

# Effects of FDI on Employment in Organised Manufacturing Sector in India: An empirical analysis for the period 1991- 2014

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## Abstract :

Employment generation is a very important objective for the country like ours where there exists surplus labour. It is generally held in the theoretical literature on FDI that one of the major benefits of FDI inflows is generation of new employment in the host economy. Since the beginning of the economic reforms programme in 1991, characterized by neoliberal economic policies, GDP in India has registered unprecedented growth. But this economic growth in India is job-less growth since regular employment in the formal or organized sector of the economy has not increased at all with economic growth (Sen and Dasgupta, 2009). Due to non-availability of necessary data in this regard I have made an attempt in this paper to find the impact of FDI inflows in selected organized manufacturing sectors in India. I have made use of the quantitative data of employment in the organized manufacturing sector which is available from Annual Surveys of Industries (ASI) as published by the Central Statistics Office (CSO) of Government of India to assess the impact of FDI on employment in the organized manufacturing sector.

**Keywords :** economic reforms , forward and backward linkages , greenfield investment , jobless growth , regular employment and contractual employment , skilled and unskilled labours and panel regression.

**1.Review of Literature:** The effects of FDI on employment can be direct as well as indirect. Both direct and indirect effects may have both positive and negative influences on employment. Direct effects of FDI on employment include the following:

- (1) FDI inflows are generally generated by large multinational corporations (MNCs). Their production in the host economy may directly lead to increase in labour demand (Banga, 2005). With foreign investment infested firms expanding their production capacity, more and more jobs are created directly in these firms (Lall, 2003). However, it all depends on the nature of technology of production adopted by the foreign investment infested firms. For example, if the technology is highly capital-intensive and labour-saving there may be reduction in the employment potential in the host economy. As argued by Driffield and Taylor (2009), the transfer of capital-intensive technology by the MNCs may lead to a shift of skilled labour from low-paid domestic works to higher-paid works offered by the MNCs and thereby there may be absolute reduction in aggregate employment in the host economy.
- (2) Whether the direct employment effect of FDI would be positive relies on the nature of FDI (Lall, 2003). In case of Greenfield investment, it is expected that new production units will be setup which would raise the demand for labour. On the other hand, in case of Brownfield investment viz FDI which is of mergers and acquisition type (M&A type), demand for labour in the host economy may not go up. Rather, as shown by (Jenkins, 2006), M&A type FDI may reduce aggregate employment in the host economy.
- (3) FDI in export-oriented industries in the host economy, which has plenty of cheap labour, may increase aggregate employment. For example, in East Asia in the nineties simple processing activities for exports generated large number of low wage and low skill jobs (Lall, 2003). This means although

aggregate employment rose in East Asian countries, the quality of employment increased was not good as they were mostly low waged and low skilled ones.

- (4) The present-day technologies are skill biased as these technologies involve skilled labourers than unskilled ones. And since foreign investment infested firms generally use modern technologies they usually prefer skilled workers to unskilled workers (Machine and Reeven, 1998). But in developing countries like India unskilled workers are generally more than skilled workers. This was exemplified by Feenstra and Hanson (1997) in case of FDI inflows in Mexico during 1975-88. Generally, skilled workers are paid more than the unskilled workers and also receive other benefits from the FDI infested firms in order to reduce labour turnover. Since skilled workers form a tiny portion of total labour force in a country like India the foreign investment infested firms in reality benefit a small section of workers (Pradhan et. al., 2004).

Indirect effects of FDI on employment generation are the following:

- (1) It is held that through forward and backward linkages FDI can generate employment in domestic firms in host economy. (Lall, 2003). Larger the local linkages, greater is positive indirect effects of employment generation [Ilyanda1999; Golejewska, 2002]. But if foreign investment infested firms depend greatly on imported inputs such indirect positive impact on employment generation may not be present (Jenkins, 2006). Indirect positive effect may be there if there is demand for better transport services, marketing facilities and other infrastructure facilities (Kingombe 2002).
- (2) If due to FDI the existing labour intensive local firms go out of business or shed employees to gain cost competitiveness, there may be negative indirect effects on employment (Sahu, 2010).
- (3) If FDI adds to incomes resulting in higher consumption, savings and investment, new service-oriented employment may be generated (Lall, 2003).
- (4) The labour market efficiency in the host economy in terms of labour laws, institutions, trade unions, and industrial relations and like influences employment generating capacity of FDI (Golejewska, 2002; Lall, 2003).

Pradhan et al (2004) examined the effect of FDI on wages and employment in Indian manufacturing for 2001-02 and found that the foreign investment infested firms pay generally higher wages to their workers without any negative effect in employment as compared to their domestic counterpart. Bhaskar (2013) showed that FDI in Indian automobile industry has significantly generated employment. However, Rizvi and Nishant (2009) in the context of Pakistan, India and China for the period 1985-2008 found no direct positive employment effect due to FDI. Banga (2005) in terms of a dynamic panel data estimation for 78 three-digit industries in the post reform period in India found higher wage rate in the industries with FDI but no positive effect on employment.

Banga (2005) identifies rigid labour laws in the Indian organised manufacturing sector as a major obstacle to FDI. It is held that to attract more and more FDI inflows in Indian manufacturing sector, there should be flexible labour regime where flexibility implies numerical flexibility, wage flexibility, functional flexibility and temporal flexibility.

According to Earnets and Masso (2004), labour market flexibility should be measured at two different levels – the macro level and the micro level. At the macro level, flexibility in labour market can be divided into institutional flexibility (measured by the extent of interference of state institution and trade unions in the free operation of labour market) and wage flexibility (the degree of responsiveness of wage with the market fluctuation). Micro level flexibility characterises different flows of workers (transition between labourmarket states), occupational mobility (switch labourers from one task to other as situation arises), and geographical mobility (shifting workers from one unit to other) and by job flows (job creation and job destruction). According to Stiglitz (2002) if there is free market then economic agents operate freely to

employ all resources at market clearing prices leading to efficiency. Whyman and Baimbridge (2006) identified government, trade unions and monopsonistic employers as market distorting agents which restrict free operation of market forces to ensure full employment of all resources and social optimal welfare.

Numerical flexibility helps the employers to change employment quickly and easily by driving away workers without skills and appointing new workers in contractual or temporary basis (Sen and Dasgupta, 2009; Standing et. al., 1996).

Two parallel arguments are found for the role of flexibility in labour market to attract FDI and creating employment. Labour market flexibility can have two opposite effects on FDI inflows. Economists in favour of flexible labour market argue that stringent labour market regulations cause firms to slow down the reallocation of resources in response to market changes which in turn imposes costs on firms (Patnaik 2011). Labour market regulations adversely affect FDI inflows due to (a) the probable decrease in foreign firms' profit due to high labour costs and (b) decrease in foreign firms' decision making capacity to respond with demand change (Parcon 2008). For these reasons, most of the developing countries are forced to opt for more flexible labour regime to attract FDI inflows. The proponents of flexible labour regime feel that such regime would attract more FDI and thereby, there will be more employment.

The critiques of flexible labour regime opine that different notions of flexibility itself deter the possibility of new employment generation, especially in case of functional flexibility where multi-skilling and re-training of existing workers reduce the scope of fresh recruitment (Sen and Dasgupta, 2009). Moreover, the market liberalisation and privatization may lead to what Keynes in the Chapter 3 of his *The General Theory of Employment, Money and Interest* defined as involuntary unemployment in 1936. In an unregulated market employers can compel their employees to work for longer hours at low wages. (Sengenberger, 2002).

Indian labour laws are blamed to be 'highly protective of labour... (which) have restricted labour mobility, have led to capital-intensive methods in the organised sector and adversely affected the sector's long run demand for labour.... Evidence suggests that States, which have enacted more pro-worker regulations, have lost out on industrial production in general' (Economic Survey, 2005-06 as cited in Nath 2015).

Indian labour market is already quite flexible in reality due to the presence of vast informal sector and lack of strict application of the existing labour protection laws (Bhirdikar et. al., 2011).

**2. Assessment of FDI and Employment in Organised Manufacturing Sector in India:** Most of the studies concerning employment in India have dealt with different employment issues relating to manufacturing sector, especially organised sector. CSO covers the organised employment data through its Annual Survey of Industries (ASI). But the organised sector in India provides only a small fraction of total employment. The majority of workforce is employed in informal sector, the detailed data of which is not available at the secondary level. The employment-unemployment surveys conducted by NSSO periodically reports about workforce in informal sector. The lack of reliable statistics on the size, distribution and contribution of informal sector in the economy restricts our analysis of effect of FDI on employment generation.

To analyse the employment scenario in different sectors where FDI has come and the role of FDI on employment generation in these sectors we have used the ASI (Annual Survey of Industries) data at the 3-digit level. We have considered the ASI data in each sector which are concerned with organised manufacturing industry for two reasons: (a) unavailability of data for the informal sector; and (b) FDI comes

primarily into the formal/organised sectors although it may have direct or indirect effect(s) on informal sector(s) or forward/backward linkage(s) with informal sector(s) in India. Though indirect employment may be generated in the informal sector due to FDI inflows, it remains out of our quantitative analysis due to the lack of proper data. Moreover, though the present work deals with the post-liberalisation period sector-wise FDI (received) data is available in SIA newsletter from 1999-2000. For this reason in this chapter our work concentrates on the data from 1999-2000 onwards.

We have considered here ASI data at the three-digit level for metallurgical industry group, food processing industry group, chemical, fertilizer & pharmaceutical industry group and automobile industry group from 1999-2000 to 2013-14. Industrial classification has changed at different times. The NIC code for four industry groups we have considered here are presented in the Table 3.1 in terms of latest available industrial classification (National Industrial Classification, 2008). Industries are reclassified by using concordance procedure for the earlier period according to National Industrial Classification (2004) and National Industrial Classification (1998).

**Table 3.1**  
**NIC Codes of Different Industry Groups as per the National Industrial Classification (2008)**

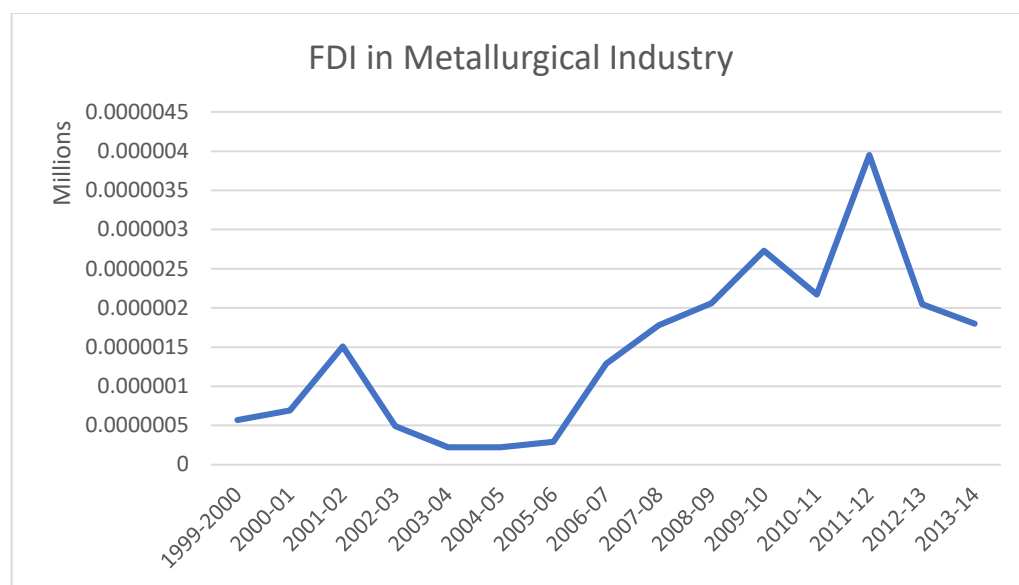
Name of the 3-digit Industrial Groups	NIC codes
Chemical, Fertilizer, and Pharmaceuticals	201+202+203+210
Automobile Industry	291+292+293
Metallurgical Industry	241+242+243+251+259
Food Processing Industry	101+102+103+104+105+106+107+108+110

Source: Author's own construction based on NIC (1998, 2004 and 2008)

We have considered in the figures below (Figure 3.1 to Figure 3.8) the FDI inflows, regular employment and contractual employment from 1999-2000 to 2013-14 for the metallurgical industry group, food processing industry group, chemical, fertilizer and pharmaceutical industry group and automobile industry group.

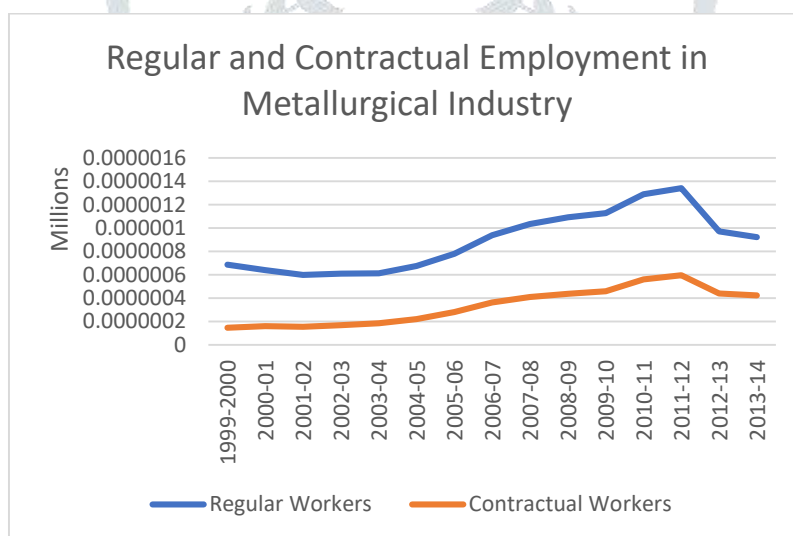


**Figure 3.1**



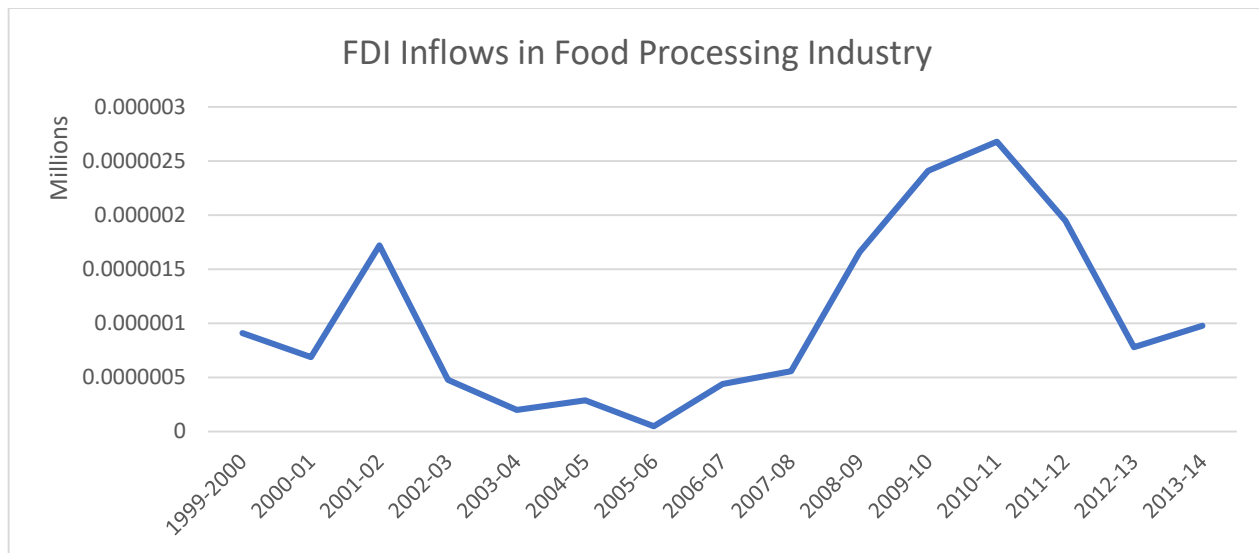
Source: SIA Newsletter as available at [http://dipp.nic.in/English/Publications/FDI\\_Statistics/FDI\\_Statistics.aspx](http://dipp.nic.in/English/Publications/FDI_Statistics/FDI_Statistics.aspx)

**Figure 3.2**



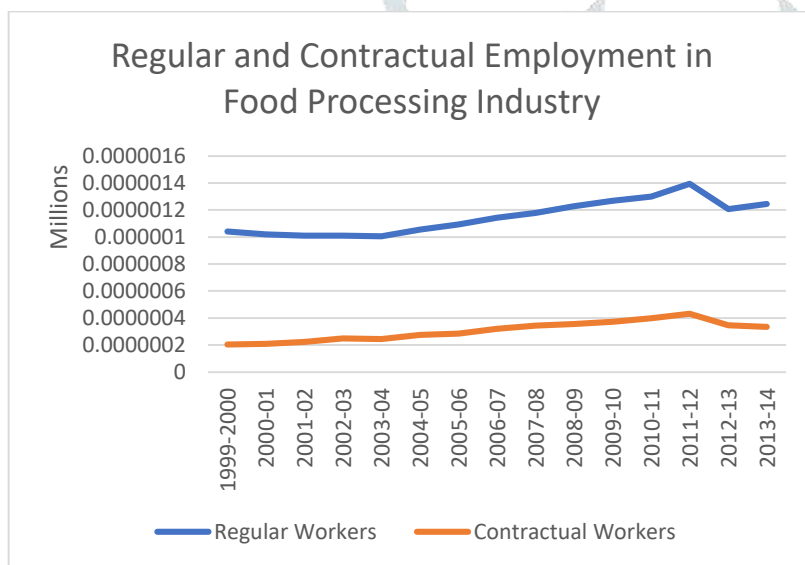
Source: Annual Survey of Industries (various years)

**Figure 3.3**



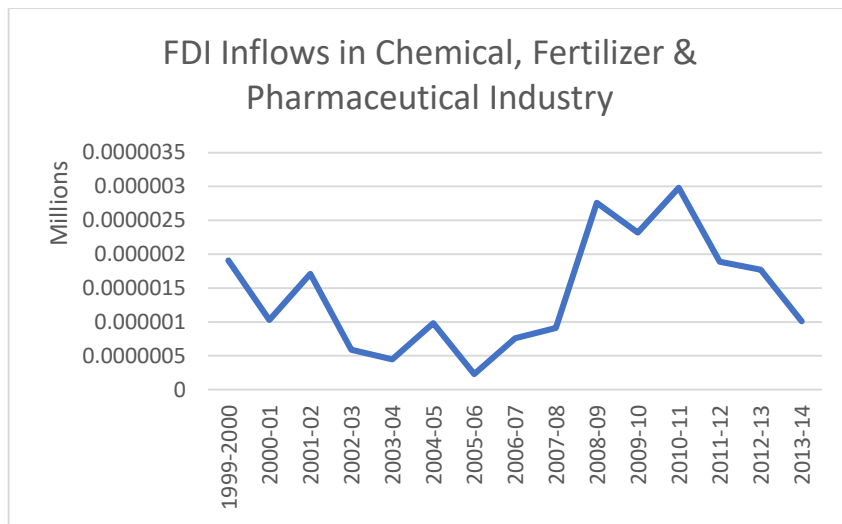
Source: SIA Newsletter as available at [http://dipp.nic.in/English/Publications/FDI\\_Statistics/FDI\\_Statistics.aspx](http://dipp.nic.in/English/Publications/FDI_Statistics/FDI_Statistics.aspx)

**Figure 3.4**



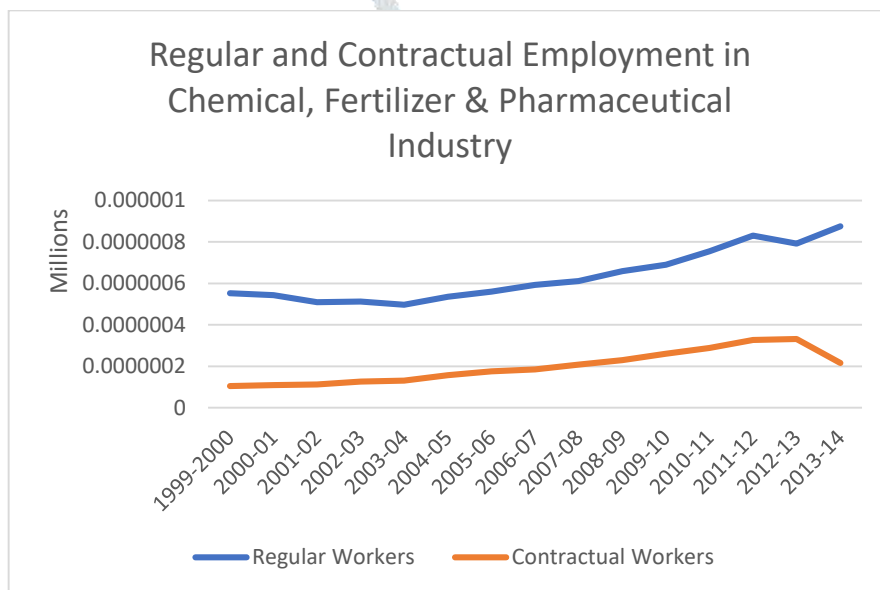
Source: Annual Survey of Industries (Various Years)

**Figure 3.5**

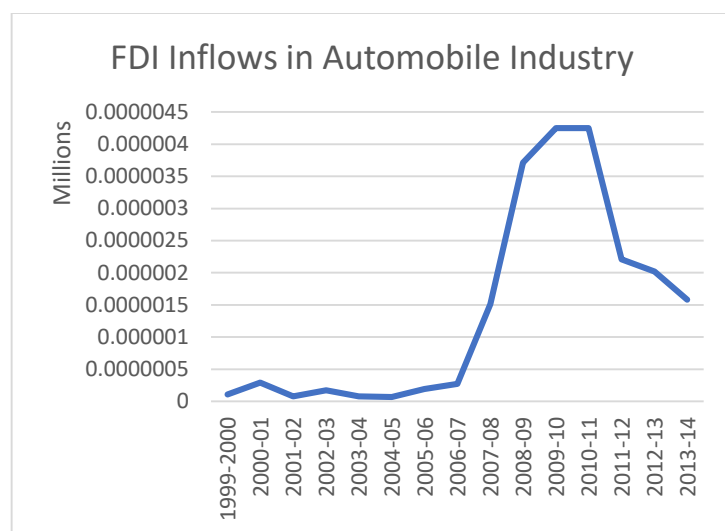


Source: SIA Newsletter as available at [http://dipp.nic.in/English/Publications/FDI\\_Statistics/FDI\\_Statistics.aspx](http://dipp.nic.in/English/Publications/FDI_Statistics/FDI_Statistics.aspx)

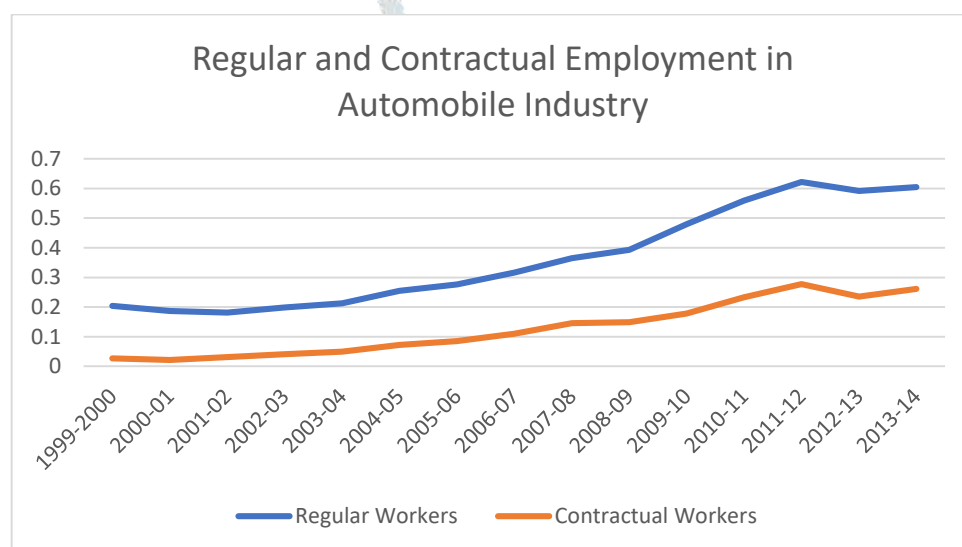
**Figure 3.6**



Source: Annual Survey of Industries (Various Years)

**Figure 3.7**

Source: SIA Newsletter as available at [http://dipp.nic.in/English/Publications/FDI\\_Statistics/FDI\\_Statistics.aspx](http://dipp.nic.in/English/Publications/FDI_Statistics/FDI_Statistics.aspx)

**Figure 3.8**

Source: Annual Survey of Industries (Various Years)

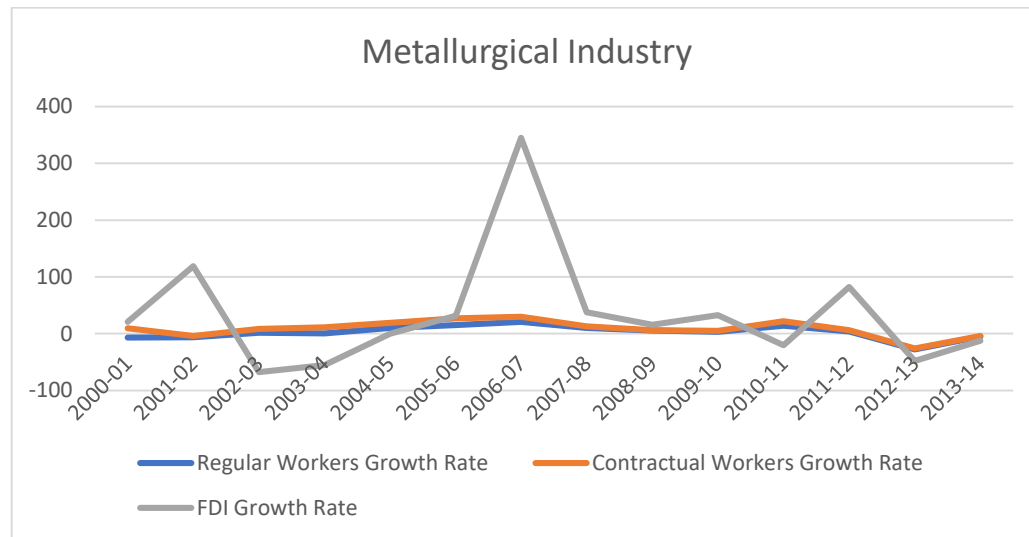
The above figures indicate the FDI inflows, regular employment and contractual employment in the four industry groups considered here from 1999-2000 to 2013-14. Note that in these four industry groups there is year-to-year fluctuation in FDI inflows. However, both regular and contractual employment remained stagnant increasing marginally over the years in all these industry groups.

Now we plot the FDI annual growth rates, annual growth rates in regular employment and annual growth rates in contractual employment from 2000-01 to 2013-14 for the four industry groups considered here. These are indicated from Figure 3.9 to Figure 3.12. First thing to notice from these figures that there is wild fluctuation in annual growth rate of FDI inflows in all these four industry groups for the period considered here. Secondly, in certain years high positive annual growth rate in FDI inflows was not accompanied by commensurate high positive growth rate in either regular employment or contractual employment. Thirdly, in some years the annual growth rate in contractual



employment is greater than annual growth rate in regular employment. This raises the doubt about the quality of employment generated in these FDI-infested industry groups.

**Figure 3.9**



Source: Annual Survey of Industries (Various Years) and Indiatat.Com

In fact, in the above four figures it can be noticed that while there are wild fluctuations in annual FDI growth rates from 2000-01 to 2013-14 annual growth rates of both regular and contractual employment remained very low and stagnant.

Now, we make an attempt to investigate the effects of FDI inflow on the employment, both regular and contractual. The time period of our said investigation is 1999-2000 to 2013-14 for which data for both the sectoral FDI inflows and regular and contractual employment are available. The FDI data as reported in SIA newsletter is available from 1999-2000. We have converted the sectoral FDI data to real FDI by deflating nominal FDI values by the appropriate WPIs. It is to be noted here that Nath (2015) also made an attempt to test the impact of FDI on employment in selected manufacturing industry where FDI came. Our effort is different from Nath (2015) in two respects. First of all, Nath (2015) considered the employment figures from 1999-2000 to 2011-12 whereas in this work it is for the period 1999-2000 to 2013-14. Secondly, Nath (2015) did not attempt the test with the help of a panel regression of impact of FDI on Net Value Added, Regular Employment and Contractual Employment respectively which we have attempted here in the present work.

We first ran a panel regression taking all the four industry groups (metallurgical, food processing, chemical, fertilizer & pharmaceutical, and automobile) for the period 1999/2000 to 2013-14. First, we regressed Net Value Added (NVA) on FDI. We have deflated NVA and FDI values by appropriate WPIs with 2004-05 as base year. Then we regressed number of regular workers (RW) on real FDI and lastly, number of contractual workers (CW) on real FDI.

$$\text{Log NVA} = \alpha_{1i} + \beta_{1i} \text{Log FDI} \quad \text{where } i = 1, 2, 3, 4 \text{ denotes the industry group} \quad (3.1)$$

$$\text{Log RW} = \alpha_{2i} + \beta_{2i} \text{Log FDI} \quad \text{where } i = 1, 2, 3, 4 \text{ denotes the industry group} \quad (3.2)$$

$$\text{Log CW} = \alpha_{3i} + \beta_{3i} \text{Log FDI} \quad \text{where } i = 1, 2, 3, 4 \text{ denotes the industry group} \quad (3.3)$$

The result of these three regressions are indicated in Table 3.3 below. First of all, note that all the three regressions are insignificant as  $R^2$  values are quite low. Secondly, for the first regression elasticity of NVA with respect to real FDI is non-significant – its value being 0.083. Hence, we can assert that FDI inflows in the selected four manufacturing industry groups do not bear any significant impact on net value added and thereby on output of these industry groups during the period under consideration. Thirdly, the regular worker employment elasticity of real FDI as is captured by  $\beta_{2i}$  term is significant at 10% level but is less than one, which implies real FDI is regular employment inelastic. As the value of  $\beta_{2i}$  is 0.229 it implies 1% increase in FDI raised regular employment by 0.229% only during the period under consideration. Fourthly, note that the contractual worker employment elasticity of real FDI as captured by  $\beta_{3i}$  term in the third regression is significant at 10% level but is less than one, which implies real FDI is contractual employment inelastic. As the value of  $\beta_{3i}$  is 0.354 it implies 1% increase in FDI raised contractual employment by 0.354% only during the period under consideration. Finally, note that the employment elasticity of FDI is more in the case of contractual employment than in the case of regular employment. This means increase in FDI inflows raises contractual employment more than the regular employment. This puts a question mark on the quality of employment generated by FDI inflows.

**Table 3.2**

**Results of Panel Regressions**

$\alpha_{1i}$	$\beta_{1i}$	$R^2$	$\alpha_{2i}$	$\beta_{2i}$	$R^2$	$\alpha_{3i}$	$\beta_{3i}$	$R^2$
3.537	0.083	0.03	0.316	0.229	0.183	0.054	0.354	0.249
(0.000)	(0.653)		(0.027)	(0.001)		(0.759)	(0.000)	
Significant/intercept is accepted	Non-Significant/elasticity is rejected		Significant/intercept is accepted	Significant/elasticity is accepted		Non-Significant/intercept is rejected	Significant/elasticity is accepted	

Source: Author's own calculations.

Next, we ran the following regressions separately for each of the four selected industry groups – the results of which are indicated in Table 3.3 below:

$$\text{Log NVA} = \alpha_1 + \beta_1 \text{Log FDI} \quad (3.4)$$

$$\text{Log RW} = \alpha_2 + \beta_2 \text{Log FDI} \quad (3.5)$$

$$\text{Log CW} = \alpha_3 + \beta_3 \text{Log FDI} \quad (3.6)$$

The results are diverse when we consider an industry group separately for the period 1999/2000 to 2013/14. First of all, except for automobile industry FDI has not any significant impact on net value added (NVA) and hence, on output

of the concerned industry groups. Secondly, regular worker elasticity of FDI is significant for metallurgical and automobile industry group but insignificant for food processing and chemical, fertilizer & pharmaceutical industry group. However, except for food processing industry the contractual worker elasticity of FDI is significant for the remaining three industry groups viz. metallurgical, chemical, fertilizer and pharmaceutical and automobile industry groups. Except for the automobile industry group, the value of  $R^2$  is very low for the other three industry groups.

So, it can be asserted that FDI does not have much influence on output and employment as our regression results indicate. When we regress the industry groups separately we find FDI has more significant influence on output and employment in automobile industry compared to the metallurgical industry, food processing industry and chemical, fertilizer & pharmaceutical industry. Lastly, compared to regular employment, FDI has more significant influence on contractual employment. And since in general going by the fact that the quality of employment is inferior in the case of contractual employment compared to regular employment, FDI in the recent past has promoted inferior quality of employment in the Indian manufacturing sector.

**Table 3.3**

**Individual Regression Results**

	$\alpha_1$	$\beta_1$	$R^2$	$\alpha_2$	$\beta_2$	$R^2$	$\alpha_3$	$\beta_3$	$R^2$
METALLURGICAL INDUSTRIES	3.715 (0.002)	0.212 (0.802)	0.005	0.426 (0.015)	0.242 (0.006)	0.456	0.215 (0.492)	0.363 (0.028)	0.319
FOOD PROCESSING INDUSTRIES	4.674 (0.000)	0.116 (0.186)	0.130	0.136 (0.049)	0.036 (0.219)	0.114	-0.439 (0.010)	0.039 (0.562)	0.027
CHEMICAL, FERTILIZERS AND DRUGS INDUSTRIES	3.345 (0.000)	0.153 (0.563)	0.026	-0.122 (0.448)	0.042 (0.597)	0.022	-0.664 (0.064)	0.037 (0.826)	0.004
AUTOMOBILE INDUSTRIES	4.629 (0.000)	0.297 (0.002)	0.546	0.153 (0.259)	0.274 (0.000)	0.66	0.094 (0.738)	0.482 (0.001)	0.576

	$\alpha_1$	$\beta_1$	$\alpha_2$	$\beta_2$	$\alpha_3$	$\beta_3$
METALLURGICAL INDUSTRIES	Significant / Intercept is accepted	Non-Significant/elasticity Is rejected	Significant / Intercept is accepted	Significant / elasticity Is accepted	Non-Significant/intercept is rejected	Significant / elasticity Is accepted
FOOD PROCESSING INDUSTRIES	Significant / Intercept is accepted	Non-Significant/elasticity Is rejected	Non-Significant / intercept is rejected	Non-Significant / elasticity Is rejected	Significant / Intercept is accepted	Non-Significant / elasticity Is rejected
CHEMICAL, FERTILIZERS AND DRUGS INDUSTRIES	Significant / Intercept is accepted	Non-Significant/elasticity Is rejected	Non-Significant / intercept is rejected	Non-Significant / elasticity Is rejected	Non-Significant / intercept is rejected	Significant / elasticity Is accepted
AUTOMOBILE INDUSTRIES	Significant / Intercept is accepted	Significant / elasticity Is accepted	Non-Significant / intercept is rejected	Significant / elasticity Is accepted	Non-Significant / intercept is rejected	Significant / elasticity Is accepted

Source: Author's own calculations.

### 3.3 Conclusion:

Despite the hue and cry for flexibility in labour market, the Indian labour market is already enough flexible, if not in terms of legal regulations but in practice. The deceleration in employment growth has been accompanied with fast growing informalisation of the labour market as evidenced in terms of greater growth in contractual employment than regular employment. With almost stagnant or decelerating employment creation in the formal sector in the form of regular or permanent employment, which aggravates during liberalisation, informal sector remains only option for absorbing ever-increasing work force. Most of the rules are applicable only for organised sector. Moreover, informal workers within organised sectors are also not under the purview of most of the labour laws. And most importantly the FDI infested industries – especially the MNCs in India – are flouting *in general* all the existing labour laws of the country as the Maruti Suzuki Workers' Struggle suggests as a case.

Hence, like other industries in India, the over-dependence on contractual workers prevails also in those industries which attract FDI. For some selected industries attracting FDI it is shown that there is wild year-to-year fluctuation in FDI inflows while both regular and contractual employment growth remained low and stagnant. Our regression results also indicate that effects of FDI on contractual employment are more pronounced than on regular employment. FDI has positive and significant elasticity with contractual employment. Whether FDI really contributes towards quality employment generation is doubtful.

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