Why Do Foreign-Owned Firms Pay More?
The Role of On-the-Job Training

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Abstract: While foreign-owned firms have consistently been found to pay higher wages than domestic firms to what appear to be equally productive workers, the causes of this remain unresolved. In a two-period bargaining framework we show that if training is more productive and specific in foreign firms, foreign firm workers will have a steeper wage profile and thus acquire a premium over time. Using a rich employer-employee matched data set we verify that the foreign wage premium is only acquired by workers over time spent in the firm and only by those that receive on-the-job training, thus providing empirical support for a firm-specific human capital acquisition explanation. JEL no. F23, J24

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1 Introduction

It appears to be widely accepted wisdom that foreign-owned firms pay higher wages than their domestic counterparts in the host country and a sizeable body of literature now provides evidence to substantiate this fact. Nevertheless, the causes of this differential are as of yet unresolved. For example, while the studies by Lim (1977) for Malaysian manufacturing, Aitken et al. (1996) for Mexico and Venezuela, Lipsey and Sjöholm (2004) for Indonesia, and te Velde and Morrisey (2003) for five African countries all find that part of the wage differential can be explained by worker and firm characteristics, a sizeable proportion remains unaccounted for. Similarly, the existence of an unexplained wage differential between foreign and domestic firms seems prevalent for developed countries; see Aitken et al.

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There are several theoretical models that may explain why the wage premium in foreign-owned firms is acquired by workers over time through on-the-job training. It may be that training is more productive in foreign firms because foreign firms have access to firm-specific assets that give them a technological advantage over domestic firms in the same industry (see, Caves 1996), or foreign-owned firms having better access to capital which allows them to invest in better technology. If foreign firms choose a more training intensive outcome for one of the above reasons this may also lead to more able workers being chosen in the foreign sector which would also affect the wage profile. Yet another possibility is that monitoring is more difficult in foreign firms causing firms to pay efficiency wages. Such wage premia may induce the firms to engage in more specific training as in Acemoglu and Pischke (1999).

We investigate these possibilities empirically by using a rich employer-employee matched data set for manufacturing firms in Ghana, which allows us to control for a large variety of firm and worker level characteristics that could arguably be driving any wage differentials across nationality of ownership type. Distinguishing between those workers that have received on-the-job training from those that have not, our econometric estimations of wage regressions suggest that returns to on-the-job training explain the foreign firm wage premium. Specifically, we find that while there are no differences in starting wages between workers in domestic or foreign-owned firms, workers receiving on-the-job training in foreign firms experience higher wage growth than those working and receiving on the job training in domestic firms.

The remainder of the paper is structured as follows. Section 2 sets out the theoretical model. Section 3 discusses the data while Section 4 presents the results of the econometric estimations. Finally, Section 5 concludes.

2 Theoretical Framework

Traditionally the impact of firm-specific training on wages is analysed using Hashimoto’s (1981) model where competition ensures that the contract maximizes expected joint surplus in an uncertain world. More recently, some authors have used two period bargaining models to solve for the pre