AN EXTENDED ABSTRACT OF INCENTIVES AND INWARD FOREIGN DIRECT INVESTMENTS: GOOD INSTITUTIONS PAY OFF

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In order to attract FDI and the associated benefits, many countries have been implementing incentive policies to target foreign multinationals. Because of that, we analyze the impact of investment incentives on greenfield foreign direct investment (FDI). Drawing on location choice theories, we propose that the effectiveness of financing and fiscal incentives for greenfield projects in attracting FDI depends on the institutional conditions of the host country. We performed a GMM analysis on FDI incentives in 106 countries in the period 2010-2017. Our result shows how institutions matter when competing for FDI and that incentives do not compensate for weak institutions. As we divided our sample according to the institutional environment, we were able to see the impact of incentives in countries with either good or weak institutions, and this impact changed alongside the type of incentive due to institutional differences. When the sample of 106 countries was divided based on their institutional environment, the proposed models showed that the effect of loans/grants deals grew in countries with good institutions, while both tax and loans/grants showed a significant and positive impact on countries with weak institutions, although with a low coefficient. Thus, countries with similar institutions compete against each other by offering incentives. In this case, countries with good institutions offer loan/grant incentives, which is preferred by the MNEs, while developing countries that cannot offer many financing incentives rely on tax incentives to compete among themselves as their institutional environments are similar. The results support the notion that good institutions pay off as countries with better institutions require fewer incentives to attract foreign investment.

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