Firm Performance and Foreign Ownership:
Evidence from a Hungarian Comprehensive Panel

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Abstract
This paper analyzes the effects of foreign ownership on firm-level productivity using comprehensive Hungarian panel data. The data set follows firms from 1986, when any foreign presence in corporations was prohibited, until 2005, the year after EU accession. Hungary has experienced an unusual volume of foreign investment, and the data contain a large number of foreign-owned firms, and more ownership switches between domestic-foreign, state-foreign and foreign-domestic than in previous studies. Fixed effects, random trend models, and matching are applied to control for selection in foreign acquisitions and divestitures. We find that acquisitions increase productivity regardless of whether the target company was owned by the state or a domestic investor, while divestitures do not. These results depend on the treatment of selection, as well as on how well one controls for inputs in the production function: controlling for material costs reduces the estimated productivity effect of foreign acquisitions, while defining labor not in quantities but in prices (the wage bill of the company) to capture possible differences between the quality of labor across ownership types, the effect is further attenuated. Our results show that selection plays an important role in foreign acquisitions and divestitures, and that ownership is correlated with the quality of inputs used. The inadequate treatment of selection and control for inputs may severely bias the estimates of foreign ownership on productivity.