Wage And Working Condition In India : Impact of Foreign Direct investment

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INTRODUCTION : In the era of globalization, every country needs resources to fulfill the financial gaps of its economy, which hinders the smooth running of development of the economy as well as its people. The resources can be made available from internal as well as, external sources. For the growth of Indian economy after liberalization, multinational companies are desirable to invest in the country for infrastructure development and generating employment.

Multinational corporations invest through foreign direct investment (FDI) in India, which play a vital role to promote economic growth, and generating employment as well as infrastructure development. FDI is a mean of integrating India to global economies and arrangement of capital for investment, and leading to economic growth. Often seen a driver for economic development, FDI is perceived to be beneficial for local development, arousing much controversy and social concerns as well. Multinational companies have been accused of taking unfair advantage of low wages and weak labour standards in India. They also have accused of violating human and labour rights in countries where the government fails to enforce such rights effectively.

The policy makers of Indian government have tended to emphasize benefits that FDI can bring to the Indian economy, including improvement of pay and working conditions, which may be direct or indirect. Multinational companies are able to provide higher wages and better working conditions due to their higher productivity, which in turn is explained by greater technological know-how and modern management practices.

Despite being more productive, there is caution that the Multinational companies would offer better pay or good working conditions for identical workers than their local counterparts. In competitive labour markets, they may pay higher average wages only to the extent that they employ a more skilled workforce or must compensate workers for undesirable differences in the characteristics of jobs. The employment activities of foreign owned corporate may affect local labour market conditions through their impact on labour demand and supply. FDI may reduce the supply of labour available to domestic firms by lowering the willingness of individuals to work for such companies, which would also have a tendency to raise wages in domestic firms.

LITERATURE REVIEW : There is a consensus that multinational firms tend to provide better pay to workers than their domestic counterparts, particularly in developing countries. Aitken *et al.* (1996) compare average wages between domestic and foreign-owned firms, which shows that average wages in foreign-owned plants tend to be about 30 percent higher than in domestic plants. Moreover, these wage differences persist once one controls for size, geographic location, skill mix and capital intensity. This suggests that foreign-owned firms pay higher wages than their local competitors in developing countries. But, this does not mean that foreign ownership improves employment conditions as the workforces in domestic and foreign firms may be qualitatively different. In order to address the possibility that average wage differences between foreign and domestic firms merely reflect differences in the composition of the workforce, a number of studies have analyzed to what extent foreign wage premia persist after controlling for observable differences in worker quality. Lipsey and Sjöholm (2004) use a plant-level dataset and find that, while differences in average labour quality account for a significant part of the raw foreign wage premium, it remains large. Wages in foreign-owned plants are 12 percent higher for production workers and 20 percent for non-production workers. Morrissey and Te Velde (2003) present similar findings for five Sub-Saharan African countries.

Girma and Görg (2007) find that foreign takeovers of domestic firms tend to increase wages, but the effects are relatively small. Lipsey and Sjöholm (2006) find that after controlling for firm fixed effects, foreign takeovers raise production-worker wages by 17 percent and non-production-worker wages by 33 percent. However, the results from firm-level analysis may be misleading because they do not control for changes in the composition of the workforce that may be associated with cross-border takeovers. To the extent that foreign takeovers are

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associated with skill upgrading, this would bias the estimated foreign wage premium upwards. Using linked employer-employee data (worker-level data), it is possible to control for changes in the composition of the workforce due to cross-border M&A by focusing on the wage effects for individual workers who stay in the same firm. Those data also allow one to look at the role of ownership for workers who change jobs between domestic and foreign firms. This is interesting because it allows one to analyse differences in pay conditions between foreign and domestic firms for *new* workers. As productivity differences may have more important implications for workers at the moment of hiring than for stayers (Beaudry and DiNardo, 1991), one may expect the role of ownership to be more important for this category of workers.

Martins (2006) and Heyman et al. (2007) found that the foreign wage premium disappears after controlling for worker selection and may even reduce individual wages by 3 percent for workers in foreign firms relative to their counterparts in domestic firms. By contrast, Andrews *et al.* (2007) for, Malchow-Moller *et al.* (2007) and Balsvik (2006) find small positive effects (1 percent – 3 percent). Few studies exploit worker mobility to analyse the role of foreign ownership. Two exceptions are Andrews *et al.* (2007) and Balsvik (2006), who show that workers moving from a domestic to a foreign firm experience a 6 o\percent increase in wages in Germany and 8 percent in Norway. These findings may indicate that the short-term effects of foreign ownership may be more important for new hires in foreign firms than workers who stay in firms that change ownership.

While most studies indicate that foreign ownership has a positive impact on wages, a number of studies indicate small negative effects. Unfortunately, it is not clear what drives these differences in estimated wage premia across studies. They may reflect differences in country characteristics or the nature of FDI, as well as differences in the methodology. This study tries to find out the impact of FDI on the wage and working conditions of India.

A number of studies have attempted to characterize employment conditions in MNCs and analysed its determinants. While the definition of employment conditions differs across studies, the literature appears to suggest that MNCs have a relatively low tendency to export labour practices to their foreign affiliates, tending instead to adapt to local

practices (e.g. Almond and Ferner, 2006). Bloom *et al.* (2008) use survey data on management and work-life balance practices for over 700 medium-sized firms in the US, UK, Germany and France to analyze to what extent US multinationals export certain practices to their affiliates in Europe. The evidence indicates that US MNCs export management practices but not work-life balance practices. Freeman *et al.* (2007) compare labour practices in domestic and foreign affiliates of a single US firm in different countries and also find that US firms adapt their labour practices to host-country conditions to an important extent. The literature suggests a number of reasons why US MNCs might have a low propensity to export labour practices. First, labour practices tend to be embedded in national rules and social norms. i.e., the extensive regulation of the labour market in many European countries and the strong role of trade unions may make it difficult or unattractive for US MNCs to export labour practices to Europe (Bloom *et al.*, 2008). Second, the low propensity of US MNCs to export working practices may also reflect strategic considerations. i.e., local affiliates with a domestic market orientation may enjoy a significantly greater degree of discretion about the way human resources are managed than firms that are more export-oriented. The low propensity of US MNCs to export labour practices may reflect the specific management style of US MNCs and not be representative for MNCs originating from other countries.

Labour markets may be segmented between foreign and domestic firms because foreign-owned firms tend to provide better working conditions in order to limit worker turnover or because of institutional differences, such as more complete compliance with labour laws or greater bargaining strength vis-à-vis trade unions. Positive productivity spillovers may also fail to materialize because of the lack of absorptive capacity in domestic firms or because of the crowding-out effect of foreign entry on local competitors. Several recent studies have found evidence of positive spillovers concentrating on the wage effects of FDI through its impact on labour demand and supply. Using data for the UK electronics industry, Driffield and Girma (2003) find that FDI has a large positive effect on wages in domestic firms through its impact on labour demand and a small positive effect through its impact on labour supply. Wage spillovers appear to be more important for skilled than unskilled workers, which may reflect the relative scarcity of skilled labour. Lipsey and Sjohölm (2004) find that FDI is positively associated with

average wage levels in domestic firms, particularly those of non-production workers.

Other recent studies have attempted to analyse how productivity and wage spillovers may occur by looking at specific ways domestic firms engage with foreign firms. For example, Görg and Strobl (2005) examine empirically the contribution of worker mobility to productivity spillovers using a panel of Ghanaian manufacturing firms. They find that domestic firms with an owner who has previously been employed in a foreign firm in the same industry, are more productive than other domestic firms. Balsvik (2006) analyses productivity spillovers through worker mobility using linked employer-employee data for Norway. She finds that workers with prior experience in MNCs tend to contribute 20-25percent more to productivity than workers without such experience. Moreover, the contribution to firm productivity exceeds the private return to mobility, which suggests that worker mobility entails genuine productivity externalities. Poole (2006) analyses the role of worker mobility for wage spillovers using linked employer-employee data forBrazil.16 She finds evidence in support of positive wage spillovers and that their magnitude depends on the skill levels of workers previously employed by MNCs and incumbent workers in the domestic firm. Backward linkages provide an alternative channel through which spillovers may occur from FDI to local firms. Using input-output tables, a number of studies have shown that backward linkages from foreign plants to local suppliers are associated with positive productivity spillovers (see Javorcik, 2004 for Lithuania; Blalock and Gertler, 2008 for Indonesia).

Intuitively, this may reflect the fact that foreign firms often have a strong interest in helping local supplier firms to improve the quality of inputs or to ensure that subcontractors respect minimum labour standards (Moran, 2007, Sabel *et al.*, 2000). There is little systematic analysis that specifically looks at the effects of backward linkages from MNCs on wages and working conditions in supplier firms. Harrison and Scorse (2006) provide indirect evidence that reputation-sensitive MNCs helped raising the wages of unskilled workers in Indonesian textiles factories without, however, inducing a reduction in unskilled employment in those factories. This may indicate that MNCs not only helped raise wages but also productivity. A number of case studies have analyzed the impact of private codes of conduct adopted by MNCs on working conditions in upstream suppliers. In general, the effectiveness of such codes in the

supply chain appears to be limited (ETI, 2006). The benefits of codes of conduct are likely to be greater and more enduring when they are integrated into the management structures that govern production and when the interests of workers in employment and production are represented in effective institutions. This is more likely when MNCs actively engage with supplier firms to help improve working practices and productivity. For example, Locke *et al.* (2007) find that the quality of labour practices across suppliers depends to an important extent on the involvement of MNCs in the production process of supplier firms. Similarly, Frenkel and Scott (2002) conclude in a study for Adidas that compliance programmes based on long-term partnerships are more likely to bear fruit than those based on the policing of working conditions. Also, Locke and Romis (2007) compare two supplier firms for Nike that both produce T-shirts and are located in the same region, but differ substantially in terms of their working conditions (wages, overtime, job satisfaction and employee voice). They attribute these differences to the way the plants are managed. While in one plant labour is treated as a variable input whose costs needs to be minimized, in the other plant workers are seen as an important factor to bolster productivity and output quality. Interestingly, despite paying higher wages, productivity is higher and unit labour cost lower in the plant that provides better employment conditions.

FDI IN INDIA : Foreign Direct Investment (FDI) is seen as a driver for economic development as it may bring capital, technology, management know-how, jobs and access to new markets. Indian government has developed policies to encourage inward FDI. While FDI and multinational companies (MNCs) are often perceived to be beneficial for local development, they have also aroused much controversy and social concerns. FDI is defined as an investment made to acquire a lasting interest by an entity resident in one economy in an enterprise resident in another economy. The investment should allow the investing entity to exert direct control over the management of assets in the invested firm. It is typically assumed that this is the case when a foreign investor owns 10 percent or more of the ordinary shares of voting power (or the equivalent). Investments that fall short of the 10 percent ownership threshold are classified as portfolio investments. The global stock of inward FDI as a percent of global GDP has increased from less than 5 percent in 1980 to 25 percent in 2006. In India, the increase

in FDI is largely driven by the ongoing liberalisation of trade and investment and technological developments in information and communication technologies.

Although the bulk of FDI continues to take place between OECD countries, the relative importance of non- OECD countries for inward and outward FDI has grown substantially during the past 15 years, reflecting the integration of developing countries into the world economy, and particularly, of the so-called BRICs – i.e. Brazil, China, India and Russia. FDI has risen from 22 percent in 1990 to 32 percent in 2005 and their share in the global stock of outward FDI from 10 percent in 1990 to 17 percent in 2005. The rising importance of non-OECD countries as a destination for FDI has a number of potential implications. Since the mid-1990s FDI has become the most important source of external finance for developing countries, thus reinforcing its potential role for the development process in those countries. The increasing number of potential destinations for FDI and the growing dependence of developing countries on FDI have intensified competition among countries to attract FDI.

But, the rise in FDI from OECD countries into India has also raised serious social concerns about poor labour practices in the foreign operations of MNCs originating from OECD countries. This is particularly the case, as minimum labour standards are not always effectively enforced in such countries. The rise in outward FDI from the selected emerging economies almost entirely reflects the rise in FDI between non-OECD countries (also referred to as South-South FDI). Outward FDI by emerging economies into the OECD remains relatively marginal, despite recurrent claims in the popular media that developing countries are increasingly acquiring strategic assets in developed countries.

SECTOR VISE FDI INVESTMENT : While FDI has increased significantly in all major sectors of the economy, there has been a progressive shift towards services at the expense of manufacturing. In developed countries, inward FDI in the manufacturing sector decreased from 41 percent to 30 percent, whereas it increased from 50 percent to 63 percent in services. In developing countries, inward FDI in the manufacturing sector decreased from 44 percent to 32 percent, whereas it increased from 47 percent to 58 percent in services. The primary sector continues to account for about 10 percent of global inward FDI.

However, while its share has declined somewhat in developed countries, it has increased slightly in developing countries. Electronic and electronic equipment is a high-technology industry in most developed countries, but tends to be relatively low-tech in many developing countries. FDI by sectoral technology intensity suggests that, the progressive shift toward services is associated with the growing importance of knowledge-intensive sectors. Between 1990 and 2005, knowledge-intensive services have increased their shares in inward FDI from 27 percent to 40percent in developed countries and from 34 percent to 43 percent in developing countries.

FDI may be a way for foreign firms in developed countries to supply markets in developing countries, which may reflect the increasing importance of services off shoring by OECD MNCs to developing countries. There has been a gradual shift of inward FDI towards more skill- intensive sectors, with this trend being particularly pronounced in India. FDI is often said to have increased the relative demand for skilled labour and to have contributed to the rise in earnings inequality that is observed in many developed and developing countries. The average skill-intensity of the sector need not necessarily correspond to the skill-intensity of the activities conducted in the foreign affiliates of MNCs.

EMPLOYMENT PROVIDED BY MNCs : Very small number of MNCs account for the rise in FDI. In 2005, the world s100 largest MNCs accounted for 10 percent of foreign assets, 17percent of sales and 13 percent of employment of all MNCs (UNCTAD, 2007). Of these top-100 MNCs, 72 have their home in five countries (France, Germany, Japan, the United Kingdom and the United States), and only seven come from emerging economies (mainly from Asia). When focussing on the top-100 MNCs from developing countries, the importance of South, East and South-East Asia is clear (78 out of 100, with more than half of them having Hong Kong, China and Chinese Taipei as home countries). 10 percent of these MNCs have mainland China as their home country.

The increase in FDI is also reflected by a rise in the number of jobs in the foreign affiliates of MNCs. An estimated 73 million workers, representing 3 percent of the global workforce, were employed in foreign affiliates of MNCs in 2006, almost three times more than in 1990. A disproportionate share of these workers is employed in the foreign affiliates of MNCs in developing and transition economies, presumably

reflecting the higher labour-intensity of production in foreign affiliates in those countries. The distribution of jobs in foreign-owned firms is also skewed towards the manufacturing sector, suggesting that the activities conducted in foreign-owned firms in manufacturing tend to be relatively more labour-intensive. The extent to which employment in foreign-owned firms reflects the causal impact of FDI on job creation depends largely on whether FDI is realized through greenfield investment or M&A. Generally, FDI realized through greenfield investment is more likely to have a positive impact on employment.

MNCs are able to provide higher wages and, possibly, working conditions because of their higher productivity which, in turn, is explained by greater technological know-how and modern management practices that allows them to compete effectively in foreign markets and to offset the cost of coordinating activities across different countries. This transfer of technological and managerial know-how across affiliates of MNCs may give rise to direct benefits. But, it may also lead to indirect benefits by increasing the productivity of domestic firms when the productivity advantage spills over from foreign affiliates to domestic firms. Productivity spillovers represent positive externalities to the host country and may explain why policy-makers have sometimes treated foreign investment more favourably than investment by domestic firms. Although not automatic, increased productivity in domestic or foreign-owned firms may lead to higher incomes, better working conditions and more employment. MNCs would offer better pay or working conditions for identical workers than their local counterparts. In competitive labour markets, MNCs may pay higher average wages only to the extent that they employ a more skilled workforce or must compensate workers for undesirable differences in the characteristics of jobs such as lower job security.

IMPACT OF FDI ON WAGE AND WORKING CONDITIONS:

FDI has direct as well as indirect effects on wage, working conditions and employment conditions in domestic firms, due to the productivity advantage of MNCs spills over to local firms or because the employment activities of foreign-owned firms affect the local labour market. The productivity advantage of MNCs may spill over to local firms for a number of reasons. First, domestic plants may be able to improve productivity by imitating production or management practices in foreign firms. Second, workers who move from a foreign-owned to a

domestic plant may contribute to transfer knowledge of modern production and management practices to their new employers. Third, spillovers may occur from foreign firms to domestic firms in the supply chain, as foreign firms may collaborate with domestic suppliers to ensure that quality standards of intermediate inputs are met and that labour practices correspond with their codes of conduct. Finally, FDI may increase productivity in domestic firms when more intense product-market competition encourages local firms to remove inefficiencies in the production process.

The employment activities of foreign-owned firms may affect local labour market conditions through their impact on labour demand and supply. New entry of foreign firms or the expansion of activities in foreign firms may raise local labour demand, thereby bidding up local wages. To the extent that foreign firms tend to pay higher wages, FDI may also reduce the supply of labour available to domestic firms by lowering the willingness of individuals to work for such firms that would also have a tendency to raise wages in domestic firms.

Foreign takeovers of domestic firms tend to have a small positive or no average effect on the individual wages of workers who stay in the same firm relative to similar workers who stay in domestic firms that are not taken over. The job mobility results indicate large wage gains for workers who move from domestic to foreign firms. This suggests that foreign-owned firms offer higher pay than domestic firms for similar workers. Moreover, the foreign wage premia accruing to workers who move from domestic to foreign firms are considerably larger than those found in the context of takeovers, which may indicate that foreign firms share their productivity advantage more extensively with new workers than with workers who do not change firms. The wage effects of foreign ownership differ considerably across countries.

The effect of foreign ownerships is potentially larger in the long-run. One would expect that the positive effects of FDI that initially accrue to new hires, eventually spread through the entire workforce as large pay disparities between new and old workers within firms are unlikely to be sustainable in the longer term. While it is not possible to estimate the causal effect of inward FDI in the long-run with the data analysed here, it is possible to place an upper bound on this effect by simply comparing wages across comparable workers in foreign-owned and domestic firms.

CONCLUSION : Foreign direct investment has been one of the most dynamic components of the world economy in recent decades. Inward FDI has become the main source of external finance for India. The increased role of FDI in India has raised expectations about its potential to contribute to the development process in the country, by serving as a channel for the international diffusion of know-how. One concrete way local economies may benefit from FDI is through the creation of high-quality jobs, such as when MNCs offer better pay and working conditions than domestic firms in the host country. MNCs may also increase the supply of good jobs indirectly by stimulating domestic firms to improve employment conditions. However, there has been considerable uncertainty (and controversy) about whether MNCs are, in practice, an important driver of improvements in pay and working conditions.

It can truly be concluded that MNCs tend to promote higher pay in the countries in which they operate. The positive wage effect tends to be concentrated among workers that are directly employed by MNCs, but there also appears to be a small positive impact on wages in domestic firms participating in the supply chains established by MNCs. These effects are larger in India because the technology gap between foreign and domestic firms is larger in the former. The evidence about whether MNCs provide non-pay working conditions that are superior to those in domestic firms is more mixed. While working conditions in foreign firms tend to differ from those in comparable domestic firms, they do not necessarily improve following a foreign takeover.

FDI is a potentially important driver of improving living standards for workers, which suggests that governments should strive to create a framework for international investment which facilitates economically and socially beneficial forms of FDI. The impact of MNCs on wages and working conditions varies in complex ways across different types of investments, workforce groups and national environments which suggest that governments and other stakeholders may be able to take measures to enhance the contribution of FDI to economic and social development. Among the types of initiatives that may prove to be helpful are government measures to enforce labour standards and public and private initiatives to promote responsible business practices.

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