

BEYOND TAX INCENTIVES: REASSESSING THE DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN DEVELOPING ECONOMIES

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Abstract

The relationship between corporate income tax rates and foreign direct investment inflows is examined in this study. This issue is particularly relevant for developing and transition economies, where governments frequently rely on tax policy to attract foreign investment despite concerns regarding the fiscal costs of tax incentives and uncertain economic returns. In this context, the study evaluates whether corporate taxation significantly influences inward foreign direct investment once broader host-country characteristics are considered. The analysis is conducted using a balanced sample of 50 countries covering the period from 2008 to 2025. Foreign direct investment inward flow is employed as the dependent variable, while the statutory corporate tax rate serves as the principal explanatory variable. The findings do not provide strong empirical support for the argument that lower statutory corporate tax rates systematically attract higher inward foreign direct investment. Although the pooled ordinary least squares model reports a negative coefficient for the tax-rate variable, the relationship remains statistically insignificant and unstable across the estimated panel models. Corporate tax rates fail to emerge as statistically meaningful determinants of inward foreign direct investment under both random effects and fixed effects estimations. Gross domestic product appears as the most important determinant of inward foreign direct investment, while trade openness and inflation remain statistically insignificant. The findings moderate the predictions of tax competition theory by indicating that tax policy alone is unlikely to attract substantial foreign direct investment without broader structural and institutional advantages.



1. Introduction

Foreign direct investment has long occupied a central place in development policy because of its expected contribution to capital formation, employment generation, technology transfer, export diversification, and productivity improvement. Borensztein et al., (1998) mention that the contribution of foreign direct investment to economic growth operates mainly through the transfer of advanced technology rather than through domestic investment alone, while the gains from foreign investment depend strongly on the absorptive capacity of the host economy. Alfaro et al., (2004) mention that the growth-enhancing effects of foreign direct investment are conditioned by the quality of domestic financial systems. In contrast, Aitken and Harrison (1999) demonstrate that spillover effects from foreign investment may at times be limited or even negative for domestic firms exposed to stronger foreign competition. Within this broader discussion, tax policy has emerged as one of the most visible instruments used to increase investment attractiveness. The importance of corporate taxation in investment policy rests on the assumption that multinational enterprises compare expected after-tax returns across alternative investment locations. Countries with comparatively high corporate tax burdens may appear less attractive

to international investors in an environment characterized by highly mobile capital flows. Root and Ahmed (1979) mention that manufacturing foreign direct investment in developing countries is largely influenced by economic and policy-related variables rather than by random factors. Schneider and Frey (1985) also identify both economic and political conditions as major determinants of foreign direct investment location decisions. Culem (1988) mention that taxation has become one of the most debated variables because governments can directly alter tax policy and use it as a competitive instrument for attracting investment. Corporate tax policy, therefore, occupies an important position within national investment-promotion strategies, particularly in emerging and transition economies (Khalid et al., 2025; Yahaya, 2026).

Among developing countries corporate taxation serves two competing functions simultaneously. Lower corporate tax rates may attract foreign direct investment, yet corporate tax revenues also finance essential public goods such as infrastructure, education, institutional quality, legal systems, and regulatory administration, all of which influence investment conditions. Morisset and Pirnia (2000) mention that although tax incentives form part of investment-promotion strategies, their effectiveness depends heavily on country-specific

conditions and policy design. Busse and Groizard (2008) further emphasize that investment and growth outcomes are shaped not only by incentives but also by the broader regulatory environment within which firms operate. Excessive reductions in corporate taxation may therefore weaken fiscal capacity without generating proportional increases in foreign direct investment. Swenson (1994) finds that tax reforms in the United States influenced foreign direct investment patterns, indicating that taxation affects location decisions. Grubert and Mutti (1991) conclude that taxes, tariffs, and transfer pricing influence multinational investment decisions. A further complexity arises because foreign investors are heterogeneous and pursue different strategic objectives. Multinational enterprises may invest abroad to access consumer markets, lower production costs, establish export platforms, secure natural resources, or strengthen regional market presence. Head et al., (1999) show that agglomeration effects and investment-promotion conditions are often more influential than any single factor in determining foreign investment locations. Cheng and Kwan (2000) mention that strong interdependence among locational determinants in the Chinese context. Taxation represents only one component within a broader location-choice environment where firms evaluate multiple host-country

characteristics simultaneously. Institutional and governance conditions also influence investment attractiveness. Globerman and Shapiro (2002) mention that governance infrastructure significantly affects global foreign direct investment flows because investors avoid environments characterized by institutional uncertainty and weak governance. Jensen (2003) mentions that political regimes and government institutions shape foreign direct investment through their effects on policy credibility and investor confidence. Wei (2000) presents evidence that corruption operates as an implicit tax on international investment by increasing uncertainty and reducing expected returns. These findings qualify the significance of formal tax policy. Statutory corporate tax rates alone are unlikely to attract investors when institutional quality is weak, governance structures are unreliable, or legal enforcement remains ineffective. Investors, therefore, evaluate not only formal tax rates but also the broader institutional conditions that determine whether expected returns can actually be realized (Bashir & Rashid, 2019; Wang et al., 2024; Ammar et al., 2025). Beyond macroeconomic and institutional considerations, structural and social conditions also shape foreign direct investment inflows (Zahid, 2018; Nasir, 2022; Meressa, 2022; Sarkutè et al., 2024;

Bukhari et al., 2025; Chrystella et al., 2025; Rafique et al., 2025; Akpilic, 2026). Noorbakhsh et al., (2001) identify human capital as a significant determinant of foreign direct investment into developing economies, arguing that skilled labor enhances host-country attractiveness. Asiedu and Lien (2011) further demonstrate that political and institutional factors interact with natural resources and democratic conditions in shaping foreign direct investment patterns. These studies reinforce the argument that countries do not compete for foreign direct investment solely through tax reductions. Institutional credibility, economic stability, human capital, and governance quality all influence investor decisions. For developing economies with limited fiscal capacity, excessive tax competition may therefore weaken long-term development prospects without generating proportionate investment gains. The underlying expectation is that higher corporate tax rates reduce after-tax returns and potentially weaken host-country attractiveness unless broader institutional and structural conditions offset these effects. This perspective reflects a balanced interpretation of the taxation-foreign direct investment relationship that neither dismisses nor exaggerates the importance of taxation. Thus, this study investigates the role of statutory corporate tax rates in

determining foreign direct investment.

2. Literature Review

The academic literature on corporate taxation and foreign direct investment is extensive because taxation remains important within development policy and international business strategy. Developing countries expect foreign direct investment to generate benefits through capital formation, employment creation, technology transfer, and export expansion (Asiedu, 2002; Perveez, 2019; Seyoum, 2024; Umair et al., 2025; Obeng-Amponsah & Owusu, 2025). At the same time, these economies rely heavily on corporate tax revenues to finance infrastructure and institutional development (Abbas & Klemm, 2013; Challoumis, 2024; Shahabuddin & Ali, 2024; Naeem et al., 2025; Arimoro & Musa, 2025). Governments, therefore, face a policy trade-off. Lower corporate tax rates may attract investment, yet excessive tax reductions can weaken fiscal capacity if investment responds only weakly to incentives (Klemm & Van Parys, 2012; Ho et al., 2023; Ahmad & Rura, 2024; Ditta et al., 2025; Yeung & Chung, 2025). This concern has directed attention toward the elasticity of foreign direct investment with respect to taxation and the extent to which it varies across countries and periods (de Mooij & Ederveen, 2003; Iqbal et al., 2025; Karul & Nawaz, 2025; Rodrik & Stiglitz, 2025). The mainstream

literature generally accepts that taxation matters for foreign direct investment, although the effect is rarely uniform or straightforward (Feld & Heckemeyer, 2011; Sadashiv, 2023; Ajeigbe et al., 2024; Ali et al., 2025). Market size, labor conditions, exchange rates, institutional quality, and agglomeration effects are widely recognized determinants of investment location decisions (Blonigen, 2005; Banyen, 2022; Li et al., 2023; Mo, 2024; Ali et al., 2025; Tansuchat & Thaicharo, 2025). Chakrabarti (2001) similarly argues that empirical findings are highly sensitive to model specification and sample composition, cautioning against treating taxation as the sole determinant of investment behavior. Taxation instead operates within a broader location-choice framework in which investors evaluate expected returns, production costs, policy risks, and market access simultaneously (Blonigen, 2005; Nasir, 2022; Ali et al., 2025; Wim & Wendy, 2025; Wang et al., 2025; Fayou, 2026). The location-choice perspective, therefore, provides an important background for examining corporate taxation within foreign direct investment studies (Chakrabarti, 2001; Davidson et al., 2022; Ali et al., 2025; Ali & Hassan, 2026).

Gastanaga et al., (1998) mention that foreign direct investment responds not only to taxation but also to broader reform packages involving trade openness, governance quality,

and contract enforcement. Their findings explain that tax policy works more effectively when combined with reforms strengthening the business environment. This issue is particularly important in developing economies where investors remain sensitive to policy credibility and institutional weaknesses (Asiedu, 2002; Ali et al., 2025; Kimino, 2025; Zhang & Young, 2026). Lower statutory corporate tax rates may improve investment attractiveness, yet they rarely compensate for macroeconomic instability or poor institutional quality (Blonigen, 2005; Murat, 2020; Andy et al., 2024; Ali et al., 2025; Mengoub & Tarbalouti, 2026). This recurring theme also explains why estimated tax effects frequently change after broader non-tax variables are introduced into empirical models. Devereux and Griffith (2003) demonstrate that different tax definitions correspond to different investment decisions. Effective marginal tax rates are linked more closely to marginal investment decisions, whereas effective average tax rates are more relevant for location choices across jurisdictions. This distinction explains why studies examining the same issue may produce different findings without necessarily contradicting one another (de Mooij & Ederveen, 2003; Li, 2024; Ali et al., 2025; Li et al., 2026). The discussion is especially relevant for developing-country studies because data



limitations frequently restrict researchers to statutory corporate tax rates rather than effective tax measures (Abbas & Klemm, 2013; Khalid & Abdul, 2025; Ali et al., 2025; Al-Masri & Audi, 2026; Garg et al., 2026).

Despite the conceptual advantages of effective tax measures, many studies continue to rely on statutory corporate tax rates. Statutory rates are observable across countries and politically visible as indicators of whether a country maintains an investment-friendly environment (Bellak & Leibrecht, 2009; Hong & Cong, 2024; Ali et al., 2025; Kumar & Wu, 2025). Governments also frequently emphasize headline corporate tax reductions when competing for international investment, increasing the policy relevance of statutory rates (Abbas & Klemm, 2013; Willy, 2028; Saim et al., 2025; Tsiapa et al., 2025). However, statutory rates often provide only an imperfect representation of actual investor tax burdens because allowances, administrative complexity, and treaty arrangements can substantially alter effective investment costs (Desai et al., 2004; Luna & Luna, 2018; Emako et al., 2022; Kumar et al., 2025; Hanvoravongchai, P., & Paweenawat, 2025). Economies with relatively high statutory tax rates may remain attractive because of incentives or efficient tax administration (Devereux & Griffith, 2003; Adejumobi, 2019; Khan et al.,

2025; Nguyen et al., 2025). The literature, therefore, treats statutory corporate tax rates mainly as indicators of policy orientation rather than exact measures of investor tax burdens (Bellak & Leibrecht, 2009; Diaz & Weber, 2020; Colladon et al., 2024; Aqeel et al., 2025; Bary & Hakim, 2025). The strongest evidence regarding taxation and foreign direct investment emerges from meta-analytical studies. de Mooij and Ederveen (2003) identify a broadly negative relationship between taxation and foreign direct investment across numerous empirical settings. Feld and Heckemeyer (2011) extend this evidence using a larger sample of studies and similarly report statistically meaningful negative associations between taxation and foreign direct investment. Yet both meta-analyses also emphasize substantial heterogeneity among empirical findings (de Mooij & Ederveen, 2003; Feld & Heckemeyer, 2011; Mohammadi, 2022; Shahid et al., 2025). Estimated tax effects differ according to whether studies examine investment flows or stocks, aggregate or bilateral data, statutory or effective tax measures, and simple or advanced estimation methods. The broader implication is that taxation influences investment differently depending on institutional and methodological conditions (de Mooij & Ederveen, 2003; Lu & Xing, 2022; Humza et al.,



2025). Desai et al., (2004) mention that multinational firms operate within broader fiscal environments where investment decisions depend on multiple forms of taxation. Hines (1999) similarly emphasizes that multinational investment behavior is shaped by entire tax systems rather than isolated tax instruments. Within developing-country research, statutory corporate tax rates therefore function mainly as proxies for broader fiscal environments because they remain observable and comparable across countries. Their estimated coefficients may consequently capture wider institutional and fiscal conditions beyond the legal corporate tax rate itself.

Evidence from developing countries introduces additional complexity into the taxation-foreign direct investment relationship. Asiedu (2002) mentions that the determinants of foreign direct investment differ significantly across developing economies. Tax reductions may attract investment in relatively stable economies with strong market access, yet similar policies may prove ineffective in countries characterized by weak institutions or macroeconomic instability (Blonigen, 2005; Kanwal et al., 2025). Cross-country studies should therefore be interpreted as identifying average relationships within diverse contexts rather than universal rules (Asiedu, 2002; Ahmad et al., 2025). This

heterogeneity also appears within the literature on tax incentives. Klemm and Van Parys (2012) mention that lower corporate tax rates and longer tax holidays are associated with increased foreign direct investment inflows, although they find limited evidence that such incentives improve long-run economic growth. The incentives literature, therefore, distinguishes carefully between attracting foreign direct investment and achieving development through foreign direct investment (Klemm & Van Parys, 2012; Ghauri et al., 2025). Abbas and Klemm (2013) observe “race-to-the-bottom” dynamics among developing economies where governments reduce tax burdens through statutory cuts and incentives in order to remain competitive in attracting international capital. Simultaneous reductions in corporate taxation may therefore generate only modest investment gains while reducing government revenues more broadly (Klemm & Van Parys, 2012; Nasir et al., 2025). This literature highlights the policy risks associated with sacrificing fiscal revenues under international competitive pressure (Abbas & Klemm, 2013; Anus et al., 2025).

Recent studies also question whether the negative relationship between taxation and foreign direct investment remains robust in developing-country samples. Ngwaba (2023), examining 65



developing economies, reports that foreign direct investment appears largely insensitive to corporate taxation. This finding challenges the policy expectation that lower corporate taxes necessarily attract greater inward investment. One explanation is that non-tax determinants such as infrastructure and governance increasingly dominate investment decisions (Blonigen, 2005; Marc et al., 2022). Another possibility is that statutory corporate tax rates have become weaker proxies for actual investor burdens because of growing tax incentives and special regimes (Desai et al., 2004; Marc & Ali, 2023). The relationship between taxation and foreign direct investment, therefore, remains unresolved rather than settled (Ngwaba, 2023; Marc & Al Masri, 2024). Zagler (2023) finds that high corporate taxes discourage foreign direct investment more strongly in environments characterized by weak legal security. Investors may therefore prefer relatively high-tax countries with strong institutions over low-tax economies with weak governance and poor legal enforcement. This perspective is particularly relevant for developing economies where practical policy implementation often matters more than formal legislation itself (Gastanaga et al., 1998). The institutional literature consequently reinforces the importance of analyzing taxation alongside broader governance

conditions rather than in isolation. Chakrabarti (2001) demonstrates that the relative importance of foreign direct investment determinants changes considerably across alternative model specifications. de Mooij and Ederveen (2003) similarly show that estimated tax elasticities depend heavily on tax measures, data structures, and empirical methods, while Feld and Heckemeyer (2011) confirm that estimated effects remain sensitive to research design choices. Potential endogeneity also remains problematic because lower corporate taxation may itself represent a response to weak investment performance rather than its cause (Abbas & Klemm, 2013; Audi, 2024). Omitted-variable bias is equally important because tax reforms often coincide with trade liberalization and governance reforms (Gastanaga et al., 1998). These debates reinforce the importance of transparent modeling and cautious interpretation of empirical findings.

The literature provides substantial evidence that taxation influences foreign direct investment decisions (de Mooij & Ederveen, 2003; Marc & Yu, 2024). At the same time, there is broad agreement that the magnitude and direction of tax effects depend heavily on institutional quality, empirical methodology, and broader economic conditions (Feld & Heckemeyer, 2011; Audi, 2016). Lower corporate taxation may

attract foreign investment under certain conditions, yet it cannot substitute for broader economic and institutional reforms (Gastanaga et al., 1998). The literature therefore rejects extreme positions: taxation matters, but tax reductions alone cannot reliably generate transformative foreign direct investment outcomes within developing economies (Ngwaba, 2023). These unresolved debates provide the main motivation for the present study.

3. Theoretical Methodology

Multinational firms allocate investment toward locations generating relatively higher expected returns, making host-country taxation an important determinant of location choice (Blonigen, 2005; Bakar et al., 2022). Corporate income tax directly affects the proportion of profits retained after production within the host economy (Hines, 1999; Afonso, 2024). A higher statutory corporate tax rate reduces after-tax profitability and weakens the attractiveness of the host country for foreign investment (de Mooij & Ederveen, 2003; Zhang, 2023). At the same time, investment decisions are also shaped by factors such as market size, labor conditions, institutional quality, and the investment environment (Dunning, 1993; Blonigen, 2005; Vicard, 2023). The present study, therefore, combines neoclassical investment theory, the eclectic paradigm, and tax-competition theory to examine

whether lower corporate taxation is associated with higher inward foreign direct investment in developing economies. The neoclassical theory of capital allocation argues that capital flows toward locations providing relatively higher risk-adjusted returns (Imran & Rashid, 2023). Since taxation reduces post-tax investment returns, countries with lower corporate income tax rates are expected to attract more foreign direct investment when other conditions remain similar (de Mooij & Ederveen, 2003). Consequently, higher statutory corporate tax rates reduce the incentive to invest by lowering expected profitability (Hines, 1999). This reasoning supports the proposition that corporate taxation is negatively associated with foreign direct investment inflows.

Tax-competition theory adds another important dimension to the framework. Governments in a globalized economy compete for mobile capital by reducing corporate tax burdens (Wilson, 1999). Keen and Konrad (2013) describe this process as a strategic interaction in which countries adjust policies in response to one another because capital and profits are internationally mobile. This perspective is particularly relevant for developing economies that frequently rely on tax incentives and reduced tax rates to attract foreign investment (James, 2009). However,



when many countries reduce taxes simultaneously, the competitive advantage declines while revenue losses become widespread (Wilson, 1999). Trade openness supports firms involved in international supply chains (Asiedu, 2002), while macroeconomic stability reduces uncertainty regarding future returns (Gastanaga et al., 1998). Institutional quality and legal certainty also influence investment decisions because investors may discount favorable tax policies when governance structures are weak (Zagler, 2023). The central theoretical proposition of the study is therefore that lower corporate tax rates are generally associated with higher inward foreign direct investment, although the strength of this

relationship depends on broader economic and institutional conditions. The model can be expressed as follows:

$$FDI_{it} = \alpha + \beta_1 CTR_{it} + \beta_2 GDP_{it} + \beta_3 OPEN_{it} + \beta_4 INF_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

where

FDI_{it} = foreign direct investment inflows in country i in year t

α = constant term

CTR_{it} = statutory corporate tax rate

GDP_{it} = gross domestic product, proxy for market size

$OPEN_{it}$ = trade openness

INF_{it} = inflation rate, proxy for macroeconomic instability

μ_i = country-specific effects

λ_t = time-specific effects

ε_{it} = error term

Table 1:

Definition, Measurement, and Source of Variables

Variables	Definitions	Measurements	Sources
FDI	Net inward foreign direct investment received by the host economy	FDI net inflows (BoP, current US\$)	World Bank, World Development Indicators
CTR	Statutory corporate income tax rate in the host country	Percentage (%)	OECD Corporate Income Tax Rates Database
GDP	Size of the host economy	GDP (current US\$) or log GDP	World Bank, World Development Indicators
OPEN	Degree of integration with the global economy	Trade (% of GDP)	World Bank, World Development Indicators
INF	General price instability in the economy	Inflation, consumer prices (annual %)	World Bank, World Development Indicators



The analysis is based on panel-data estimation, allowing examination of the relationship between corporate tax rates and inward foreign direct investment across countries over time. The dataset consists of a balanced panel of 50 countries covering the period from 2008 to 2025.

4. Results and Discussions

Table 2 presents the descriptive statistics for the variables included in the empirical analysis. The dependent variable, foreign direct investment inflows, demonstrates substantial variation across countries and over time, indicating an uneven distribution of international capital movements among the sampled economies. The noticeable gap between the average and central tendency explains that foreign direct investment is concentrated in a limited number of countries, while the majority attract comparatively lower inflows. This pattern is widely supported in the foreign direct investment literature, where

investment flows are often concentrated in economies with larger markets, stronger institutional environments, and more favorable investment conditions. The findings further indicate considerable heterogeneity in corporate tax structures among the selected countries, reflecting differences in fiscal policy frameworks and investment strategies adopted by governments. Economic size, represented by the logarithm of gross domestic product, appears relatively stable across the sample, although sufficient variation remains to capture cross-country differences in market capacity. Similarly, trade openness exhibits substantial dispersion, implying that the sample includes both highly open economies and relatively less integrated markets. Inflation also shows variability across countries and periods, highlighting differences in macroeconomic stability and policy effectiveness within the dataset.

Table 2:

Descriptive Statistics

Variables	Mean	Median	Standard Deviation	Minimum	Maximum
FDI inflows (US\$ bn)	12.83	2.35	36.16	-7.12	290.93
Corporate tax rate (%)	23.77	25.00	9.76	0.00	55.00
ln GDP	24.69	25.09	1.76	22.88	30.00
Trade openness (% of GDP)	92.18	79.58	55.89	22.11	437.33
Inflation (%)	6.13	4.88	5.83	-4.86	59.22



The correlation matrix presented in Table 3 provides preliminary evidence regarding the relationships among the variables before multivariate estimation. The results indicate that foreign direct investment is most strongly associated with economic size, explaining that larger economies tend to attract higher levels of foreign investment. This finding supports the market-size hypothesis, which argues that multinational firms prefer economies with stronger demand conditions and wider production opportunities (Dunning, 1993). Similar evidence is reported by Wheeler and Mody (1992) and Noorbakhsh et al. (2001), who emphasize the importance of structural development and market conditions in attracting international capital flows. In contrast, the relationship between foreign direct investment and the statutory corporate tax rate appears relatively weak at the bivariate level. This explains that lower corporate taxation alone may not necessarily guarantee higher inward investment. Instead, the influence of taxation appears conditional upon broader institutional, structural, and macroeconomic factors. This interpretation is consistent with James (2009), who mentions that taxation represents only one component of the broader investment climate considered by multinational enterprises. Likewise, Bénassy-Quéré et al. (2005)

emphasize that infrastructure quality, agglomeration effects, and market-related advantages frequently outweigh tax differentials in investment location decisions. The remaining explanatory variables show comparatively weak relationships with foreign direct investment. Trade openness demonstrates only a limited association with investment inflows, indicating that openness alone does not uniformly attract foreign capital across all economies. Inflation shows a weak negative relationship with foreign direct investment, which is broadly consistent with theoretical expectations that macroeconomic instability discourages investment. However, the limited strength of this relationship explains that inflation alone does not exert a strong unconditional influence on investment inflows within the sample. The correlation matrix also indicates that multicollinearity is unlikely to pose a serious concern in the regression analysis. None of the explanatory variables exhibits excessively high correlations, and the variance inflation factors remain within acceptable thresholds. Consequently, any weak or statistically insignificant relationship between corporate taxation and foreign direct investment is more likely to reflect the comparatively limited independent role of taxation rather than econometric problems associated with the model specification.



Table 3:

Correlation Matrix

Variables	FDI	CTR	ln GDP	OPEN	INF
FDI	1.000				
CTR	0.043	1.000			
ln GDP	0.574	0.096	1.000		
OPEN	-0.051	-0.066	-0.083	1.000	
INF	-0.079	0.163	0.019	-0.096	1.000

Table 4 reports the main regression results obtained from the pooled ordinary least squares, random-effects, and fixed-effects estimations. The pooled ordinary least squares results provide limited support for the theoretical expectation regarding corporate taxation. Although the estimated relationship between the statutory corporate tax rate and foreign direct investment is negative, the effect is not statistically meaningful. This indicates that lower statutory tax rates alone do not systematically explain differences in inward foreign direct investment across the sampled economies. In contrast, market size emerges as a consistently important determinant of foreign direct investment, supporting the theoretical argument that multinational enterprises are primarily attracted to economies offering larger domestic markets, stronger demand conditions, and broader production opportunities (Wheeler & Mody, 1992; Sarkutė et al., 2024; Chrystella et al., 2025). This finding is also consistent with Billington (1999), who mentions that investment decisions are influenced more strongly by host-country

characteristics than by taxation alone. Trade openness and inflation do not display statistically meaningful relationships in the pooled specification. Once unobserved country-specific heterogeneity is incorporated through the random-effects model, the estimated effect of corporate taxation becomes even weaker and remains statistically insignificant. This finding explains that the modest negative association observed in the pooled model is not robust after accounting for structural country-level characteristics. Consequently, the results challenge the conventional assumption that reductions in headline corporate tax rates automatically translate into higher foreign direct investment inflows. Instead, the evidence indicates that broader economic and institutional conditions may exert a more substantial influence on international investment decisions than taxation policy in isolation. Within the random-effects framework, market size continues to demonstrate a strong and positive association with foreign direct investment, reinforcing the central role of economic scale in attracting multinational activity. This outcome



aligns closely with classical location theory and the broader empirical literature, which emphasize that multinational enterprises value market potential, infrastructure quality, labor availability, supplier networks, and domestic purchasing power when selecting investment destinations (Dunning, 1993; Blonigen, 2005; Akpilic, 2026). By comparison, trade openness and inflation remain statistically insignificant, implying that these variables do not independently explain foreign direct investment patterns once broader country-specific factors are considered. The fixed-effects estimation produces similar conclusions regarding corporate taxation. Changes in statutory corporate tax rates within countries over time do not appear to generate the expected systematic changes in foreign direct investment inflows. If taxation exerted a strong within-country effect, the fixed-effects specification would be expected to capture such dynamics more clearly. However, the estimated relationship remains weak and statistically unconvincing. Market size retains a positive association with foreign direct investment, although its statistical importance diminishes under fixed effects because much of the influence of gross domestic product operates through structural differences across countries rather than short-term within-country variation. Trade openness and inflation similarly

remain insignificant in the fixed-effects specification. Additional support for the random-effects approach is provided by the variance decomposition, which indicates that country-level variation exceeds the purely idiosyncratic component of the error structure. This outcome explains that foreign direct investment differs systematically across countries because of structural characteristics not fully captured by the included regressors. Such factors may include institutional quality, geographical advantages, resource endowments, historical development patterns, regulatory credibility, and political stability. Consequently, panel estimators that explicitly account for country-specific heterogeneity are more appropriate than pooled estimation techniques for analyzing international investment behavior. The findings further imply that tax policy does not dominate other structural determinants in shaping foreign direct investment outcomes. Three econometric specifications consistently indicate that lower statutory corporate tax rates do not independently drive higher inward foreign direct investment across the sampled countries. While this does not imply that taxation is entirely irrelevant, the evidence explains that statutory corporate taxation alone is not a stable or consistently meaningful determinant once the panel structure and broader macroeconomic conditions are



considered. These findings are broadly consistent with the more cautious strand of the literature examining developing and mixed-country samples, where the effectiveness of tax competition is often conditioned by broader host-country characteristics (Azémar & Delios, 2008; Klemm & Van Parys, 2012; Ho et al., 2023). Bénassy-Quéré et al. (2005), similarly mention that taxation operates alongside agglomeration economies and location-specific advantages, while Hajkova et al. (2006) emphasize the importance of broader business and institutional conditions in attracting foreign investment. The relatively weak taxation effect may also reflect limitations associated with the measurement of the tax variable itself. The present analysis relies exclusively on statutory corporate tax rates, whereas several studies argue that effective tax measures provide a more accurate representation of the fiscal incentives facing multinational firms. Devereux and Griffith (2003) contend that effective average tax rates are theoretically more relevant for discrete investment-location decisions, while Desai et al. (2004) demonstrate that multinational enterprises respond to a broader set of fiscal considerations beyond statutory taxation. Similarly, Buettner and Ruf (2007) emphasize the role of firm-level tax incentives, and Becker et al. (2012) show that taxation influences both the quantity

and quality of foreign direct investment. Therefore, the weak and unstable relationship observed in this study may partly reflect measurement limitations rather than the complete absence of economic relevance. The positive relationship between economic scale and foreign investment is evident across all model specifications and aligns closely with international business theory, which identifies market size as a central motivation for market-seeking foreign direct investment (Dunning, 1993). Earlier empirical studies likewise emphasize the importance of structural capacity, domestic demand conditions, and broader economic fundamentals in shaping multinational investment decisions (Wheeler & Mody, 1992; Noorbakhsh et al., 2001; Campos & Kinoshita, 2003). The weaker significance under fixed effects does not diminish this conclusion, as the influence of gross domestic product primarily reflects persistent structural differences across countries rather than short-term temporal changes.

Trade openness also fails to emerge as a significant explanatory variable, despite being widely regarded as an important determinant of foreign direct investment in many theoretical frameworks (Asiedu, 2002). This outcome is consistent with evidence explaining that the effect of trade integration varies considerably across countries and types of foreign direct investment



(Demirhan & Masca, 2008; Noorbakhsh et al., 2001; Campos & Kinoshita, 2003). Highly open economies may not necessarily attract substantial foreign investment if the domestic market size remains limited. Accordingly, openness alone appears insufficient to generate strong inward foreign direct investment without complementary structural advantages. Inflation similarly demonstrates limited explanatory power within the regression models. Although inflation is often interpreted as an indicator of macroeconomic instability, it may provide only a partial representation

of the broader policy and institutional risks considered by foreign investors. Busse and Hefeker (2007) show that institutional quality, government stability, bureaucratic effectiveness, and legal reliability play a more substantial role in shaping foreign investment decisions. In this context, investors may respond more strongly to policy credibility and institutional certainty than to inflationary pressures alone. Zagler (2023) further mentions that legal and institutional uncertainty may amplify the deterrent effects of taxation, reinforcing the importance of broader governance conditions.

Table 4:

Regression Results

Variables	Model 1: Pooler OLS	Model 2: Random Effects	Model 3: Fixed Effects
Corporate tax rate	-0.399 (0.333)	0.063 (0.167)	0.185 (0.220)
ln GDP	14.612** (6.587)	14.307*** (2.030)	18.311 (13.756)
Trade openness	0.028 (0.037)	-0.009 (0.045)	-0.030 (0.088)
Inflation	-0.427 (0.339)	0.164 (0.135)	0.187 (0.178)
Constant	-347.166** (154.434)	-350.610*** (52.574)	-473.553 (359.294)
Observations	350	350	350
R-squared model fit	0.351	-	-

Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$.

5. Conclusions

This paper examines the effects of corporate tax rates on inward foreign direct investment by using a balanced panel of 50 countries from 2008 to 2025. The study evaluates whether lower statutory corporate tax rates contribute to higher FDI inflows after controlling for major

host-country determinants. The empirical results provide limited support for a systematic negative relationship between statutory corporate taxation and inward FDI. The pooled ordinary least squares model reports a negative coefficient for the tax variable, although it remains statistically insignificant.



Moreover, the coefficient changes sign across the panel estimators and remains insignificant in both the random-effects and fixed-effects models, indicating that statutory corporate tax rates were not a major determinant of inward FDI during the sample period. Market size, represented by gross domestic product, remains consistently significant across the estimated models, particularly within the pooled and random-effects estimations. Trade openness and inflation display weaker and less consistent effects, with their significance varying across specifications. These findings suggest that foreign investors respond more strongly to structural characteristics of host economies than to headline corporate tax rates alone. The results, therefore, support the argument that tax competition is unlikely to independently generate substantial increases in foreign investment. More broadly, tax policy appears to operate as one component of the investment environment rather than as a dominant determinant of inward FDI. This carries important implications for policymakers in developing and emerging economies, where reductions in statutory corporate tax rates may not automatically produce higher investment inflows. Instead, market size, structural conditions, and broader economic attractiveness appear more influential in shaping

investment decisions. Tax policy is likely to become more effective when combined with improvements in infrastructure, institutional quality, legal systems, and overall macroeconomic stability. Policymakers should therefore treat tax reductions as supportive policy instruments rather than substitutes for broader economic reforms. The study nevertheless faces several limitations. Statutory corporate tax rates may not fully capture the effective tax burden faced by multinational enterprises, while aggregate FDI inflows do not distinguish among different forms of foreign investment. In addition, part of the sample period coincides with episodes of global financial instability that may have weakened the observable effects of tax policy. Future studies may extend the analysis through longer time periods, alternative measures of taxation, or more disaggregated measures of foreign direct investment.

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