, information technology enabled services (ITES), construction, real estate, hotel and tourism, transport and logistics, etc. where FDI has been largely flowing in India. Therefore, FDI, inspite of flowing mainly to States having favourable legislations and regulations, and infrastructure, and preferentially to high value-added sectors, has been contributing towards job creation.

### Challenges and Issues

Faced with the dual challenge of attracting FDI flows into sectors having potential for generating growth and employment, and coping with a rapidly evolving economic and technological landscape, it is important to address some of the challenges and issues and understand the implications of recent government initiatives.

Figure 6: Estimated Job Growth in Eight Major Industries of India (2009-10 to 2015-16) (in million)



Source: Quarterly Report on Changes in Employment in Selected Sectors, MoLE (various years).

### Aligning Policies

The GoI on June 20, 2016, announced an amended FDI policy to facilitate ease of doing business, attract investment, and promote growth in income and employment. The amendments are designed with a focus on spurring the GoI's flagship programme – Make in India, which has been launched to transform the manufacturing sector into a key engine of growth for the economy. These amendments have resulted in India becoming the most open economy for FDI with majority of the sectors coming under the automatic approval route (PMO 2016). The Make in India programme is showing some early positive signs of attracting FDI towards establishing manufacturing facilities in India (Singh & Sasi, 2016). To illustrate, the Chinese mobile manufacturing giant Xiaomi after its foray into India in July 2014, has started manufacturing smartphones locally from August 2015 onwards in partnership with Taiwanese contract manufacturer Foxconn, and plans to ramp up manufacturing capability in the country (TNN, 2017). However, due to the capital-intensive nature of production and the disruptive advancements in technology, it is suspect whether such manufacturing units will be able to accommodate and sustain a large workforce.

Further, with the advent of 3D printing, artificial intelligence and robotics, the manufacturing sector is going to bear the brunt in terms of replacement of labour in which India has comparative advantage. Thus, it is imperative to align various policies and programmes in a holistic manner keeping with the broader objective of employment generation. One such area is the small and medium enterprises (SMEs) which employ about 40 per cent of the workforce, and contribute about 45 per cent of India's manufacturing output and 40 per cent of India's total exports (Jaffrelot, 2016). Government policy should support the well-performing SMEs to become globally competitive and increase their exports, and protect them from the threat of dumping in the context of low global commodity prices and the economic slowdown in countries like China (Mishra, 2015).



### **Archaic Labour Laws**

The government should ensure an enabling environment for FDI flow to the relatively labour-intensive industries including leather and leather products, textiles and readymade garments, and light machine tools, with units / plants set up in small towns close to rural and suburban areas, as these industries have high employment-generating potential (NCAER, 2009). The labour-intensive industries shifting to capital-intensive modes of production, being driven significantly by inflexible and cumbersome labour laws apart from diminishing relative price of capital goods. It is noteworthy that in the organised manufacturing sector, real wage growth has not grown much due to the declining bargaining power of the labour unions as firms found a way around by engaging contract workers. The government should focus on simplifying the existing labour laws and make them more flexible as this would not only help in attracting FDI, but also generate employment opportunities, particularly in the manufacturing sector (ET, 2014, 2016).

### **Informal Employment**

Informal, including contractual, employment is growing in both the organised and the unorganised sectors. But compared to manufacturing, in emerging India, a large proportion of this is taking place in the high value-added services sector. Unlike the manufacturing sector in India, where developed economies globally have a large market share vis-à-vis developing countries, services sector is expanding steadily, with ample catching-up opportunities, and with scope for entry for all (Ghani & O'Connell, 2014). The emergence of a sizable middle class across countries is spurring growth of the services sector which is now accounting for a greater share of FDI inflows.

The GoI recognising the importance of supporting informal workforce seeking livelihood has launched initiatives such as MUDRA (Micro Units Development & Refinance Agency Ltd.) and Stand-Up India focusing on the unorganised sector. With such initiatives geared towards promoting self-employment – i.e., transforming job seekers into job creators – a lot of informal employment opportunities will be created.

### **Skill Development**

In order to tide over the problem of employability for maximum employment gains, appropriate skilling should take place particularly in the sectors with high employment elasticity (with regard to GDP) and should be placement linked. The Economic Survey 2014-15 indicates the size of the formally skilled workforce in India as only 2 per cent, while 6.8 per cent of persons in the age group 15 years and above have either received or are receiving vocational training (MoF, 2015). The situation is grim when it comes to developing the skills of the vast numbers of those already employed or are seeking employment in the organised industrial sector. With labour displacing technological innovations estimated to result in job losses for about 200 million Indians by 2025 (PTI, 2016b), re-skilling of the existing workforce along with skilling of the fresh job seekers is a mammoth task. Low education base in terms of poor education attainment status of the students at the school level along with high drop-out rates also plays a hindering role vis-à-vis technical trainings (of large number of such candidates) (Jaffrelot, 2016).

Government focus on the Skill India programme is aimed at encouraging the development of a skilled labour force through the National Skill Development Mission, National Policy for Skill Development and Entrepreneurship 2015, Pradhan Mantri Kaushal Vikas Yojana (PMKVY), and the Skill Loan Scheme. However, the Skill India programme will be successful if it is geared towards skilling in areas having the desired number of jobs and ensuring job placement (Maira, 2016; Jagannathan, 2016), and constantly evolves to meet the challenge of reskilling workforce rendered redundant or unproductive by technological change.

### **Regional Inequality**

FDI flows in India have a strong regional concentration (Mukherjee, 2011) with a handful of States accounting for a major chunk of the total inflow. In the age of co-operative federalism, in order that regional inequality does not get escalated by such skewed FDI inflows, it is necessary that FDI-related policies, rules and regulations are designed taking into consideration the regional issues and adapted if necessary by all the States and Union Territories (Malhotra, 2014). A necessary requirement for this is political will both at the Centre and State level.

### **Conclusion**

It is common knowledge that FDI flow can only play the role of supplementary investment to domestic (public and private) investment required for growth and development of the economy. Domestic public investment should be channelised to such sectors delivering public goods, having long gestation periods, like infrastructure, having greater employment potential, and those where private sector investments and specifically FDI may not be attractive. FDI should never be over-emphasised in its role of creating jobs for a large pool of unemployed workforce waiting to be inducted or re-employed with new and more relevant skills. However, FDI, besides primarily contributing to the GVA of the economy, has been contributing significantly to job creation in the rapidly emerging and growing sectors in India. Thus, to state that FDI inflow in India has failed to create employment may be inappropriate. The services sector, which has been the biggest recipient of FDI equity flows for several years now, has notably contributed to job creation though somewhat lacking in quality and less than proportionate to its contribution to GVA.

The manufacturing sector on the other hand has not been able to generate employment adequately for the masses mainly due to the capital-intensive mode of production that has been adopted in this sector. The share of FDI equity flows to the manufacturing sector, however, has been going down over the years along with its dwindling contribution to GVA. A lot of expectation has been placed on the Make in India manufacturing sector to attract foreign investment and generate employment. But with so much technological innovation / advancement and use of capital-intensive (and labour displacing) mode of production, it remains to be seen how far the manufacturing sector can generate employment along with economic growth. India is faced with a huge army of unskilled and inappropriately skilled workforce. Skilling of a huge unskilled labour force is going to be an arduous task. Re-skilling of the existing workforce too requires a minimum time during which a new pool of job seekers would join the labour force. But mere skilling of people as envisaged by the Skill India initiative without the availability of requisite number of employment opportunities will intensify the problem of joblessness that can lead to social unrest. With one million new entrants in the labour force per month, joblessness can take up epic proportions that might transform India's much-hyped demographic dividend into a demographic disaster.

### **Endnotes**

<sup>1</sup> Maharashtra includes Maharashtra, Dadra & Nagar Haveli, and Daman & Diu; Delhi includes New Delhi and parts of Uttar Pradesh and Haryana; Tamil Nadu includes Tamil Nadu and Puducherry; Andhra Pradesh includes Andhra Pradesh and Telangana.

<sup>2</sup> Services sector includes sub-sectors as per DIPP classification (financial, banking, insurance, non-financial / business, outsourcing, R&D, courier, and technical testing and analysis) plus computer software and hardware, trading, hospitals and diagnostic centres, consultancy services, hotel and tourism, information and broadcasting, and printing of books. Construction is being considered as part of the industrial sector.

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