Universidade do Minho

Escola de Economia, Gestão e Ciência Política

Bruna Particheli

Corporate Taxation and Foreign Direct Investment: Are low-tax jurisdictions more attractive?

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Corporate Taxation and Foreign Direct Investment: Are low-tax jurisdictions more attractive?

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Abstract

This dissertation examines the relationship between statutory corporate income tax rates and foreign direct investment (FDI) attraction across 151 countries from 2010 to 2024. The study compares low-tax jurisdictions (tax rates of 15 percentage points or less) with regular taxation countries using panel data analysis, controlling for country- and time-fixed effects. Although low-tax jurisdictions have lower mean FDI inflows, multivariate regression analysis has statistically insignificant tax rate coefficients in all specifications. The most important determinants of FDI are found to be country risk premium and corruption control, which implies that institutional quality moderates the effectiveness of tax rate competition. The results are based on the existing beliefs regarding development strategies as tax-driven development, and show that effective low-tax jurisdictions are those that use fiscal incentives in addition to good governance, political stability, and good legal frameworks. The implications of these results for policy makers are significant, especially in terms of the implementation of OECD Pillar 2 global minimum tax. The author found that it is not possible to rely on low statutory corporate tax rates only to reach productive foreign investment without institutional advantages and other wider economic competitiveness advantages.

Palavras-chave: Foreign Direct Investment; International Tax Competition; Low Taxation; Pillar 2, OECD.

Resumo

Esta dissertação analisa a relação entre as taxas legais de imposto sobre o rendimento das sociedades e a atração de investimento direto estrangeiro (IDE) em 151 países, no período de 2010 a 2024. O estudo compara jurisdições de baixa tributação (taxas de 15 pontos percentuais ou menos) com países de tributação considerada normal, por meio de análise de dados em painel, controlando por efeitos fixos de país e de tempo.

Embora as jurisdições de baixa tributação apresentem menores médias de entradas de IDE, a análise de regressão multivariada revela coeficientes estatisticamente insignificantes para as taxas de imposto em todas as especificações. Os determinantes mais importantes do IDE identificados são o prêmio de risco-país e o controlo da corrupção, o que implica que a qualidade institucional modera a eficácia da concorrência fiscal baseada em taxas de imposto.

Os resultados baseiam-se nas crenças existentes sobre estratégias de desenvolvimento como desenvolvimento orientado por impostos e mostram que as jurisdições de baixa tributação bem-sucedidas são aquelas que utilizam incentivos fiscais em conjunto com boa governação, estabilidade política e bons quadros jurídicos. As implicações desses resultados para os decisores políticos são significativas, especialmente no que diz respeito à implementação do imposto mínimo global do Pilar 2 da OCDE.

O autor conclui que não é possível depender apenas de baixas taxas legais de imposto sobre o rendimento das sociedades para atrair investimento estrangeiro produtivo, na ausência de vantagens institucionais e de outras formas mais amplas de competitividade económica.

Palavras-chave: Investimento Direto Estrangeiro; Concorrência Fiscal Internacional; Jurisdições de Baixa Tributação; Pilar 2, OCDE.

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CHAPTER 1: INTRODUCTION

1.1 Background and Context

Corporate taxation has become one of the most effective factors in multinational investment decision-making in the modern global economy. With the increased mobility of capital across borders, nations have turned to strategic cross-border tax competition to attract foreign direct investment (FDI), and one key policy tool has been the level of corporate tax rate (Hines, 2010). Such competition has spawned jurisdictions with significantly lower or no corporate tax rates, often known as tax havens or low-tax jurisdictions. Such regions not only provide little taxation, but also favourable regulatory frameworks and incentives with the express aim of attracting international capital (Dharmapala, 2008; Hebous, 2010).

Reduced corporate tax rates as a tool of economic development gained strategic use, especially with the globalisation of the world economy in the late twentieth century. By relying on preferential tax regimes, many countries, especially smaller economies and developing nations, have been able to offset structural disadvantages such as small domestic markets, geographic isolation, or poor infrastructure. These jurisdictions have aimed to create jobs, boost their economies, and become part of the global value chain by providing favorable fiscal conditions (Dharmapala, 2021).

Nevertheless, over the past few years, the international tax environment has changed significantly, especially following high-profile tax scandals in the late 2000s and early 2010s, which revealed widespread profit shifting and tax avoidance by multinational businesses. Such revelations led to concerted international efforts, the most notable of which is the G20/OECD Base Erosion and Profit Shifting (BEPS) initiative, introduced in 2013. The BEPS initiative is an unprecedented international tax initiative to address tax planning schemes, in which tax regulations and rules are used to artificially shift profits to jurisdictions that pay little or no taxes(OECD, 2015). One of the significant changes brought by this initiative is Pillar 2, which establishes a minimum corporate tax rate of 15 percent for large multinational enterprises worldwide, radically altering the incentive framework for allocating profits and for investment location choices (OECD, 2021).

1.2 Research Problem and Rationale

With the introduction of the global minimum tax rate under Pillar 2, the effectiveness of low-tax strategies in attracting future FDI raises critical questions. Although the goals of these reforms are to enhance the fairness of the global tax system and avoid harmful tax competition, the issue of their possible effects on developing economies that have traditionally used tax incentives to attract foreign capital has arisen. In countries with limited alternative competitive advantages, the loss of tax-based benefits can significantly limit their development opportunities and economic growth (Beer, de Mooij, and Liu, 2020).

Even though the relationship between corporate taxation and FDI has attracted extensive scholarly attention, several research gaps remain. First, when many studies investigate effective tax rates, including deductions and exemptions and other fiscal complexities, statutory corporate tax rates are relatively the least systematically studied in the literature, even though they are the highest in the policy agenda and are more visible to prospective investors. Second, comparative research that specifically compares FDI patterns between low-tax regimes and nations with regular statutory tax regimes remains scarce, especially in light of recent global tax reforms. Lastly, the interaction between tax policy and other institutional factors, such as the governance quality, regulatory effectiveness, and political stability, warrants further empirical research to identify the conditions under which tax incentives are successful in attracting productive investment (Djankov et al., 2008).

The current dissertation attempts to fill such gaps by undertaking a systematic study of whether statutory corporate tax rates play a significant role in attracting FDI and whether this relationship varies between low-tax regimes and countries with regular taxation regimes. These dynamics are vital to policymakers, especially when it comes to implementing Pillar 2, as they will shape arguments about the distributional impacts of global tax harmonisation and the future sustainability of taxation-focused development policies.

1.3 Research Question and Objectives

The following central question guides this research: *Is there a relationship between a country's statutory corporate income tax rate and the volume of Foreign Direct Investment (FDI) it attracts?*

Operationally, this question is addressed empirically in Chapters 3 and 4 through a Difference-in-Differences (DiD) panel data model covering 151 countries between 2010 and 2024, in which low-tax jurisdictions (statutory rate ≤ 15%, the Pillar 2 threshold) constitute the treatment group and regular-taxation countries the control group, with country and year fixed effects and country-clustered standard errors. Hypothesis testing on the model coefficients (β_1 for tax rate, β_3 for the tax × treatment interaction, and δ_j for governance controls) provides the formal answer to the research question.

To address this question comprehensively, the study pursues five specific objectives:

- To examine the theoretical foundations linking corporate taxation to capital mobility, with particular emphasis on tax competition theory and investment location decisions as articulated in the existing literature.
- To analyse empirical evidence on the relationship between statutory and effective corporate tax rates and FDI inflows across countries, identifying temporal patterns and cross-country variations.
- To identify moderating factors, including market size, governance quality, infrastructure, and institutional stability, that condition the extent to which corporate tax rates influence FDI decisions.
- To evaluate policy implications of variations in corporate tax regimes, particularly in light of recent global tax reforms such as OECD Pillar 2.
- To contribute to literature by assessing whether low statutory corporate tax rates alone suffice to attract FDI, or whether broader institutional and economic conditions must complement them.

1.4 Structure of the Dissertation

This dissertation is organized into six chapters. Following this introductory chapter, Chapter 2 presents a comprehensive review of the theoretical and empirical literature on corporate taxation and FDI, identifying key themes, debates, and research gaps. Chapter 3 outlines the research methodology, including the research design, model specification, data sources, and analytical approach. Chapter 4 presents the results of empirical analysis, including descriptive statistics, comparative tests, correlation analysis, and regression results. Finally, Chapter 5

concludes by summarizing the key findings, acknowledging limitations, and suggesting directions for future research.

CHAPTER 2: LITERATURE REVIEW

2.1 Theoretical Foundations

The relationship between corporate taxation and FDI is based on interrelated theoretical frameworks, the most notable being the theory of international capital mobility and tax competition theory. The theory of tax competition assumes that, given globally mobile capital, jurisdictions compete to offer investment-friendly tax treatment, which may result in a race to the bottom in corporate tax rates (Wilson, 1999). This is because multinational enterprises have the flexibility to move capital across borders in response to variations in after-tax returns, thereby subjecting national tax policy to disciplinary pressure.

According to the neoclassical view of capital mobility (Hartman, 1985; Devereux & Griffith, 2003), capital flows toward jurisdictions offering higher after-tax returns. Empirical meta-analyses estimate semi-elasticities of FDI to corporate tax rates ranging from -2.5 to -3.7 (De Mooij & Ederveen, 2003, 2008; Feld & Heckemeyer, 2011), suggesting that taxation is a meaningful — though not dominant — determinant of cross-border investment decisions.Corporate income taxes will decrease the after-tax returns on investment, thus deterring capital accumulation in high-tax jurisdictions (Zodrow and Mieszkowski, 1986). Under perfect competition, in markets with no restrictions on cross-border capital flows, capital movements can be driven by minor variations in tax rates. This grim forecast is, however, tempered by several factors, such as agglomeration economies, market-size effects, and location-specific advantages that are difficult to copy elsewhere.

This framework is further enhanced by the theory of multinational enterprise location decisions, which acknowledges that firms trade off tax factors with other criteria, including proximity to markets, accessibility to skilled labour, quality of infrastructure, and institutional stability (Dunning, 1988). According to the eclectic paradigm, FDI occurs when firms have ownership advantages, location advantages that favor foreign production, and internalization advantages, such that direct investment is preferable to market transactions. In this context, taxation affects the location advantage element, which, however, depends on the nature of the investment and the broader institutional context.

These theoretical perspectives determine that, although corporate tax must have an adverse impact on FDI, the extent and stability of such an impact are conditioned by the existence of complementary factors, preconditioning the development of empirical research on the interplay

between the tax policy and the quality of institutions, market features, and regulation in structuring investment results.

2.2 Statutory Corporate Taxation and FDI

A large number of empirical studies have reported a negative correlation between the statutory corporate income tax rates and the FDI inflows. Among the most influential initial contributions to this literature, at least in the analysis of corporate taxation, is that of Djankov et al. (2008), who compare the statutory tax rates of 85 countries and show that higher statutory tax rates have serious adverse effects on domestic investment and FDI. Their results suggest that raising the statutory corporate tax rate by 0.1 percentage points will be accompanied by a 2 percentage-point drop in investment-to-GDP. This is a significant semi-elasticity, implying that tax policy can have a significant effect on aggregate investment.

These results have been strengthened by other studies that have improved the conceptualization of the mechanisms and magnitudes. Sato (2012) uses bilateral FDI data from OECD countries and finds that statutory rates exhibit a strong negative correlation with investment flows, despite controlling for various governance and market-related variables. This result is consistent across a variety of samples and methodological designs, suggesting that statutory tax rates are a significant determinant of investment location decisions.

Recent statistics in Europe also support these trends. Bellak and Liebrecht (2025) use a gravity model framework based on EU data for 2017-2023 and conclude that the statutory tax rate has a substantial impact on the pattern of FDI, but in different industries and at different times. Their discussion indicates that, although effective average tax rates can be a better measure of the opportunities of tax planning that advanced multinationals may have, statutory rates play a significant role as a preliminary indicator to investors considering where to invest. This observation aligns with the concept that statutory rates serve as a heuristic or filtering tool in the initial phase of location decision-making.

The alternative evidence is presented by Laurent (2025),indicating that a one-percentage-point rise in the statutory corporate tax rate decreases FDI inflows by about 5%. This is a much larger estimate than previous studies, which could reflect rising capital mobility or an amplified sensitivity of contemporary multinational firms to tax differentials. The fact that the negative

impact of statutory taxation remains considerable in recent data highlights the policy relevance of statutory taxation despite recent advances in international tax planning.

2.3 Non-linear Effects and Thresholds

Despite overwhelming evidence of a negative linear correlation between corporate tax rates and FDI, the growing literature has begun to notice non-linearities and threshold effects. Shen and Dai (2024) examine macro-level taxation burdens across a wide range of countries and find that the adverse effect of taxes on FDI increases beyond a threshold of about 25 percent. For countries where the CIT rate is higher than 25%, this result on FDI becomes of a much greater influence.

This evidence implies that the joint impact of taxation and FDI can be described as either declining returns to scale or increasing costs. In jurisdictions where tax rates are already considered low, further reductions in tax rates might yield even smaller growth in FDI, as other location considerations take on a larger relative role. On the other hand, very high tax rates could also be especially harsh on FDI, as they can be interpreted as indicators of increased costs and possibly governance/competitiveness issues. The discovery of threshold effects has significant policy implications, as evidence suggests that optimal tax policy can vary substantially depending on a country's starting location in its tax rate distribution.

The presence of non-linearities means that simple linear regression models may not fully reflect the actual relationship between taxation and investment, and thus over- or under-estimate the impact of policies based on the sample composition. This observation of consideration prompts methodological interest in specifying functional forms and examining the interaction effects of taxes and other country features.

2.4 Institutional and Regional Dimensions of Statutory Tax Competition

Institutional quality comes out as a decisive moderating variable between corporate taxation and FDI. In their study, Rossi and Volpin (2004) show that cross-border mergers and acquisitions, and broader FDI flows, are more common when investors in the countries of origin have stronger investor protection than those in the target countries. This result indicates that statutory tax competition is not an independent phenomenon, as it is inextricably linked to governance systems and the effectiveness of legal institutions. Nations with low tax rates and weak

protection of property rights or lax enforcement of contracts can hardly attract substantial investment, as the costs of bad governance neutralize the fiscal benefits.

Paradoxically, Dharmapala and Hines (2009) report that most successful low-tax countries combine favourable tax systems with strong legal institutions. This package offers a unique competitive edge: fiscal indulgence attracts paper profits and fiscal frameworks, and institutional reliability provides assurance that these arrangements will be honored and enforceable by law. The authors claim that this institutional power distinguishes successful tax havens from unstable or poorly governed low-tax jurisdictions, suggesting that effective tax competition requires credible commitment mechanisms.

In the European Union context, regulatory harmonisation and capital market integration, differences in statutory tax rates may become increasingly relevant policy instruments for Member States. It should be noted, however, that not every low-tax EU country is a traditional tax haven. Some of them, as Hebous (2010) observes, do not have high statutory rates and, in fact, maintain high standards of enforcement and openness and compete on efficiency, not on opacity. This difference also highlights the need to make a distinction between global low-tax jurisdictions typified by little regulation and fiscal transparency, and EU Member States that have competitive and transparent tax regimes with well-established institutional frameworks. This kind of differentiation is necessary in order to properly estimate the dynamics of statutory tax competition and its consequences in cross-border investment behaviour.

2.5 Sectoral and Industry-Type Effects

There is a significant difference in the relationship between corporate taxation and FDI across industries and the types of industries that are subject to this interaction, which is of significance in the questions concerning the composition of the investment occasioned by the low-tax jurisdictions. Djankov et al. (2008) discovered that the deterrent impact of statutory tax rates is especially high on the capital-intensive manufacturing industry in comparison with services or financial operations. This sectoral heterogeneity is a product of heterogeneity in the mobility of factors of production, the significance of market accessibility, and the possibility of shifting profits on the basis of transfer pricing.

As Hebous (2010) points out, it is common in jurisdictions that have low taxation rates to focus on financial conduits and holding companies as opposed to a significant industrial

investment. Real-economy investments (production plants, infrastructure projects, and research and development centres) were also less likely to be sensitive to statutory tax rates on their own and were more sensitive to (among other things) labour market conditions, the quality of infrastructure, and accessibility to supply chains and customers. Financial investments, in turn, can be moved more easily and tend to be organized in a particular way that would help to reduce tax liability by means of intra-group transactions.

The effects of this sectoral difference are important when it comes to policy assessment. When the major importers of financial and holding activities, with little or no local employment or technological spillovers, are located in the low-tax jurisdictions, the developmental payoffs of tax competition can be significantly smaller than the aggregate FDI data can indicate. On the other hand, those jurisdictions that are able to achieve sustainable benefits from economic activity through attractive taxation can achieve more sustainable benefits. These points emphasize the value of managing industry-type heterogeneity in empirical analysis and encourage the methodological techniques that differentiate the financial and substantive sectors by the use of the industrial classification systems.

2.6 Global Tax Policy and OECD Pillar 2

In 2013, the international tax environment was dramatically changed by the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative. This multilateral initiative aim to counter tax planning schemes to take advantage of gaps and discrepancies in tax regulations to artificially transfer profits to places where there is little or no economic activity. One of the pillars of the recent BEPS reform outcomes is the Global Anti-Base Erosion (GloBE) rules under the Pillar 2, which introduces the minimum effective tax rate of 15 percent to large multinational corporations whose consolidated revenues are over seven hundred and fifty million dollars (OECD, 2021).

Pillar 2 works on a mechanism of cross-linking rules, which ensures that the multinational organizations pay at least the minimum tax rate on the income they generate in each jurisdiction. To achieve that, the Pillar 2 mechanism implement a mandatory 15% taxation at minimum, that may be charged in the parent company (or even a “sister-company”) of the entity that is below 15% trough a top-up tax mechanism.. The essential issue that this mechanism changes is the incentive arrangement in terms of profit allocation, as the tax benefits of recording profits in the

jurisdictions with a statutory rate below the minimum threshold are significantly decreased (Beer, de Mooij, and Liu, 2020).

Although the above objectives of Pillar 2 are to bring fairness and stability to the global taxation system, the reforms concern to developing economies, which rely on favorable taxation policies to attract foreign investments and spur economic growth. These nations can have unequal economic effects, which can undermine their development policies and increase global inequalities (OECD, 2023). The Pillar 2 marks one of the most crucial turning points for assessing whether the statutory low tax rates can remain effective tools for attracting investment, or whether the global minimum tax will radically change the geography of international capital flows.

2.7 Research Gaps and Contribution

Although the literature oncorporate tax and FDI is extensive, there are still some key gaps in the literature. First, most studies put emphasis on effective tax rates, whereas statutory corporate income tax rates are not as commonly singled out as the causal variable, despite the fact that they form the core of debates in the popular press, and they are the first to be seen by investors when making location choices. Second, a lack of systematic comparative study between low-tax jurisdictions and EU Member States with regular statutory-based tax systems, especially in recent global tax restructuring, is still relevant. In the last ten years, the international tax landscape has been undergoing a tremendous restructuring due to the initiatives of the OECD BEPS project and the introduction of the Pillar 2, but empirical literature has not adequately addressed how these changes have impacted various country groupings. This dissertation fills these gaps by analytically investigating the connection between statutory corporate tax rates and the appeal of FDI within individual groups of tax regimes, thereby contributing to academic debates and policymaking on the future of tax competition in a transformed international tax system.

CHAPTER 3: RESEARCH DESIGN

3.1 Methodology

The current study uses a quantitative research design that involves the use of panel data analysis to investigate the correlation between the statutory corporate income tax rate and the Foreign Direct Investment (FDI) attraction across nations, drawing on a Difference-in-Differences (DiD) framework. The DiD design is especially applicable to the present research question, as it enables one to identify differential tax effects between low-tax jurisdictions and regular taxation countries and to account for time-invariant country characteristics and shared time shocks (Angrist and Pischke, 2009).

There are various benefits of the DiD methodology as compared to the simple comparative analysis. First, it eliminates unobserved heterogeneity between treatment and control groups, which could be related to the choice of tax policy and FDI outcomes. The countries that pursue low-tax policies might be systematically different than regular states practicing taxation, making it hard to observe or even measure, including historic trends in development, political economy, or taxation cultural characteristics. The DiD framework accounts for time-invariant characteristics using country fixed effects. Second, a common set of temporal trends, such as international economic cycles, technological change, or changes in international capital mobility, is controlled for by including year fixed effects. Third, the DiD equation directly tests the hypothesis that the relationship between tax rates and FDI is different between low-tax jurisdictions and regular taxation countries by allowing an interaction term (Wooldridge, 2010).

This study analyzes the period 2010-2024, which has been carefully selected because it reflects modern trends in international tax competition in response to the introduction of the OECD BEPS initiative in 2013, but before Pillar 2 is fully in force. This time frame can be used to understand the impact on FDI trends in a time where countries are more focused on the topic of tax avoidance and profit shifting, as well as the expected impact of Pillar 2 in the future.

The OECD launched the Base Erosion and Profit Shifting (BEPS) project in 2013 in response to growing concerns over aggressive tax planning by multinational enterprises. Final reports on the 15 BEPS Action Plans were published in October 2015, with implementation proceeding heterogeneously across jurisdictions; minimum standards (Actions 5, 6, 13, and 14) were adopted more uniformly through the OECD/G20 Inclusive Framework, while other actions remained optional. Building on this initial phase, the OECD/G20 Inclusive Framework reached

agreement on BEPS 2.0 in October 2021. This second wave is structured around two pillars: Pillar 1 reallocates a portion of taxing rights for the largest multinationals to market jurisdictions, while Pillar 2 establishes a 15% global minimum effective tax rate. Phased implementation of Pillar 2 began in major jurisdictions (European Union, United Kingdom, Japan, Korea, Canada) in January 2024, with broader adoption ongoing through 2025 and 2026.

3.2 Research Model and Hypotheses

To investigate whether the relationship between corporate tax rates and FDI differs between low-tax jurisdictions and regular taxation countries, this study specifies the following Difference-in-Differences panel regression model:

$$FDI_{\{c,t\}} = \alpha + \beta_1 CIT_{\{c,t\}} + \beta_2 Treat_c + \beta_3 \left(CIT_{\{c,t\}} \times Treat_c\right) + \beta_4 SIZE_{\{c,t\}} + \beta_5 RISK_{\{c,t\}} + \beta_6 Corruption_{\{c,t\}} + \sum_j \delta_j WGI_{\{c,t\}} + \mu_c + \gamma_t + \varepsilon_{\{c,t\}}$$

where *c* indexes countries, *t* indexes time periods, and the variables are defined as follows:

$FDI_{\{c,t\}}$ represents the natural logarithm of Foreign Direct Investment inflows to country *c* in year *t*, measured in millions of constant 2010 USD estimates. Collected from the United Nations Conference on Trade and Development (UNCTAD), consists of equity capital, reinvested earnings, and intra-company loans between associated enterprises. The log transformation is used to deal with the extreme right skewness of the distribution of FDI flows, minimize the impact of outliers, and make the coefficients' estimates interpretable.

$CIT_{\{c,t\}}$ denotes the statutory corporate income tax rate in country *c* at time *t*, expressed as a decimal (e.g., 0.25 for 25%). This variable captures the headline tax rate applied to corporate profits before accounting for deductions, exemptions, or tax planning opportunities. The Corporate Income Tax Rate (CIT) is the legal corporate tax rate. This is a variable that reflects the headline rate imposed on corporate profits in terms of the national tax law, prior to taking into consideration deductions, credits, exemptions, or tax planning opportunities. Even though effective tax rates may give more sophisticated indicators of the actual tax burden, statutory rates are the first ones to give a signal to the potential investors and the foundation of cross-country competition in taxes (Djankov et al., 2008).

$Treat_c$ is a time-invariant binary indicator equal to 1 if country c is classified as a low-tax jurisdiction (statutory corporate income tax rate ≤15% throughout the observation period) and 0 otherwise. This dummy variable identifies the treatment group in the DiD framework.

$CIT_{\{c,t\}} \times Treat_c$ represents the interaction term between the tax rate and the treatment dummy. This is the key variable of interest in the DiD framework, as its coefficient (β_3) captures the differential effect of tax rates on FDI for low-tax jurisdictions relative to regular taxation countries.

$SIZE_{\{c,t\}}$ measures country size through the natural logarithm of gross domestic product in constant 2010 US dollars, controlling for market potential and agglomeration effects. As expected, larger economies tend to receive more FDI because they have more access to the market, infrastructure, and diversification.

$RISK_{\{c,t\}}$ quantifies country-specific investment risk through the country risk premium, representing the additional return investors require to compensate for political, economic, and financial uncertainties. The Country Risk Premium (RISK) measurement includes political instability, economic instability and financial instability. The larger the risk premiums, the higher the perceived uncertainty and it should have a negative impact on the attraction of FDI (5 is negative).

$Corruption_{\{c,t\}}$ represents the corruption control index from World Bank WGI percentile rank, 0–100; Among the six WGIs, corruption control shows the highest correlation with the country risk premium (r = -0.617) and the logarithmic FDI (r = 0.370), being the indicator that best synthesizes institutional quality. Therefore, it receives separate treatment in the specification. The other WGIs are included as additional controls to isolate institutional variation not captured by corruption.

$WGI_{\{c,t\}}$ encompasses six World Governance Indicators measuring institutional quality: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption. These indicators are standardized and range from 0 to 100, with higher values indicating stronger governance. (Kaufmann et al., 2009).. These indicators are recalculated as a range of -2.5 to +2.5 in the original data to a range of 0 to 100 to be easy to understand, and the higher the indicator is, the better the governance is. The expected positive impact on FDI is expected to be on all the governance indicators (δ 0).

μ_c represents country fixed effects controlling for time-invariant country characteristics such as geographic location, natural resource endowments, historical institutions, and cultural factors that may influence both tax policy choices and FDI attraction.

γ_t captures year-fixed effects accounting for global temporal shocks affecting all countries uniformly, such as the aftermath of the 2008 financial crisis, the COVID-19 pandemic, or shifts in global capital markets.

$\varepsilon_{\{c,t\}}$ is the idiosyncratic error term capturing random variation not explained by the model.

Below is a table with the presentation of data sources used in the regression:

Table 3.1: Variable Definitions and Sources

Variable	Definition	Source	Period
ln(FDI)	Natural log of FDI inflows, current USD millions, deflated by CPI to constant 2010 USD	UNCTAD World Investment Report (UNCTADstat)	2010–2024
CIT	Statutory corporate income tax rate (decimal form), top marginal rate	KPMG Corporate Tax Rates Table; Tax Foundation	2010–2024
TREAT	Dummy = 1 if statutory rate ≤ 15%, 0 otherwise	Authors' construction	—
SIZE	Natural log of GDP, constant 2010 USD	World Bank, World Development Indicators (NY.GDP.MKTP.KD)	2010–2024
RISK	Country risk premium (decimal)	Damodaran, "Country Default Spreads and Risk Premiums" (damodaran.com)	2010–2024
CORR	Control of corruption, percentile rank (0–100)	World Bank, Worldwide Governance Indicators (Kaufmann, Kraay & Mastruzzi, 2009)	2010–2024
WGI^-	Government effectiveness, political stability, regulatory quality, rule of law, voice & accountability — percentile ranks (0–100)	World Bank, Worldwide Governance Indicators (Kaufmann, Kraay & Mastruzzi, 2009)	2010–2024
CPI deflator	Consumer Price Index (2010 = 100)	World Bank, World Development Indicators (FP.CPI.TOTL)	2010–2024

Notes: All monetary variables are deflated to constant 2010 US dollars using the World Bank CPI deflator (FP.CPI.TOTL). The 15% threshold of TREAT corresponds to the OECD/G20 Pillar 2 Global Anti-Base Erosion (GloBE) minimum effective tax rate (October 2021 Statement). Governance indicators (CORR and WGI^-) are reported as percentile ranks on a 0–100 scale.

Therefore, three formal hypotheses are derived from the theoretical framework. Each specifies the expected sign of the corresponding model coefficient.

Hypothesis 1 (H1): *Higher statutory corporate tax rates negatively affect FDI inflows in regular taxation countries.*

This hypothesis reflects the core prediction of tax competition theory that increased taxation reduces after-tax returns and discourages capital inflows (Zodrow & Mieszkowski, 1986; Djankov et al., 2008).

Hypothesis 2 (H2): *The negative effect of tax rates on FDI is more pronounced in low-tax jurisdictions, reflecting greater investor sensitivity to marginal tax variations in regimes already designed around fiscal competition.*

This hypothesis posits that countries competing primarily on tax advantages exhibit greater tax sensitivity, as their competitive positioning depends more heavily on maintaining favorable tax treatment. Low-tax jurisdictions may face stronger competitive pressure because tax rates represent their primary value proposition to investors, whereas regular taxation countries may offer compensating advantages such as larger markets, superior infrastructure, or stronger institutions.

Hypothesis 3 (H3): *Institutional quality is a positive determinant of FDI inflows: better corruption control and broader governance strengths attract more FDI, while higher country risk deters it.*

Specifically, stronger governance quality should positively influence FDI, while higher country risk should negatively affect investment. These effects may mediate or even dominate the tax effects, suggesting that successful FDI attraction requires more than favorable tax rates alone. This hypothesis draws on the complementarity thesis of Dharmapala and Hines (2009), which argues that effective tax competition requires strong institutions alongside low rates.

3.3 Sample and Data Sources

The sample includes 151 countries observed over the period 2010-2024, yielding a total of 1,661 country-year observations. Based on the statutory corporate income tax rates of countries during the period of observation, countries are categorized into treatment and control groups. The treatment sample, comprising 43 low-tax jurisdictions with statutory rates of 15 percent or less,

yielded 473 observations in total. A total of 108 countries with standard taxation systems (statutory rates of over 15 percent) will form the control group, yielding 1,188 observations.

The treatment group criteria is based on the following. First, it is equal to the lowest tax rate suggested under Pillar 2 of the OECD, and the results can be applied directly to the contemporary policy discussions. Second, it is a significant deviation from the international standards; the average statutory corporate tax rate in the world during the period of observation is about 23-24 percent. Third, the threshold has been used to ensure that both groups have enough sample size to make significant statistical inferences without a meaningless policy difference between treatment and control regimes. The data is gathered from various authoritative international sources. The FDI inflows are collected from the United Nations Conference on Trade and Development (UNCTAD) World Investment Report database. The database of Professor Aswath Damodaran contains statutory corporate income tax rates for countries, compiled from official country rates and international bodies. The country risk premiums are also received by the database of Professor Aswath Damodaran. The World Bank database of the World Development Indicators provides the country size (GDP) data in millions of constant 2010 US dollars. The six World Governance Indicators (WGI) — corruption control, government effectiveness, political stability, rule of law, regulatory quality, and voice & accountability — are taken from the Worldwide Governance Indicators project of the World Bank (Kaufmann, Kraay, & Mastruzzi, 2009), with each indicator measured on a 0–100 percentile-rank scale where higher values denote better governance.

3.4 Descriptive Analysis

The descriptive statistics are first computed separately for the treatment group (low-tax jurisdictions with a statutory rate not exceeding 15 percent) and the control group (regular-tax countries with a statutory rate above 15 percent), providing background information on the key characteristics of the two regime types. Second, two-sample t-tests with unequal variances are used to assess whether the observed differences between the groups are statistically significant, offering preliminary evidence of systematic variation in the main variables.

3.4.1. Descriptive Statistics

The sample comprises 615 observations across 41 countries that are considered low-tax jurisdictions based on average statutory corporate income tax rates of 15 percent or less in the year of observation (2010-2024). Table 3.2 below shows the detailed descriptive statistics of the treatment group. About the FDI inflow, these jurisdictions have a mean of 1.747 (log scale), equivalent to approximately USD 5.7 billion in current scale (= e^1.747 × 100, where the multiplication factor reflects the FDI deflator construction), with a high dispersion of standard deviation of 2.083. This large variance is due to the heterogeneous nature of the treatment group, which includes both large financial centers that have an extremely high inflow of investments and smaller jurisdictions that have a significantly smaller inflow of FDI receipts. There is a pronounced right skew of the distribution, similar to the minimum of -4.60 and a maximum of 7.59, which implies that the few very successful tax havens are overrepresenting the aggregate investment flows in this category.

The mean statutory corporate tax rate in this group is 8.98 percent, indicating that these jurisdictions offer considerably more favourable tax regimes than those on a global scale. The size of the country, which is proxied by log GDP, has a mean of 5.551 and moderate dispersion (SD = 1.792), meaning that low-tax jurisdictions cover more than just economies of small islands, but also larger competitive regions. The country risk premium of 5.10 percent on average is quite moderate, and it is a sign that successful low-tax jurisdictions are likely to merge fiscal benefits with moderate levels of political and economic stability, which is consistent with the complementarity thesis of Dharmapala and Hines (2009), who argue that institutional quality and favorable tax treatment go hand in hand. In terms of governance indicators, the treatment group is a mixed one. The corruption control is averaged at 48.55 (the scale is 0-100), whereas the government effectiveness is at 47.93, indicating that the institutional quality is moderate in general. The political stability has the highest mean of 51.70, which is very high compared to other governance dimensions, meaning that there are numerous low-tax jurisdictions that have managed to keep their political situations stable. The best average of regulatory quality is of 52.62 and the worst of 43.55 is the voice and accountability, which can imply that in these jurisdictions, democratic participation may be not as underlined as other institutional dimensions.

Table 3.2: Descriptive Statistics for the Treatment Group: Low-Tax Jurisdictions (Statutory CIT Rate ≤ 15%), 2010–2024

Treatment group consists of 41 jurisdictions with statutory corporate income tax (CIT) rate ≤ 15% during the observation window 2010–2024. FDI inflows expressed in natural logarithm of constant 2010 USD millions; tax rate in decimal form; size in natural log of GDP (constant 2010 USD); risk premium in decimal form; governance indicators on the 0–100 percentile-rank scale, with higher values indicating better governance. Source: own calculations from UNCTAD, World Bank (WDI, WGI), and Damodaran datasets.

Variable	Obs	Mean	Std. Dev.
FDI (log)	562	1.747	2.083
Tax Rate	526	0.0898	0.0898
Size (log GDP)	580	5.551	1.792
Risk Premium	414	0.0510	0.0389
Corruption Control	546	48.55	25.88
Government Effectiveness	546	47.93	25.81
Political Stability	546	51.70	27.85
Rule of Law	546	47.02	24.65
Regulatory Quality	546	52.62	24.46
Voice & Accountability	526	43.55	24.38

3.4.2 Control Group (Regular Taxation Countries)

The control group comprises 2,265 entries of 151 countries where the statutory corporate income tax rate is above 15 percent and these are conventional taxation regimes. Table 3.3 shows the statistics. These countries with regular taxation also have significantly higher average FDI inflows of 2.431 (log scale) than the treatment group of 1.747 (similar dispersion SD = 2.446). This initial observation is contrary to the simple theory that lower tax rates will automatically lead to increased investment attraction because the lower the statutory rate in a country, the more FDI on average is being received, and this makes them worth further investigation using a multivariate analysis (Wilson, 1999; Zodrow and Mieszkowski, 1986). The average statutory tax rate of the control group is 24.11 percent, which is far higher than the average in the treatment group of 8.98 percent and is almost equal to the world average of the same at the time of observation.

This group a country size that is significantly larger; the mean log GDP of 6.971, as opposed to 5.551 in the treatment group, which is over a tenfold difference in absolute economic

scale. This marked size difference is a significant confounding factor, which needs to be highly regulated during the multivariate analysis since larger economies normally have a market size advantage as an attracting factor to FDI that does not bear in any way on the tax policy consideration (Djankov et al., 2008). The average country risk premium of 4.81 percent is a small difference of the treatment group (5.10 percent), but the difference is not large and not significant as it was ultimately to be established under formal testing. The control group has interesting patterns of governance indicators. The average government effectiveness is 49.11 slightly higher than in the treatment group. Rule of law (48.04) and corruption control (47.60) display the same level as low-tax jurisdictions, whereas voice and accountability (48.94) is much higher in regular taxation countries, which indicates stronger democratic institutions on average. Interestingly, political stability (45.61) is lower in the control group than in the treatment countries (51.70), meaning that there are some low-tax jurisdictions that have managed to develop stable political environments as part of their competitive positioning. The quality of regulatory (48.31) is also lower than among the treatment group (52.62), which is consistent with the fact that some low-tax jurisdictions are competing with a regulatory efficiency in addition to the fiscal benefits (Hebous, 2010).

Table 3.3: Descriptive Statistics for the Control Group: Regular-Taxation Countries (Statutory CIT Rate > 15%), 2010–2024

Control group consists of 110 countries with statutory CIT rate above 15% during 2010–2024. Variable definitions and units identical to Table 3.1. Source: own calculations from UNCTAD, World Bank (WDI, WGI), and Damodaran datasets.

Variable	Obs	Mean	Std. Dev.
FDI (log)	2,041	2.431	2.446
Tax Rate	1,733	0.2411	0.0884
Size (log GDP)	2,086	6.971	2.207
Risk Premium	1,743	0.0481	0.0465
Corruption Control	2,008	47.60	29.98
Government Effectiveness	2,007	49.11	29.92
Political Stability	2,008	45.61	28.16
Rule of Law	2,007	48.04	29.83
Regulatory Quality	2,007	48.31	29.96
Voice & Accountability	2,011	48.94	29.12

3.5 Comparative Analysis Between Groups. Two-Sample t-Tests

The two-sample t-tests were conducted under the unequal-variance assumption to formally determine whether the differences between the treatment and control groups are statistically significant. The results of these comparative tests are shown in Table 3.4 for all the key variables. The most notable result concerns FDI inflows. In contrast to traditional tax competition accounts, the control group (standard taxation countries) displays much higher FDI than the treatment group. The difference in log FDI of 0.684 is statistically significant at the 1 percent level ($t = 6.63$, $p = 0.001$), which implies that the average level of foreign investment in countries with a higher tax rate is significantly higher. This paradoxical outcome is a reminder that it is crucial to control for confounding variables, especially country size, in subsequent multivariate analyses. The tax rates between groups are significantly different as per design, and the control group has 15.13 percentage points more on average ($t = 33.97$, $p < 0.001$), which proves effective stratification of samples.

The size of the country presents a dramatic difference, with control group GDP being higher than treatment group GDP by a log point of 1.42 ($t = 16.01$, $p = 0.001$), which is a difference greater than four fold in the scale of the economy. This difference in size stands out as a major confounding variable that can be the source of the paradox in FDI pattern in raw comparisons. Surprisingly, the country risk premiums do not differ significantly between groups (difference = -0.0029, $t = -1.32$, $p = 0.188$), indicating that low-tax status does not have a statistically significant effect on the investment risk when studied on the entire sample. There are several dimensions among the governance indicators that have a significant difference. Control countries have a much bigger voice and accountability (difference = 5.39, $t = 4.33$, $p < 0.001$) and treatment countries have a much bigger political stability (difference = -6.09, $t = -4.52$, $p < 0.001$). The quality of regulation is in favor of countries where the treatment is carried out (difference = -4.31, $t = -3.47$, $p < 0.001$), as was expected by the hypothesis that jurisdictions with low taxes can compete based on the efficiency of their regulation. It is interesting to note that corruption control, government effectiveness, and rule of law have no significant differences, implying that these institutional dimensions are diverse in the two groups and not systematic to distinguish between the tax regimes.

Table 3.4: Two-Sample t-Tests – Treatment vs. Control Groups

Variable	Treatment Mean	Control Mean	Difference	p-value
FDI (log)	1.747	2.431	-0.684***	<0.001
Tax Rate	0.0898	0.2411	-0.151***	<0.001
Size (log GDP)	5.551	6.971	-1.420***	<0.001
Risk Premium	0.0510	0.0481	0.003	0.188
Corruption Control	48.55	47.60	0.95	0.462
Gov. Effectiveness	47.93	49.11	-1.19	0.357
Political Stability	51.70	45.61	6.09***	<0.001
Rule of Law	47.02	48.04	-1.02	0.414
Regulatory Quality	52.62	48.31	4.31***	<0.001
Voice & Account.	43.55	48.94	-5.39***	<0.001

*Note: *** p<0.001, ** p<0.01, * p<0.05. Treatment group: tax rate ≤15% (n=615); Control group: tax rate >15% (n=2,265).*

CHAPTER 4: RESULTS AND ANALYSIS

The empirical research starts with a correlation analysis that examines pairwise relationships among all continuous variables and provides the first hint at the patterns of association and potential multicollinearity issues that may occur during regression estimation.

Then, the hypotheses postulated in Section 3 will be tested using the Difference-in-Differences (DiD) defined in equation (1), i.e., the hypothesis that the effect of tax rates on FDI is different in the countries with and without a low taxation regime, controlling for country and year fixed effects and with robust country-level standard errors (Wooldridge, 2010). Finally, robustness tests will examine alternative tax rate thresholds (10 and 20) and assess whether the fundamental results are consistent with alternative definitions of low-tax jurisdictions. This analytical approach is a full-fledged analytical procedure that allows the assessment of the three formal hypotheses, and consideration of possible confounding variables and specification sensitivities.

4.1 Correlation Analysis

The correlation analysis presented in this section is computed on the full sample — i.e., the treatment group (low-tax jurisdictions, statutory CIT rate ≤ 15%) and the control group (regular-taxation countries, > 15%) pooled together, **totaling** 1,659 country-year observations across 151 countries over 2010–2024. Table 4.1 below reports the pairwise Pearson correlation coefficients for all continuous variables, providing an initial indication of the direction, magnitude**,** and statistical significance of the bivariate associations.

Table 4.1 shows the pairwise correlation coefficients for all continuous variables in the entire sample, providing initial information on the direction and strength of the bivariate correlations. The linkage between tax rates and FDI takes a paradoxical trend. The steady-state relationship between tax rates and FDI is positive and statistically significant ($r = 0.247$, $p < 0.05$), which shows that nations with high statutory rates of corporate taxes are more likely to attract foreign direct investment. This counterintuitive result is evidence of the confounding effects of country size and institutional quality in that larger, more developed economies are also more likely to have the higher tax rate and higher levels of FDI inflows, which is why multivariate analysis that corrects for the confounding effects of country size and institutional quality is of critical importance in making conclusions that the cause of effect of taxation on investment (Wooldridge,

2010). Country size displays the strongest bivariate association with FDI of the entire matrix ($r = 0.827$, $p < 0.05$), confirming that larger economies attract proportionally larger investment flows — a pattern consistent with market-size and agglomeration arguments — and reinforcing the need to control for GDP in the multivariate analysis in order to isolate the independent effect of tax policy. Country size is also positively correlated with the statutory tax rate ($r = 0.365$, $p < 0.05$), suggesting that larger economies sustain higher tax rates, plausibly because market-access advantages compensate the fiscal disadvantage they would otherwise impose on investors. The country risk premium reveals that the relationship between its value and FDI is expected to be strong and negative ($r = -0.441$, $p < 0.05$), which is one of the strongest bivariate correlations in the analysis and indicates that the considerations of risk also play a significant role in the location of investment decisions. The correlation of negative relationships between risk and governance ($r = -0.551$ to $r = -0.748$) between the institutional and investment risk indicates that the two variables are closely interrelated constructs.

Table 4.1: Pearson Correlation Matrix among the Continuous Variables of the DiD Model — Full Sample

Pairwise Pearson correlation coefficients computed on the full sample of 151 countries over 2010–2024 (1,659 country-year observations). * indicates statistical significance at the 5% level. Variable definitions: FDI in natural log of constant 2010 USD millions; Tax Rate and Risk Premium in decimal form; Size in natural log of GDP (constant 2010 USD); governance indicators (Corruption Control, Government Effectiveness, Political Stability, Rule of Law, Regulatory Quality, Voice & Accountability) measured on a 0–100 percentile-rank scale, with higher values indicating better governance. Source: own calculations using Stata; data from UNCTAD World Investment Report (FDI), Damodaran (tax rates and country risk premium), World Bank WDI (GDP) and World Bank WGI (governance, Kaufmann, Kraay, & Mastruzzi, 2009).

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(1) FDI (log)	1.000									
(2) Tax Rate	0.247*	1.000								
(3) Size (log GDP)	0.827*	0.365*	1.000							
(4) Risk Premium	−0.441*	0.064	−0.340*	1.000						
(5) Corruption Control	0.284*	−0.013	0.098	−0.658*	1.000					
(6) Government Effectiveness	0.482*	0.018	0.309*	−0.742*	0.904*	1.000				

Pairwise Pearson correlation coefficients computed on the full sample of 151 countries over 2010–2024 (1,659 country-year observations). * indicates statistical significance at the 5% level. Variable definitions: FDI in natural log of constant 2010 USD millions; Tax Rate and Risk Premium in decimal form; Size in natural log of GDP (constant 2010 USD); governance indicators (Corruption Control, Government Effectiveness, Political Stability, Rule of Law, Regulatory Quality, Voice & Accountability) measured on a 0–100 percentile-rank scale, with higher values indicating better governance. Source: own calculations using Stata; data from UNCTAD World Investment Report (FDI), Damodaran (tax rates and country risk premium), World Bank WDI (GDP) and World Bank WGI (governance, Kaufmann, Kraay, & Mastruzzi, 2009).

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(7) Political Stability	0.030	−0.091*	−0.213*	−0.551*	0.789*	0.714*	1.000			
(8) Rule of Law	0.344*	0.007	0.144*	−0.703*	0.937*	0.926*	0.789*	1.000		
(9) Regulatory Quality	0.483*	−0.025	0.312*	−0.748*	0.859*	0.929*	0.660*	0.899*	1.000	
(10) Voice & Accountability	0.189*	0.115*	−0.004	−0.508*	0.786*	0.726*	0.729*	0.807*	0.737*	1.000

4.2 Panel Regression Results

Table 4.2 below presents the results of the fixed-effects panel regression analysis as estimated on the entire sample size of 1,559 observations in 151 countries. The model has country fixed effects to ensure that it controls the country characteristics which remain constant over time, year fixed effects to ensure global time shock, and robust standard errors clustering at the country level to ensure that there is within-country correlation of error effects across time periods. The model has obtained an R-squared (within) of 0.0637, implying that the time-varying covariates are able to explain the within-country variation in FDI of about 6 percent. The larger R-squared of 0.6149 between and the overall R-squared of 0.5370 indicate much more explanatory power over cross-sectional than over time change.

Table 4.2: Panel Regression Results – Main DiD Model

Variable	Coefficient	Std. Error
Tax Rate (β_1)	0.291	(0.475)
Treatment	0	(omitted)
Tax × Treatment (β_3)	-1.345	(1.309)
Size (log GDP)	0.277	(0.286)
Risk Premium	-4.079*	(1.894)
Corruption Control	0.0121***	(0.00588)
Governance Controls	Yes	

*Note: * p<0.05, ** p<0.01, *** p<0.001. Robust standard errors clustered by country in parentheses. Governance controls (government effectiveness, political stability, rule of law, regulatory quality, voice & accountability) are included in the specification but their individual coefficients are not reported due to severe multicollinearity (pairwise correlations of 0.68 to 0.94, see Table 4.1) N=1,659, Countries=151. Country and year fixed effects included. R^2 (within) = 0.0637. Total effect for treatment group ($\beta_1+\beta_3$) = -1.054 (SE=1.208, p=0.384).*

The coefficient of 0.291 (SE = 0.475, p = 0.541) is economically weak and statistically insignificant, leading to the rejection of Hypothesis 1. The 95% confidence interval [-0.647, 1.228] contains both economically meaningful negative and positive values, indicating substantial uncertainty about the direction of the effect. This insignificant result contradicts the basic prediction of the tax competition theory and suggests that, once country-specificities are controlled for and global time trends are taken into account, differences in statutory tax rates do not systematically influence investment location decisions (de Mooij and Ederveen, 2003). The treatment status (tax treatment) and tax rate interaction (tax treatment) have a coefficient of = -1.345 (SE = 1.309, p = 0.306), which is also not statistically significant. This finding on the interaction term shows no signs of attenuation in sensitivity to taxes across low-tax jurisdictions and regular taxation nations, which directly contradict Hypothesis 2. The sum of the effect of tax rates of low-tax jurisdictions is equal to -1.054 (SE =1.208, p =0.384), which is also not statistically significant. The country risk premium is the largest and strongest predictor of FDI; the coefficient value of -4.079 (SE = 1.894, p = 0.033) indicates that an increase in the risk premium by 1 percentage point is associated with a decrease in the log of FDI by 4.08 points, other factors remaining constant. This significant adverse impact shows that investors are risk-averse and seek high-risk destinations, avoiding them as a priority of the risk management and institutional stability concerns, which are central in the investment attraction policies (Rossi and Volpin, 2004). Of the

governance indicators, only control on corruption is statistically significant. The correlation coefficient of 0.0121 (SE = 0.0059, p = 0.042) is that one unit higher in the corruption control index (0-100 scale) is linked with a 0.0121-point rise in the log FDI. Though the magnitude of this economic coefficient is modest, the extent of change in corruption scores among countries is great, which suggests that the impact may have an economic implication. A shift in a country's corruption control from the 25th to the 75th percentile (about 50 points) would raise log FDI by about 0.6, a significant jump in attracting investment. The five additional World Governance Indicators (voice and accountability, political stability, government effectiveness, regulatory quality, and rule of law) are included as controls in the multivariate specification, but their individual coefficients are not reported in Table 4.2. The reason is methodological: as documented in Table 4.1, these indicators exhibit pairwise correlations between 0.68 and 0.94, generating severe multicollinearity that inflates standard errors and complicates the individual interpretation of each coefficient. Corruption Control is reported individually because it is the indicator most strongly correlated with both FDI inflows and country risk premium, serving as a parsimonious summary of institutional quality. Their joint contribution is captured in the model fit, but individual sensitivities cannot be reliably disentangled given the data structure. This tendency is probably the manifestation of the idea of multicollinearity of these variables, which are very interrelated as the governance, with corruption control being a summary variable that shows the common variation on institutional quality dimensions.

4.3 Hypothesis Testing and Interpretation

The main inquiry of this study is as follows: Does the rate of statutory corporate income tax in a country play a big role in determining the amount of FDI in the country? As presented in Table 4.2, the evidence does not support H1 or H2.

The Difference-in-Differences (DiD) panel regression model (with country and year fixed effects) evidence shows an obvious negative response. Hypothesis 1, which was a negative influence of the increase in tax rates on FDI in the regular taxation countries (1 0), is decisively rejected. The tax rate variable coefficient is positive but economically irrelevant and statistically insignificant (0.291, SE = 0.475, p = 0.541), with a very broad confidence interval (-0.647 to 1.228), which includes zero, and excludes the effects of the tax rate that are considered meaningful. This is the direct opposite of the fundamental premises of neoclassical theory of tax competition

in which it is assumed that the higher the tax, the lower the after-tax returns on capital, hence it discourages inflows and encourages a race to the bottom in interjurisdictional rates (Wilson, 1999).

Equally, Hypothesis 2, which postulates a stronger negative tax effect in the low-tax regimes (3 0), lacks empirical support. The coefficient of the interaction between the treatment dummy (representing low-tax status) and the tax rate is -1.345 (SE = 1.309, p = 0.306) and this is not significant. This insignificance is further proved by the joint test of the total tax effect in low-tax jurisdictions (1 + 3 = -1.054, SE = 1.208, p = 0.384). These findings indicate that the sensitivity of FDI to tax differentials is not systematically different between the types of regimes and the idea that the low-tax jurisdictions, due to their fiscal positioning, are exposed to heightened competitive pressures is refuted. Theoretically, the given dissociation may be attributed to the eclectic paradigm (Dunning, 1988) according to which FDI location decisions can be discussed as a complex trade-off. Locational benefits are influenced by taxation but are in many cases not primary (when compared to ownership benefits, e.g., firm-specific technologies) or internalization benefits (e.g., control of operations). Tax rates can be a filter, as opposed to a determining factor, when non- tax elements such as market nearness, availability of skilled labor, and institutional stability prevail.

Tax rates can be a filter, as opposed to a determining factor, when non-tax elements such as market nearness, availability of skilled labor and institutional stability prevail. This kind of paradox corresponds with the theories of agglomeration economies, where bigger markets create self-reinforcing agglomerations of economic activity, which are able to attract FDI regardless of the tax burden (Krugman, 1991). In fact, the control group nations are significantly bigger, with a mean log GDP of 6.971 compared to 5.551 in the treatment group (difference = -1.420, $p < 0.001$), which is more than a fourfold difference in the level of the economy. This size benefit will probably offset any increased average tax rates (24.11%), and these countries will be able to attract the investment to them due to their wider competitive advantages.

The descriptive statistics give more background information to these finding showing counterintuitive patterns that highlight the confounding effect of other variables. Although low-tax jurisdictions have attractive mean tax rate (8.98), they have lower average FDI inflows (1.747 on the log scale, SD = 2.083) than the regular taxation countries (2.431, SD = 2.446). This difference is statistically significant ($t = 6.63$, $p < 0.001$) as it has been verified using two-sample t-tests with unequal variances. This kind of paradox corresponds with the theories of

agglomeration economies where bigger markets create self-reinforcing agglomerations of economic activity, which are able to attract FDI regardless of the tax burden (Krugman, 1991). In fact, the control group nations are significantly bigger, with a mean log GDP of 6.971 compared to 5.551 in the treatment group (difference = -1.420, $p < 0.001$), which is more than a fourfold difference in the level of the economy. This size benefit will probably offset any increased average tax rates (24.11%), and these countries will be able to attract the investment to them due to their wider competitive advantages.

The hypothesis 3, which deals with the conditioning role of country characteristics, has rather weak support but strong. The country risk premium has turned out to be the most predictive control variable as it has a coefficient of -4.079 (SE = 1.894, $p = 0.033$). This means that an increase in the risk premium by one percentage point (all other factors remaining the same) is associated with the decrease in the log FDI by four percentage points. The economic size is enormous: to a nation with average inflows of FDI, this may be a 98 percent reduction in real terms, which underlines the very strong risk aversion of investors. This result is echoed by the portfolio theory extensions of FDI, where uncertainty increases the required returns and capital flows to safer havens (Rossi & Volpin, 2004).

In addition to this, corruption control is also a prominent positive factor (coefficient = 0.0121, SE = 0.0059, $p = 0.042$). A one-unit improvement would be associated with a 1.21 percent improvement in FDI inflows, which is not very significant, but it would take a significant improvement in score (say 50 points) to cause transformative effects- e.g a 50 point improvement would be enough to raise log FDI by 0.605, or an 83 percent change in absolute inflows. This is in line with the complementarity thesis of Dharmapala and Hines (2009) who hold that effective low-tax policies must have strong institutions to enforce them and to make them credible. In the treatment group, the mean score of governance issues is moderate (e.g., corruption control = 48.55) that implies the inefficiency of fiscal incentives with the institutions. Other World Governance Indicators (WGIs) (political stability, t-mean difference = 6.09, $p < 0.001$) and regulatory quality (t-mean difference = 4.31, $p < 0.001$) are also significant between groups in t-tests but not regressions probably because the two are multicollinear. Corruption control can serve as a proxy of the general institutional quality, whereby latent features such as transparency and accountability that enable business activities can be taken into consideration.

These views are supported by the correlation analysis that indicates positive bivariate correlation between tax rates and FDI ($r = 0.247$, $p < 0.05$) though reverses to insignificance when controlled. There are strong positive relationships with country size ($r = 0.827$ with FDI-size, $r = 0.365$ with tax-size) which implies that larger economies maintain higher taxes, as well as attract more investment, which is in line with market-potential theories. The institutional primacy is further highlighted by negative relations between risk and FDI ($r = -0.441$) and the relations among governance variables ($r = -0.551$ to -0.748) (institutional primary). Theoretically, these findings build on the tax competition theories by including institutional moderators, which can imply that the race to the bottom is alleviated in the situation of high capital mobility when non-tax factors are at the forefront (Hebous, 2010).

The findings indicate that institutional quality — proxied here by Corruption Control — and country risk premium emerge as the only statistically significant determinants of FDI inflows in the multivariate specification (Table 4.2). The remaining governance dimensions, while individually difficult to interpret due to multicollinearity (Section 4.1), contribute to the overall fit of the model and reinforce the interpretation that broad institutional quality, rather than tax policy, drives cross-country variation in FDI flows.

4.4 Robustness Checks

In order to determine the stability of the key results, the robustness checks were carried out based on the treatment threshold of 10 percent and 20 percent. The coefficient of tax rate at the 10 percent threshold is 0.038 (SE = 0.465, $p = 0.935$) with an interaction coefficient of -1.816 (SE = 1.702, $p = 0.288$) which is insignificant. Combined with the effect of the treatment group gives -1.778 (SE = 1.652, $p = 0.283$), which proves that there is no tax sensitivity. The 20 percent mark gives a tax rate coefficient of -0.438 (SE = 0.534, $p = 0.414$) and an interaction term of 0.740 (SE = 0.853, $p = 0.387$), which is not statistically significant once again. The total effect equals 0.302 (SE = 0.663, $p = 0.649$). In all the specifications, country risk premium is the most prominent and always significant determinant of FDI (coefficients of -4.08 to -4.28, all $p < 0.05$), and corruption control is of marginal importance. These strength tests confirm that the null tax finding is not due to the 15 percent threshold decision but reflects a strong empirical trend among a variety of definitions of low-tax jurisdiction (Feld & Heckemeyer, 2011).

Table 4.3: Robustness Checks: DiD Panel Regression Estimates under Alternative Treatment Thresholds

Variable	(1) Threshold = 10%	(2) Threshold = 15% (Baseline)	(3) Threshold = 20%
Tax Rate (β_1)	0.038 (0.465)	0.291 (0.475)	−0.438 (0.534)
Tax × Treatment (β_3)	−1.816 (1.702)	−1.345 (1.309)	0.740 (0.853)
Total effect for treatment group ($\beta_1 + \beta_3$)	**−1.778 (1.652)**	**−1.054 (1.208)**	**0.302 (0.663)**
p-value ($\beta_1 + \beta_3$)	*0.283*	*0.384*	*0.649*
Risk Premium	−4.28* (1.94)	−4.079* (1.894)	−4.08* (1.91)
Corruption Control	0.0118† (0.0061)	0.0121* (0.00588)	0.0119† (0.0060)
Size (log GDP)	0.291 (0.288)	0.277 (0.286)	0.265 (0.291)
Governance Controls	Yes	Yes	Yes
Country FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	1,659	1,659	1,659
Countries	151	151	151
R^2 (within)	0.063	0.064	0.063

*Notes: Dependent variable: natural log of FDI inflows (constant 2010 USD millions). Estimator: country fixed-effects panel regression with year fixed effects and standard errors clustered at the country level. Robust standard errors in parentheses. Treatment dummy redefined in each column according to the indicated statutory CIT-rate threshold. The five governance indicators not reported individually are jointly included as controls (multicollinearity argument, see Section 4.2). † $p < 0.10$; * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$.*

4.5 Comparison with Former Literature

This non-significant relationship between tax and FDI contrasts with a sizeable amount of empirical literature and attempts to reconcile the methodological, contextual, and conceptual differences across the studies. The negative relationships have always been captured in influential works. As an example, Djankov et al. (2008) examined 85 countries and concluded that an increase in tax rate of 10% decreases the level of investment to GDP by 2 percentage points, which is high in terms of semi-elasticities. Sato (2012) applied it to OECD bilateral flows and discovered significant negative effects despite governing control.

More recently, Laurent (2025) found semi-elasticities of -4.8 in European data, indicating increased sensitivity in the presence of increasing capital mobility, whereas Bellak and Liebrecht (2025) estimated the importance of statutory rates as early indicators of investors in EU settings between 2017-2023 using gravity models.

The lack of significant results of this dissertation align with recent critiques and meta-analyses that emphasize heterogeneity. In a meta-study of 46 papers by Feld and Heckemeyer (2011), the average semi-elasticities were around -2.55, but there was high variation by sample composition, type of data, and controls - which are less helped in the panel design with fixed effects which is used here. De Mooij and Ederveen (2003) summed up 25 research papers, and the average elasticities were -3.3, although they found that on endogeneity and institutions, attenuation occurs. The negative effect of cross-sectional estimates is that the DiD model has country fixed effects that capture time-omnipresent confounders (such as geography, culture) and annually varying effects that capture global shocks (such as post-2008 recovery, COVID-19), which likely reduces biases in cross-sectional estimates.

Another lens is given by non-linearities and thresholds. According to Shen and Dai (2024), significant amplified tax effects were found to exist at a rate above 25 percent, with declining effects at lower levels. In this sample, with global averages around 23-24, the linear models have the disadvantage of underestimation at either extreme, but the robustness checks (e.g. 10 percent and 20 percent) also produce similar nulls: with coefficient of tax = 0.038 (p=0.935), interaction = -1.816 (p=0.288); coefficient of tax = -0.438 (p=0.414) and 0.740 (p=0.387). This implies low overall sensitivity, possibly because the post-BEPS period (2013-2024) the OECD (2015) overhauls cut profit shifting, and statutory rates have lost their arbitrage value (Clausing, 2018; Prettl, 2016).

Other reconciliation is found in sectoral and compositional effects. Hebous (2010) and Pulina (2021) distinguish between "phantom" FDI (e.g., holding companies in tax havens) and the real FDI (productive assets), and taxes have a mostly negative impact on the former. Here, aggregate UNCTAD data incorporates the two, and may cover up tax effects, where low-tax jurisdictions may focus on phantom flows without raising totals. Merz et al., (2017) observed the financial FDI was much tax-elastic and Djankov et al., (2008) maintained that the impacts were greater in manufacturing that is capital-intensive. Disaggregation might be used to see latent patterns; e.g., Azémar and Desbordes (2013), found external finance-related sectors to be tax-sensitive.

This study is reflected in the literature's focus on institutional interactions. In Asian settings, Nicolae-Bogdan Ianc (2025) and Lesmana (2023) found the FDI effect of effective taxation mediated by government, similar to the role of corruption control in this case. The post-

TCJA analysis by Dharmapala (2021) emphasized the complementarities between institutions, whereas Bénassy-Quéré et al. (2005) and Buettner and Wamser (2008) emphasized the size and risk controls. The positive relationship between tax and FDI (r=0.247) is sorted out in the multivariate analysis, which reflects the rerouting information of Erokhin (2023).The regional differences are important: European-oriented research (Bellak and Liebrecht, 2025) has higher effects, as they are integrated, whereas global samples such as this one are thinned out with heterogeneities in the developing countries. The temporal context matters; BEPS remains overstated in the period before its existence (e.g., Hines, 2010), since incentives were changed (Beer et al., 2020).

In general, the results are similar to those of institution-oriented studies, even though they do not follow tax-centric empirics, suggesting that the conditional effects may not be critical in contemporary, post-reform environments.

4.6 Policy Implications

The empirical evidence has far-reaching policy implications related to national and international taxation policy, especially at a time when there has been heightened global tax coordination and developmental problems in several economies. The study directly calls the quality of low-tax jurisdictions and the prevalent view of taxation countries that by lowering headline tax rates, they have an effective, inexpensive way to attract foreign investment invalid because the statutory corporate income tax rates have no substantial independent effect on FDI inflows. The discovery is particularly relevant to small open economies, island states, and developing countries that have long established themselves as low-tax havens to minimize structural weaknesses, including small domestic markets, geographic isolation, insufficient infrastructure, or small workforces (Dharmapala, 2008; Hebous, 2010). Descriptive data indicating that, even after size differences are controlled, low-tax jurisdictions tend to receive less FDI inflows on average than higher-tax normal countries is a pointer that tax incentives are not sufficient to neutralize other location disadvantages. The policymakers in such jurisdictions must be cautious with the design or maintenance of aggressive package of tax-reduction because the marginal returns on further reduction of rates seem to be constrained when the basic institutional thresholds are reached.

Rather, country risk premiums (-4.079, p=0.033) are found to have a significant negative effect, and corruption control (0.0121, p=0.042) makes a positive contribution, which points to more promising policy levers. Far larger FDI reactions than tax reliefs can be created by cutting the perceived risk of investment by providing plausible enhancements of political stability, macroeconomic predictability, contract execution, and financial-sector resiliency. An example is a continued push to reduce the risk premium by say several percentage points, which would mean significant positive changes in log FDI with higher developmental returns in the guise of increased job creation, technology transfer, and supply-chain integration. On the same note, specific anti-corruption reforms that increase the score on the corresponding World Governance Indicator may have economically valuable returns, as the coefficient is large, and the gap between governance quality in different countries is huge. These priorities are consistent with the proposals made by UNCTAD (2022) and the literature on sustainable development overall, which point to the fact that the enabling environment of productive and long-term foreign investment should be established by credible institutions and not by rapid profit-shifting flows.

A particularly timely policy environment is the ongoing implementation of the OECD Pillar 2 that presupposes setting a global minimum effective tax rate of 15 percent on the large multinationals (OECD, 2021). It was also warned by critics that the minimum tax would have a disproportionate impact on the low-tax developing economies due to the erosion of their main competitive instrument to attract FDI to its detriment, potentially increasing global inequalities and limiting the opportunities to grow in a resource-poor environment (Beer et al., 2020; Jiménez et al., 2025; OECD, 2023).

Nevertheless, the current results moderate these anxieties, in case statutory (and hence effective) rate differentials are very weak determinants of aggregate FDI location choices after the institutional factors have been held constant, then Pillar 2 will not cause large scale capital flight by jurisdictions that are currently below 15. The reform can instead have the overriding benefit of minimizing damaging base erosion and profit shifting without causing significant collateral damage to actual investment flows. This reinforces the arguments suggested by Eckhard Janeba and Schjelderup (2023) that the revenue benefits of Pillar 2 may exceed any small impacts of relocation, particularly with capacity-building support to allow low-income countries to enhance governance and other locational benefits.

The implications of the results in countries that practice regular taxation (generally larger, more diversified economies) are that medium statutory rates can be maintained with no or minor FDI penalties, assuming that the institutional quality is competitive. Instead of defensive tax cuts, these countries can concentrate on enhancing some complementary policies to include efficiency on regulatory measures, development of skilled workforce, and investment in infrastructure. The difference between well-managed low-tax regimes that are transparent and the so-called havens is even more pertinent to harmonization debates in the European context (Hebous, 2010). In general, the evidence supports the adoption of a new approach moving towards multilateral cooperation rather than unilateral tax competition to contain race-to-the-bottom effects and leave room to institutional competition. Tax design policies by policy makers ought to be combined with wider policy competitiveness, and the focus in governance overhaul should be directed towards providing sustainable FDI gains rather than depending on fiscal incentives.

The empirical results have three direct policy implications. First, the rejection of Hypothesis 1 calls into question development strategies that rely heavily on low statutory corporate tax rates as the primary instrument to attract FDI. Once country fixed effects, country risk, and institutional quality are accounted for, statutory rates do not exert a measurable independent effect on FDI inflows. Countries should not assume that lowering corporate tax rates will, by itself, increase capital inflows. Second, the strong negative effect of the country risk premium and the positive effect of corruption control identify the dominant determinants of cross-country FDI: investors prioritize macroeconomic and institutional stability over fiscal advantages. This suggests that policy efforts targeting institutional quality, regulatory predictability, and reduced macroeconomic risk are likely to yield higher returns in terms of FDI attraction than further reductions in statutory tax rates. Third, in the context of OECD Pillar 2 implementation (January 2024 onward), the 15% global minimum effective tax rate effectively neutralizes the use of low statutory rates as a competitive instrument. The empirical findings suggest that the actual cost of Pillar 2 to low-tax jurisdictions may be smaller than commonly anticipated, because the marginal effect of tax rates on FDI was already statistically insignificant under the pre-Pillar 2 regime. Jurisdictions that historically combined low rates with strong institutional quality (e.g., Ireland, Singapore) are likely to retain their attractiveness, while those that relied primarily on rate

competition without complementary institutional foundations face the greatest adjustment challenge.

CHAPTER 5: CONCLUSION

5.1 Summary of Key Findings

This dissertation examined the relationship between statutory corporate income tax rates and FDI inflows in 151 countries between 2010 and 2024, using a Difference-in-Differences panel specification with country and year fixed effects.

The fundamental conclusion is clear cut: Both Hypothesis 1 (negative effect in regular-taxation countries) and Hypothesis 2 (stronger negative effect in low-tax jurisdictions) are rejected. These null results are robust to alternative threshold definitions (10% and 20%) reported in Table 4.3 and contradict the core prediction of neoclassical tax-competition theory (Zodrow & Mieszkowski, 1986; Wilson, 1999), under which mobile capital should be highly sensitive to after-tax return differentials.

The descriptive evidence reinforces this null finding by way of an apparent paradox: low-tax jurisdictions show, on average, **lower** FDI inflows than regular-taxation countries (Table 3.3), a counterintuitive pattern explained by their substantially smaller economic size and by the predominance of agglomeration effects (Krugman, 1991).

Hypothesis 3 — the conditioning role of country characteristics — receives the strongest support. **Country risk premium** emerges as the most economically significant determinant of FDI: a one-percentage-point increase in the risk premium is associated with a fall in log FDI of around four points, holding all else constant. **Corruption Control** is the only governance indicator that reaches conventional statistical significance in the multivariate specification, with a 50-point improvement on the WGI percentile-rank scale corresponding to roughly a 0.6 increase in log FDI — an economically meaningful magnitude that supports the complementarity thesis of Dharmapala and Hines (2009): low-tax policies are effective for FDI attraction only when accompanied by credible institutional frameworks.

The remaining five Worldwide Governance Indicators are jointly included as controls but their individual coefficients are not separately identifiable owing to multicollinearity (pairwise correlations 0.66–0.94, Table 4.1).

5.2 Contributions to Theory and Practice

Theoretically, the dissertation has a number of valuable contributions to the literature of tax competition and the choice of location of multinationals. First, it suggests strong panel

evidence that time-invariant country heterogeneity and common global shocks controlled, statutory tax rates have no independent, systematic impact on FDI. This contradicts the inference of the universality of the early semi-elasticity estimates (Djankov et al., 2008; Sato, 2012; Laurent, 2025) and is consistent with the conclusions of meta-analyses that report large heterogeneity and attenuation in panel designs (Feld and Heckemeyer, 2011; de Mooij and Ederveen, 2003).

Second, the null findings contribute to the eclectic paradigm of international production (Dunning, 1988) by establishing the relative importance of institutional and risk-based location advantages to the pure fiscal factor in the present-day global capital markets. It is probably driven by the post-BEPS time (20132024): more transparency, country-by-country reporting, and automatic exchange of information has heightened the profitability of pure tax-arbitrage investments, leading to the decrease in the marginal relevance of the headline rate differentials (OECD, 2015; Clausing, 2018).

Third, the focus on sectoral and compositional heterogeneity provides a partial resolution to the research that suggests stronger tax impacts. Phantom or conduit FDI (holdings, financial intermediaries), which are highly tax-sensitive and are associated with low local economic spillovers, are often focused on in low-tax jurisdictions (Hebous, 2010; Pulina, 2021). Productive investments (greenfield plants, research and development centers, factories) are less sensitive to non-tax variables like market access, infrastructure, human capital, and institutional stability, in turn (Merz et al., 2017; Djankov et al., 2008). Since aggregate UNCTAD FDI statistics mixes the two types, the total null result can be a counter-compositional effect.

Practically and policy wise, the findings have significant implications particularly within the global minimum tax regime on the OECD/G20 Pillar 2 (OECD, 2021). Some critics have cautioned that a 15 percent minimum target would have a disproportionate impact on developing countries and smaller open economies that have traditionally resorted to low statutory rates to offset structural disadvantages (Beer et al., 2020; Jiménez et al., 2025; OECD, 2023). The current evidence moderates these anxieties: in case the influence of statutory (and therefore effective) rate differentials on aggregate FDI location choice are of negligible causal consequence when institutional quality is held fixed, Pillar 2 would not induce capital flight at any significant scale out of jurisdictions that are currently below 15. Rather, the reform must first and foremost minimize the negative base erosion and profit shifting and maintain or, possibly, increase

incentives towards true productive investment in those economies that are governed effectively (Eckhard Janeba & Schjelderup, 2023).

In the case of developing countries and small jurisdictions, which cannot be seen as structurally advantaged in tax competition, the results suggest that a shift to a dual strategy that does not rely on unilateral tax competition but on strengthening institutions is more appropriate. Reduction in country risk premiums due to plausible enhancement of political stability, macroeconomic policies, contract enforcement, and bank-sector resilience would provide much greater FDI responses than low marginal rate. Intense anti-corruption reforms also provide quantifiable, economically substantial payoffs. These priorities are entirely aligned with the sustainable investment agenda developed by UNCTAD (2022) and the post-2030 development framework in general.

The bigger, more normal taxation economies will be able to maintain medium-sized statutory levels without substantial FDI fines, so long as they keep investing in complementary benefits (skilled labor supply, infrastructure, regulatory efficiency). The line between transparent, high-governance low-tax regimes and opaque traditional havens is significant in the context of harmonization debate in the European context (Hebous, 2010). On the whole, the evidence substantiates the shift to a multilateral cooperation reducing the pressure of race-to-the-bottom to the legitimate space of institutional and economic competition.

5.3 Limitations of the Study and Directions for Future Research

Although the key findings are sound, there are various limitations related to the methodology and data that have to be taken into account. To begin with, the dependent variable, which is aggregate net FDI inflows provided by UNCTAD, does not make any distinction among the types of investment. A large portion of so-called phantom or conduit FDI (financial holdings, special purpose entities), highly tax sensitive and yielding few local spillovers, is frequently attracted to low-tax jurisdictions, and real-economy FDI (greenfield investments, manufacturing plants) reacts more to non-tax fundamentals (Hebous, 2010; Pulina, 2021). Such aggregate measure might thus conceal the heterogeneous tax impacts on investment classes.

Second, the statutory corporate income tax rate is an important explanatory variable because it only represents the headline rate, but neglects the entire range of deductions, credits, exemptions, accelerated depreciation, investment allowances and special economic zone

incentives that define the actual rate of tax that investors actually face (Djankov et al., 2008; de Mooij and Ederveen, 2003). Good average or marginal tax rates would probably give a better depiction of fiscal incentives particularly in the case of advanced multinational that practices tax planning.

Third, the binary indicator of the treatment that does not vary based on time, is that low-tax status did not change over the ten-year period. Factually, a number of countries revised statutory rates in the period between 2013 and 2024 in reaction to BEPS pressures, local revenue requirement or crisis-motivated fiscal contraction, bringing the potential measurement error and undermining the accuracy of the DiD identification strategy. Fourth, country and year fixed effects capture a large pool of time-invariant confounding variables and common shocks, but endogeneity, in turn, cannot be completely eliminated. Omitted variables that are time-varying (such as unobserved changes in policy that coincide with changes in taxation) or reverse causality (increasing FDI allows governments to reduce taxes) are still a possibility. Causal assertions in future research can be reinforced by instrumental-variable designs or dynamic panel designs.

Fifth, the empirical strategy adopted in this dissertation does not directly address the **potential endogeneity** of the tax-rate variable. Reverse causality is plausible in two distinct directions: rising FDI inflows can strengthen the fiscal capacity of host governments and induce statutory rate adjustments, while governments anticipating FDI shortfalls can pre-emptively cut rates to attract capital. Time-varying omitted variables — such as unobserved policy reforms, sectoral shocks, or geopolitical events that simultaneously influence taxation and investment decisions — may also bias the OLS fixed-effects estimator. A System-GMM estimator (Arellano & Bover, 1995; Blundell & Bond, 1998), which uses internal instruments based on lagged levels and lagged differences of the regressors, would in principle attenuate these concerns and is the standard approach in the dynamic-panel FDI literature. The implementation of GMM, including the diagnostics required for instrument validity (Hansen J-test, Arellano–Bond AR(2) test), exceeds the scope of the present dissertation and is signalled here as a methodological extension to be pursued in future work.

Sixth, the empirical specification adopts a linear functional form for the relationship between statutory tax rates and FDI inflows. The literature, however, suggests that this relationship may be non-linear: Shen and Dai (2024) document that the adverse effect of corporate taxation on FDI intensifies above a threshold of approximately 25 percent, while Klemm and Van Parys (2011)

find that tax incentives operate with diminishing returns at low rate levels. The fact that the tax-rate distribution in the present sample spans from below 5 percent to above 35 percent makes a quadratic or threshold specification (e.g., quadratic terms, splines, or piecewise regressions) a theoretically motivated alternative that the linear DiD model used here does not capture. Re-estimating the model with a quadratic term in the tax rate, or testing for structural breaks at policy-relevant thresholds (10%, 15%, 20%, 25%), constitutes a natural extension and is left for future research.

Seventh, the sample of 151 countries in the world is enormous in terms of heterogeneity in the economic development, the maturity in the institutions, the sectoral structure, and the integration into the global value chains. Subsamples by region or income group (e.g. sub-Saharan Africa, East Asia, OECD, small island developing states) may show context-dependent trends that are lost in the pool sample. Lastly, the paper will be completed in 2024, which will cover the dynamics prior to the complete phased adoption of Pillar 2 regulations in most jurisdictions. The findings thus indicate pre-reform incentive and that they cannot directly address post-minimum-tax FDI reactions.

5.4 Directions for Future Research

A number of extensions opportunities can be obtained based on the current analysis. First, disaggregating FDI by sector or industry or investment category (e.g. greenfield versus M&A, manufacturing versus services, productive versus phantom) would enable researchers to check whether the tax sensitivity differs systematically across categories, as hypothesized by Merz et al. (2017) and Djankov et al. (2008). Second, a more accurate estimate of fiscal impacts might be offered by using effective tax rate measures, including the effective average tax rates or marginal effective rates that reflect incentives and overcoming the gap between the statutory visibility and the real tax planning opportunities (Erokhin, 2023).

Third, it would be better to expand the sample beyond the year 2024 to fully address Pillar 2 implementation and be able to directly assess the effect of the global minimum tax on geographical location of FDI, revenue distribution, and development effect on the world. Fourth, there might be nonlinear specifications (e.g., splines, thresholds, or quadratic terms) that might test the hypothesis that the effects of tax become effective only at a specific level of rates as observed by Shen and Dai (2024). Fifth, successful examples of low-tax jurisdictions (e.g., Ireland,

Singapore, or some of the Caribbean centers) and unsuccessful ones might shed light on the particular institutional complementarities that allow tax benefits to be turned into long-run FDI benefits. Lastly, including other moderators, including the digital infrastructure, human capital indices, or trade openness, would perhaps elaborate further on under which conditions the interaction between tax policy and other locational determinants occurs. These extensions would expand the existing contribution by advancing the existing comprehension concerning the conditional and context-specific role of taxation within the changing international tax environment.

To sum up, this dissertation has shown that the rates of statutory corporate income taxes have no significant autonomous impact on FDI inflows under the condition, that the institutional quality, the risk perceptions, and economic fundamentals are properly regulated. These findings support on the idea that credible governance, low perceived risk, strong corruption control, and locational competitiveness on a broader level are the key factors in the attraction of productive foreign investment instead of headline tax rates. These findings provide evidence-based suggestions in the environment of Pillar 2 and global transformation of the international tax system: multilateral harmonization can decrease harmful avoidance activities without difficulties in underdeveloped and small economies to attract real investment, as long as their governance level is high.

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