

The Effect of Foreign Investment on Income Inequality and Median Earnings in Mexico

ABSTRACT

Research on earnings inequality in the United States has focused on the effects that capital flows to developing countries may have on the distribution of income. The outflow of investment to countries with lower wages is thought to lower demand for low-skilled labor and reduce the wages of workers in the lowest income categories. Few studies, however, have examined the effects of *inflows* of capital investment on income inequality in developing countries. Has the influx of foreign direct investment had the opposite, equalizing effect in developing countries that the outflow is said to have had in the U.S.? In this study I examine the effect of foreign investment on income inequality across a sample of over 100 Mexican urban areas. Results of the statistical analysis indicate that foreign investment is strongly associated with higher levels of earnings inequality across Mexican cities, even while it raises the median income. The effects of other factors such as the size of the manufacturing sector and the informal economy, the age and educational structures of the working population and internal migration to urban areas, are also considered.