Non-Technical Summary

Of the research paper: "***Foreign Ownership and the Distribution of Wages in Hungary, 1992-2000: An Unconditional Quantile Decomposition Approach***"

Project title in contract: "*Wage Inequality and Firm Characteristics in Hungary: Evidence from Linked Employer-Employee Data, 1986-2008*"
Contract number: RRC X-92
Principal Investigator: Gábor Antal

This paper examines the relationship between foreign direct investment (FDI) and changes in the wage distribution in the Hungarian business sector between 1992 and 2000. During this period, the share of workers employed by foreign-owned companies increased from five to close to forty percent, while inequality of earnings grew substantially.

Many studies investigate the effect of foreign ownership on conditional average wages controlling for other firm-level and individual worker characteristics, and usually find small but significant positive effects. This paper analyzes a different question: What would the unconditional wage distribution look like in 2000, had the level of FDI remained at its 1992 level?

To answer this question, I use a large linked employer-employee dataset, and apply a recently developed decomposition technique to quantify the contribution of changes in foreign penetration to changes in wages at several quantiles of the wage distribution. The method allows the researcher to control for changes in other dimensions of observable worker composition, like the distribution of highest educational attainment; experience; occupational and industrial structure; or the spatial distribution of the workforce. It is also possible to disentangle two channels of contributions of these factors: changes in the share of workers with a particular characteristic, and changes in the returns to that characteristic.

The results indicate that:

- the rise in the share of employees working for foreign-owned companies had a positive wage effect across the whole distribution
- the effect is rather similar in magnitude at all quantiles, meaning that the main impact of FDI is shifting the wage distribution to the right
- FDI also has a smaller inequality enhancing effect, especially above the median
- FDI's contribution to wage changes is primarily due to the increased foreign employment share and not to changes in the returns to working at a foreign-owned company.

These findings suggest that foreign working capital has mostly beneficial wage effects from a policy point of view. However, these estimated effects can only be considered as causal effects of FDI under very strong assumptions, in particular, if:

- similar mechanisms of participation in the labor market prevail in 1992 and 2000
- there is no self-selection of workers into foreign employment based on unobservable heterogeneity
- foreign investors do not systematically select target firms for acquisitions with characteristics that are correlated with wage changes
- there are no spillover effects of FDI on domestic employees' wages.