Foreign Direct Investment in Central- and East European Countries: A Panel Study
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Abstract

In recent years many Central- and East European Countries have lowered their corporate tax rates in order to attract Foreign Direct Investment (FDI). This paper builds on the OLI-approach to examine the effect of such policies on FDI. We estimate a panel of 56 bilateral country-relationships of 7 home and 8 host countries over a period of 1995-2003 and use a gravity-model setting to check for market-related, efficiency-related and transition-specific determinants. Contrary to earlier studies using statutory tax rates, we use bilateral effective average tax rates as a measure of the corporate tax burden. The results indicate that taxes are an important location advantage determining the location decisions of foreign MNEs and that taxation is almost equally important to other cost factors like real unit labor costs. In particular, results suggest a semi-elasticity of FDI with respect to taxation of -4.5.

Keywords: Taxation; Foreign Direct Investment; Multinational Enterprises; Transformation Economies;

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