Does Taxation Matter on the Location Choice of Foreign Investors?

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Abstract

There is no consensus about the effects of foreign direct investments on the overall economy. While some economists mention to the negative effects of foreign direct investments based on the decrease in economic dependency of countries, some others claim that foreign direct investments stimulate economic growth by filling the deficiencies of savings and investments. Less developed or developing countries usually have disadvantaged positions as they have low amount of factors of capital. Therefore, foreign direct investment flows are very crucial especially for them and nowadays, a wide range of countries try to attract investments by benefiting from different policies.

Since capital controls and restrictions on trade have already reduced in most of the countries, differences in taxation become one of the basic determinants that affect the location choice of foreign direct investments. This study aims to investigate the relationship between taxation and foreign direct investments. For that purpose, we try to mention to the results and suggestions of previous studies in the previous literature as much as possible. Thus, we exhibit the mechanisms that explain the relationship between taxation and foreign direct investments.

We also confirm our suggestions with some empirical evidence. By using a data set covering the period 2006-2016 and by benefiting from the empirical tests that determine the cointegration relationship between the variables, our study concludes that there is a long run relationship between taxation and foreign direct investments. However, no significant relationship observes in the short run.

Keywords : Taxation, Foreign Direct Investments.

JEL Classification Codes : E60, E62.