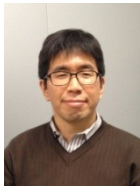



# Opinions

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## The Effects of Inward FDI on the Skill Premium in Korea



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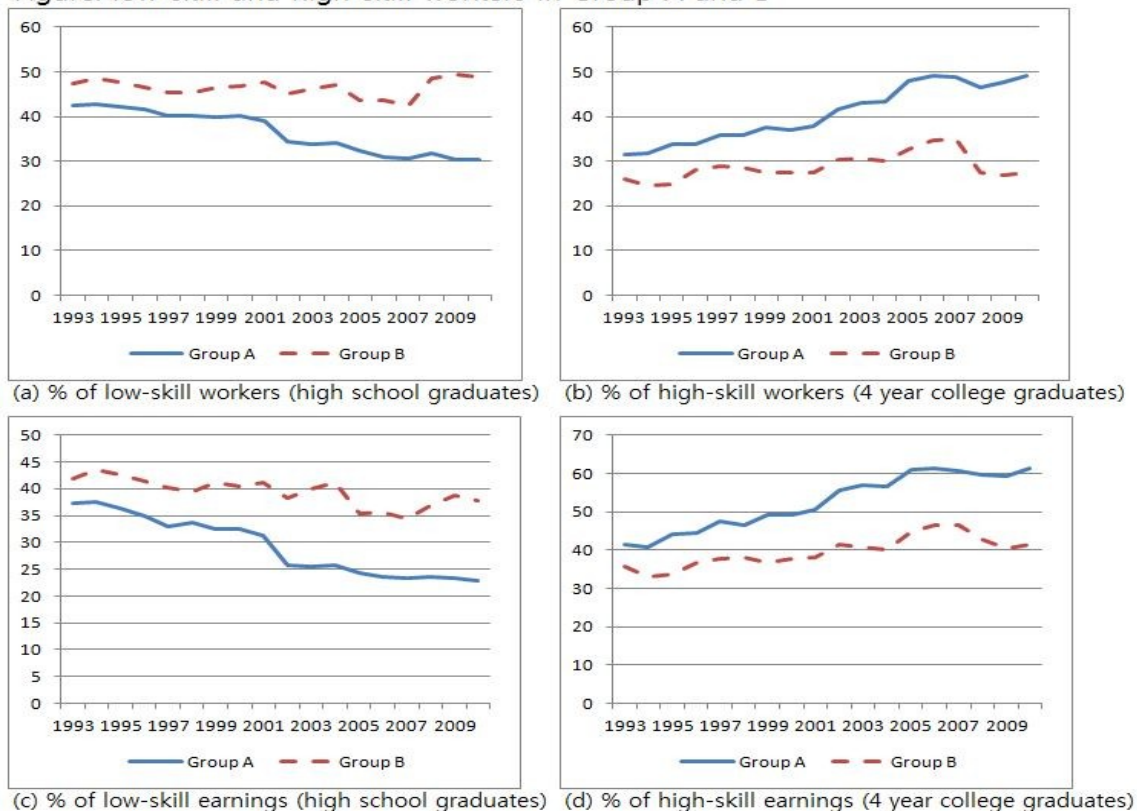
Foreign firms now account for about 20 percent of total exports and 6 percent of employment in Korea. Given that growing inequality is one of the defining economic trends of the last three decades, there would be a link between inward FDI and growing inequality. It is in particular necessary to examine industries of which characteristics inward FDI tends to most affect relative employment and wage rates for high skill workers. Thereby, various incentives by policymakers to attract inward FDI should be evaluated and carefully implemented with consideration to its effects on the labor market.

Based on the evidence from inward FDI and the labor market in Korea, I argue that the increase in FDI inflow affects the labor

market only in the case of certain industries, and that one primary characteristic of those industries would be the large volume of initial FDI inflow. I divided the industries into two sub-groups, one with a large initial volume of FDI inflow (Group A) and the other with a small initial volume of FDI inflow (Group B). Group A consists of industries such as wholesale/retail, finance/insurance, electricity/electronics, food/accommodation, chemicals, transport machines, machine/equipment, food, and business services. These industries can be characterized by a large volume of initial FDI inflow. For instance, the wholesale/retail industry received USD 340 million, the largest FDI inflow between 1993 and 1995. Meanwhile, the recreation industry in Group B received only USD 5 million, the smallest amount, during the same period.

The figure below summarizes the relative employment and earnings of low-skill workers - panel (a) and (c) - and high-skill workers - panel (b) and (d) - in two groups. There are clear downward trends in low-skill workers' employment - panel (a) - and earnings - panel (c) - in Group A (blue line), while the downward trend is weak in Group B (red dotted line). At the same time, the upward trends of both employment and earnings of high-skill workers are more pronounced in Group A than they are in Group B, as seen in panel (b) and (d).

Figure: low-skill and high-skill workers in Group A and B



In addition, reduced form regression results send a similar message as in the above figure. Using industry-level FDI inflow data from Korea's Ministry of Trade, Industry, and Energy, as well as micro-level labor survey data from the Ministry of Employment and Labor, I ran a regression with the log of wage on the interaction term of the log of FDI and a college dummy with the other control variables. I did not find any significant effect of FDI on the wage premium for high-skill workers in Group B. On the other hand, the wage premium for high-skill workers in Group A tends to change by  $0.412 - 0.0168 \cdot \log(\text{FDI})$  percent with every 1 percent increase of FDI inflow. The inflection point for a negative effect is more than USD 44 trillion, which is a great deal higher than USD 12 billion, the aggregation of FDI inflow into Korea's 19 industries in 2010. Thus, FDI inflow tends to be positively associated with the wage premium for high-skill workers in the industries of Group A.

Due to the limitation of data, I was unable to further address the empirical link between FDI inflow and the wage premium. Nonetheless, there are at least two possible explanations about why inward FDI tends to be positively associated with employment and the wage premium for high-skill workers mainly in industries with a large volume of initial FDI inflow.

First, initial FDI inflow might stand for the easiness of labor reallocation in the industries of Group A, either technically or institutionally. Therefore, foreign firms, which must aggressively address technological changes in the production process, tend to enter the market. In turn, the entry of such foreign firms can affect employment and wage rates for high-skill workers.

Second, it might take time for the reallocation process from low-skilled to high-skilled workers to take place, due to labor market frictions. If this is the case, for now we may not be able to observe the reallocation process. In the long run, however, Group B likewise would undergo reallocation in a more pronounced manner. 