

Property Rights, Tax Incentives and Bogus Foreign Direct Investment

Haozhen Zhang

Abstract: To our knowledge, this paper provides the first evidence of the effects of FDI round-tripping incentives on the scale of round-tripping. We find that round-tripping could be an explanation for the data reporting discrepancies between FDI host and source countries since investors have no incentive to report their “bogus” foreign investment to their source countries. If the data reporting discrepancies were caused partly by round-tripping, those reporting differences should be correlated with round-tripping incentives. Therefore, we first calculate the difference between the FDI inflows from 10 source regions reported by 50 host countries and FDI outflows reported by these 10 source regions. Second, these reporting differences are regressed on measures of the host countries’ political stability, property rights protection and preferential fiscal incentives to foreign investment. Our results from both aggregate and disaggregated data show that the FDI reporting differences are positively related to the host countries’ preferential fiscal incentives, and negatively correlated with the host country’s property rights protection and political stability. These results are statistically significant and robust to different function specifications and different indicators for property rights protection.

Keywords: FDI, round-tripping, fiscal incentives, property right

1. Introduction

An International Monetary Fund (IMF 2004) report defines “round-tripping” as domestic investors’ channeling of funds to special purpose entities abroad and the subsequent return of the funds to the local economy in the form of foreign direct investment (FDI). Studies (e.g., Xiao, 2004 and IMF, 2004) describe two major incentives for round-tripping. First, preferential fiscal policies (e.g., reduced tax rates and tax holidays) for foreign direct investment produce incentives for domestic investors to round trip their funds to benefit from these policies.

Second, domestic investors in countries with weak protection of property rights or an unstable political environment may have a strong incentive for round-tripping in order to gain property rights protection and to diversify domestic risk. In countries with weak protection of property rights, domestic investors are motivated to park their wealth in countries with relatively strong property rights protection. When these investors see profit opportunities, they return their funds to the domestic economy. Besides, according to IMF (2004), when the property rights protection is weak, some domestic investors prefer to keep their identities anonymous by investing through round-tripping. Moreover, in some countries (especially developing countries), the protection of property rights is generally weak, but there is better protection of the property rights of foreign investors than of domestic investors. This may be due to a desire to attract more foreign investment or in response to international political pressure. A UNCTAD (2003) study reported that in 2002, a total of 248 new FDI regulations were adopted by 70 countries, 236 of them

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representing changes more favorable to FDI. In particular, “76 of the 248 measures were promotional in nature, including incentives and 49 provided further protection to FDI and foreign investors”.

Numerous studies (e.g., Broadman, 1999; Chipalkatti & Rishi, 2001; OECD, 2003; Aykut & Ratha, 2003; IMF, 2003; Xiao, 2004) have reported the existence of round-tripping in some developing countries such as China and Russia. However, round-tripping is difficult to observe. To our knowledge, no empirical study has examined the relationship between round-tripping FDI and tax and property rights incentives since direct data on round-tripping are not available.

However, direct observations are not necessarily required to empirically study this phenomenon. A United Nation’s report finds that “the discrepancy of home and host country statistics is pointing towards the existence of round-tripping” (World Investment Directory, 2003, p46). For instance, while Russia reported that its FDI inflows from Cyprus were 678 million US dollars in 2000 and 512 million dollars in 2001, the total FDI outflows to the whole world reported by Cyprus were only 126 million Cyprus pounds (or 202 million US dollars) in 2000 and 140 million Cyprus pounds (or 218 million US dollars) in 2001.¹ This statistical discrepancy signals round-tripping since domestic investors in Cyprus have no incentive to report fake FDI outflows to their country. Two recent studies (Fisman and Wei, 2004; Xiao, 2004) take new indirect approaches to estimate scales of tax evasion and round-tripping, respectively. In particular, Fisman and Wei (2004) argues that evasion of tariffs and other taxes could be an explanation for the trade data reporting discrepancies of China (the import country) and Hong Kong (the export country) because exporters do not have incentives to report fake data to the export country/region. On the other hand, Xiao (2004) argues part of China’s FDI inflows is financed by domestic capital that leaves the country and then returns as round-tripping FDI. Moreover, he also reports that “it is common for fake foreign invested enterprises to use false capital auditing reports and false bank deposit documents to meet requirements of registered capital input by foreign partners” (Xiao, 2004, page 16). That is, investors cannot only round trip their domestic capital but they can also inflate the true foreign investment in their enterprises. Xiao (2004) then used FDI reporting discrepancies between China and its FDI source countries as a proxy measure of round-tripping FDI in China. Since both the “true” or “fake” foreign investors have no incentive to report any “bogus” investment to their source countries, the FDI inflows reported by China (the host country) are much greater than the FDI outflows reported by source countries.

The above studies provide a method that might be used to examine relationships between the scale of round-tripping and its incentives. Our study examines the effects of round-tripping incentives on the scale of round-tripping by considering the relationship between indicators of round-tripping incentives and the reporting discrepancies between FDI host and source countries. First, we calculate the difference between the FDI inflows from 10 source regions reported by 50 host countries and FDI outflows reported by these 10 source regions. Second, these reporting differences are regressed on indicators that measure the host countries’ political stability, property rights protection and preferential fiscal incentives to foreign investment. Our results show that the reporting difference between FDI host and source countries is positively related to the host countries’ preferential fiscal incentives, and negatively correlated with the FDI host country’s property rights protection and political stability. Overall, these results are statistically

¹ The FDI data of Russia and Cyprus are from the United Nations’ World investment directory, 2004 and the Annual Report of Balance of Payment 2002, the Central Bank of Cyprus.

significant and robust to different functional form specifications and different indicators for property rights protection.

The rest of this paper is organized as follows. Section 2 reviews the related literature. Section 3 describes our data. Section 4 discusses the aggregate reporting discrepancies across countries. Section 5 uses disaggregated data to examine the relationship between reporting discrepancies and the indicators of round-tripping incentives. Section 6 provides conclusions and policy implications.

2. Literature review

Some types of behavior, such as tax evasion and round-tripping, are difficult to observe. Two recent studies (Fisman and Wei, 2004; Xiao, 2004) use a new approach to estimate the extent of tax evasion and round-tripping in China, respectively. Fisman and Wei (2004) studied the effect of tax rates on evasion by examining evasion related to China's imports from Hong Kong. They argue that evasion of tariffs and other taxes could be an explanation for the trade data reporting discrepancies of China and Hong Kong. That is, if there is no tax evasion and measurement error, the exports to China reported by Hong Kong should be the same as the imports from Hong Kong reported by China. They computed the difference between Hong Kong's reported exports and China's reported imports of the same products by using the World Bank's World Integrated Trade Solution database. They then used the following specification to examine their prediction.

$$\log(\text{export}) - \log(\text{import}) = \alpha + \beta \text{taxrate} + \varepsilon$$

That is, they regressed the logarithm ratio of Hong Kong's reported exports and China's reported imports on the tax rates. Their results showed that the indicator for evasion gap, $\log(\frac{\text{export}}{\text{import}})$, is highly correlated with tax rates. They argued that their approach could be extended to measure other behaviors such as corruption that is also difficult to observe directly.

Xiao (2004) estimated the scale of round-tripping in China. He found that the FDI inflow statistics reported by China are higher than the FDI outflow statistics reported by the source regions. Because foreign investors do not have an incentive to report "fake investment" in China to their home countries, Xiao argued that the FDI outflow statistics reported by the source regions reflected the scale of the true FDI. He then used the gap between the FDI inflow statistics reported by China and the FDI outflow statistics reported by the source regions as a proxy measure of round-tripping FDI in China. Xiao (2004) showed that based on the available statistical information, China's round-tripping FDI was around 40 percent or within the range of 30 percent to 50 percent of total FDI over the period 1994 to 2001. The underlying logic behind these two studies is similar.

Wei (2000) studied the relationship between corruption and FDI using data on bilateral investment from 12 source countries to 45 host countries in 1993. He regressed the FDI outflows reported by source countries on a series of independent variables including host country's corruption level, political stability, the tax rate on foreign corporation, a dummy on linguistic ties, etc. After using three different indexes of corruption individually, he found that an increase in the tax rate on foreign corporations, political

instability or the corruption reduced inward FDI in host countries. Our study extends these empirical studies by examining the effects of property rights and fiscal incentives on the scale of round-tripping.

3. Data

3.1. FDI data

The United Nations Conference on Trade and Development's (UNCTD) FDI country-profile database and the OECD International Direct Investment Statistics Yearbooks (2002, 2003) provide FDI statistics for 112 countries.² Basically, these two databases provide FDI statistics in developed and developing countries in Europe, America, and Africa and in several Asian countries.³ Generally, there is no discrepancy between the FDI data reported by these two databases because they compile FDI statistics based on national official sources (e.g. central banks or national statistics organizations).

The FDI statistics that can be used in this study must have the following characteristics. First, the study requires disaggregated data on FDI inflows and outflows by country. However, the data for most African and Caribbean countries as well as some countries on other continents have not reported in disaggregated form by country in these databases. Second, the study requires the inflow data to be reported by FDI host countries and the outflow data by source countries. Although disaggregated statistics are available for some countries, the inflow data are sometimes based on information reported by the source countries. For example, UNCTD provides the data of FDI inflows to the Bahamas. However, these FDI inflow data are not reported by Bahamas (the host country) but by the source countries.

After considering these two requirements, we find that FDI statistics for about 60 countries cannot be used for the purposes of this study. Third, in order to calculate the FDI reporting difference between countries, we need to use both the inflows reported by FDI host countries and outflows reported by the FDI source countries. As a result of this strict requirement for data, we lose observations since some countries have not reported FDI flows to or from certain countries. For instance, Canada only reported FDI flows to and from three specific countries (United States, United Kingdom and Japan) with the remaining flows being broadly defined geographical destinations such as "European Union", "other developed countries" and "unspecified". Therefore, only for the case of Canada, we lose 52 observations.⁴ In another example, Italy and the Netherlands have not reported outflows to Bolivia, which reported inflows of 51.90 and 47.4 million dollars from Italy and the Netherlands. After deleting these missing values, there are a total of 276 paired observations for FDI between host and source countries.⁵ Fourth, the number of FDI host countries in the sample is also constrained by the availability of data on political stability, property rights protection, and preferential tax incentives. For example, data on property rights protection of four countries (Armenia,

² Hard copies of the FDI data for Latin America (World Investment Directory, 2004) and Central and Eastern Europe (World Investment Directory, 2003) are available. The data for other countries are available at the website of UNCTD's FDI database <http://www.unctad.org/Templates/Page.asp?intItemID=1923&lang=1> (last accessed data: Oct. 3, 2007).

³ These two databases do not cover China, the largest FDI recipient developing country. We collected FDI data for China from Statistical Yearbook of China, 2001. The website is <http://www.stats.gov.cn/yearbook2001/indexC.htm> (last accessed data: Oct.03, 2007).

⁴ Since Canada is also a source country in our sample, the missing values related to Canada is 52.

⁵ If there is no missing value problem, there should be 490 (50x10-10) observations.

Azerbaijan, Cambodia and Kazakhstan) are not available.⁶ Fifth, the disaggregated FDI inflow data for most Central and Eastern Europe countries are not available after 2000. Therefore, our study will focus on the data in 2000. Sixth, for some countries (especially for developed countries in Europe), FDI flows are reported in their local currencies. We convert these statistics into US\$ values by employing yearly average exchange rates reported by OECD and the CIA World Fact-book.⁷

Based on available statistical information, we use bilateral FDI flows from 10 source regions to 50 host countries in 2000. The 10 FDI source regions are Australia, Belgium and Luxembourg, Canada, France, Germany, Italy, Japan, Spain, Switzerland, and the United States.⁸ All of these countries are among the top sources of outward FDI.⁹ The 50 host countries are listed in table 1.

3.2. Data on political stability

Political instability produces incentives for round-tripping. On the one hand, political instability leads to weak governance. In a less stable political environment, the government usually has less ability to protect investors' property rights. On the other hand, political instability creates uncertainty regarding future protection of property rights. Other things being equal, this uncertainty may provide an incentive for domestic investors to round trip their funds in order to reduce the investment risk due to future policy changes. We use a political stability index for 2000 compiled by the World Bank (2004). The World Bank (WB) index is based on "several hundred individual variables drawn from 37 separate data sources constructed by 31 different organizations" (World Bank, 2004). This index is scaled from -2.500 to 2.500, with higher values corresponding to more stable political environments. As shown in Table 3, the ratings of the 50 countries in our sample range from -1.353 to 1.737.

3.3. Indicators of property rights protection

We use two measures of property rights protection. Since neither index includes the ratings of Armenia, Azerbaijan, Cambodia and Kazakhstan, there are only 46 countries in our sample when we analyze the effect of property rights protection on the FDI reporting difference. The first measure is the Fraser Institute (2005) rating of Legal Structure and Security of Property Rights for 2000. This Fraser Institute (FI) index is based on measures of the following five factors: judicial independence, impartial courts, protection of intellectual property, military in politics, and law and order. The FI index is scaled from 2.636 (very low protection) to 9.625 (very high protection) in our sample. The second measure is the property rights index of the World Economic Forum (2003). Since the World Economic Forum (WEF) index for 2000 only includes 38 of the countries in our sample, we use the WEF index for 2003. The

⁶ We still use the FDI data of these countries when we regress FDI reporting difference on political stability and preferential tax incentives.

⁷ The website of this factbook is <http://www.cia.gov/cia/publications/factbook/fields/2076.html> (last accessed data: Oct. 3, 2007).

⁸ FDI data for the US is collected individually from the database of US Department of Commerce, Bureau of Economics Analysis. There is no discrepancy between the FDI data reported by US BEA and by OECD and UNCTD. The BEA database is used because it covers more US FDI-recipient countries.

⁹ United Kingdom is not chosen as a source country since UK's FDI outflow data is incomplete (it do not include FDI outflows by "public corporations and in property"). (World Investment Directory, 2005).

ratings of the 47 countries in our sample range from 2.1 to 6.5 with higher values corresponding to better protection of property rights. Table 2 provides the ratings from both indexes.

3.4. Preferential fiscal incentives to foreign investment

We use a dummy variable on preferential fiscal incentives available to foreign investment to analyze the relationship between preferential tax incentives and FDI reporting differences. Information on preferential fiscal incentives to foreigners is scant. In many cases, tax incentives for FDI in some countries are not preferential tax incentives since these incentives are also available to domestic investment. Basically, we use information from the following four sources to decide whether there are preferential fiscal incentives for foreign investment: the U. S. Department of Commerce’s Country Commercial Guide (various years), Price Waterhouse’s Corporate Taxes Worldwide Summaries (2000), the World Wide Corporate Tax Guide 2000 published by Ernst & Young International Ltd, and the Inter-American Development Bank’s report (2001) on legislation for foreign investment statutes in countries in the Americas. See Appendix 1 for clear statements related to 50 host countries’ preferential fiscal incentives. Based on available information, preferential fiscal incentives for foreign investment exist in the following 11 countries/regions: Armenia, Azerbaijan, Belgium-Luxembourg Economic Union (BLEU), Cambodia, China, Korea, Lithuania, Macedonia, Russia, Tunisia and Uganda.

3.5. Other control variables

In addition to the data discussed above, we use three other dummy variables. These three dummies take the value of 1 if a common language is spoken by at least 9% of the population in both host and source countries, if both countries have ever had a colonial link, and if the two countries are contiguous, respectively, Centre d’Etudes Prospectives et d’Informations Internationales (CPII, 2004) provides data on all three variables.

4. Aggregate reporting discrepancies and round-tripping incentives

We calculate the difference between the FDI inflows from 10 source regions reported by 50 host countries and FDI outflows reported by these 10 source regions in 2000. That is, Reporting Difference $_i$ = Total FDI inflows from 10 source countries reported by host country i – Total FDI outflows to country i reported by 10 source countries.

We use two measures for FDI reporting difference. First, we use a ratio of the reporting difference to total inflows reported by the host country.

$$(\text{Diff/Total})_i = \frac{\text{Difference}_i}{\text{Total FDI inflows from 10 source countries reported by the host country } i}$$

Table 1 provides FDI reporting discrepancies and other related statistics for our sample. Second, following Fisman and Wei (2004), we also use the logarithm of the ratio of inflows reported by host countries and outflows reported by source countries as a dependent variable.

$$\log\left(\frac{\text{inflows}}{\text{outflows}}\right) = \log(\text{inflows}) - \log(\text{outflows})$$

Both above measures can reflect the scales of the reporting difference across countries. $(\text{Diff}/\text{Total})_i$ or $\log(\frac{\text{inflows}}{\text{outflows}}) > 0$, total inflows reported by country i are greater than the corresponding outflows reported by source countries.

In addition to round-tripping FDI, measurement errors may contribute to the FDI reporting discrepancies. The UNCTD's report (World Investment Director, 2004) argued that the FDI reporting discrepancies could be induced by differences in the data collection and accounting methods across countries. Moreover, some discrepancies may result from the fact that some countries' definitions of FDI depart from international conventions recommended by the IMF and OECD. However, the UNCTD's report also finds that "the discrepancy of home and host country statistics is also pointing towards the existence of round-tripping" (World Investment Directory, 2004, p46). For instance, this UNCTD's study reports that a large part of Russian FDI flows is not reflected in developed countries' statistics.

As shown in Table 1, two countries where substantial round-tripping of FDI is suspected, China and Russia, have high positive Diff/Total values (0.572 and 0.945), even though the source countries in our sample do not include Hong Kong and Cyprus, regions that are the most important locations for round-tripping for China and Russia, respectively. Table 2 provides disaggregate bilateral Diff/Total reporting difference for China and Russia. Among the total of 14 observations in our sample (9 for China and 5 for Russia), only the reporting difference between China and Spain is negative. These calculations are consistent with the existence of round-tripping in these two countries.

Therefore, the reporting discrepancies have two underlying sources: round-tripping FDI and measurement errors. That is, it is reasonable to assume that the Reporting difference = Round-tripping FDI (PR, T, STA) + measurement errors, where round-tripping is a function of PR (the property rights protection variable), T (the tax incentive variable), and STA (the political stability variable). In the absence of round-tripping and measurement error, the reporting difference should be equal to zero. If the reporting discrepancies were only caused by measurement errors, those reporting differences will not be related to the factors such as property rights protection, tax incentives and political stability. Therefore, this implies a possible approach for testing the existence of round-tripping and measuring the effects of property rights protection and fiscal incentives on the scale of round-tripping.

The aggregate data suggest a strong correlation between the reporting difference and round-tripping incentives. Figures 1-4 show the relationships between FDI reporting discrepancies and our indicators of property rights and tax incentives. In these figures, $(\text{Diff} / \text{Total})_i$ measures the scale of reporting difference. Trend lines in these figures show that FDI reporting discrepancies are positively related to preferential tax incentives and negatively related to political stability and property rights protection in the FDI host counties. Basic OLS models are used to test whether these relationships are statistically significant. In addition to $(\text{Diff} / \text{Total})_i$, $\log(\frac{\text{inflows}}{\text{outflows}})$ is also used as alternative dependent variables.

However, when we use $\log(\frac{\text{inflows}}{\text{outflows}})$ to measure the scale of reporting difference, 8 observations are dropped since non-positive inflows or outflows are reported in these 8 host countries. Using aggregate

data, we estimate the correlation between reporting difference and four key independent variables individually. As shown in Table 4, the coefficients on four independent variables are all statistically significant at 1% or 5% levels.¹⁰

5. Empirical results

For our sample of countries, the measures of political stability and protection of property rights are highly correlated. As discussed, political instability not only leads to weak protection of property rights but also increases the uncertainty of future property rights protection. In this sense, political stability can be considered as an indirect indicator of property rights protection. As shown in Table 3, the correlation coefficients between political stability and the two property rights indexes are 0.881 and 0.782, respectively. Therefore, we will regress these three property rights indicators individually with other independent variables since a regression on highly correlated independent variables can produce less precise estimates.

5.1. Political stability, preferential tax incentives and FDI reporting differences

The prediction that is examined in this section is that the difference between reported FDI statistics by the FDI host and by source countries is decreasing in the host countries' political stability because of round-tripping. We will use the following two specifications:

$$\frac{Diff_{ij}}{Total_i} = \lambda_1 Stability_i + \lambda_2 Tax_i + X_{ij}\beta + \varepsilon_{ij} \quad (1)$$

$$\log(inflows_{ij}) - \log(outflows_{ij}) = \gamma_1 Stability_i + \gamma_2 Tax_i + X_{ij}\beta + \varepsilon_{ij} \quad (2)$$

where $Diff_{ij}$ = (FDI inflow from source country j reported by host country i - FDI outflow to host country i reported by source country j); $Total_i$ = total FDI inflows reported by host country i ; $stability_i$ = the level of political stability in the host country i ; Tax_i is a dummy variable that equals one if the host country offers preferential tax incentives and X includes other variables such as political stability in source country and a possible geographic / linguistic / colonial connection between host and source countries. We also use source country dummies to control for possible differences in data collection methodology, account methods and FDI definitions across source countries, and all other source country characteristics that may affect the reporting discrepancies. When we use the source country dummies, the source countries' political stability variable has to be dropped from regressions due to perfect multicollinearity between source country dummies and source countries' political stability.

The left part of Table 5 (the OLS (1)-(7)) reports the regression results for specification 1.¹¹ As expected, the coefficients on the political-stability variable in the host country are always negative and statistically significant at 5%. The coefficients are around -0.15 , which implies that a one-grade increase in the host

¹⁰ The Breusch-Pagan tests are used to test for heteroskedasticity. When the hypothesis of homoscedasticity is rejected at 10% level, the tables report the heteroskedasticity-consistent covariance matrix estimators.

¹¹ The Breusch-Pagan tests are used to test for heteroskedasticity. When the hypothesis of homoscedasticity is rejected at 10% level, the tables report the heteroskedasticity-consistent covariance matrix estimators.

country's political stability reduces FDI reporting-difference ratio by 0.15 or 15 percent. On the other hand, the coefficients on the tax dummy are all positive and statistically significant at least at 10% level. This implies that preferential tax policies provide incentives for round-tripping.

As shown in the right part of Table 5 (the OLS (8)-(14)), regression results for specification 2 also imply strong relationships between FDI reporting differences and both political stability and preferential fiscal incentives available in host countries. The coefficients on the measure of political stability in the host country are negative and generally statistically significant.¹² The coefficients on the preferential tax incentives available in the host country are all positive and statistically significant at 5% at least. Moreover, coefficients on colonial links between host and source countries are positive and statistically significant at 1% in the regressions with source country dummies. All these findings are consistent with the round-tripping theory. We use Ramsey RESET test to test for possible specification errors. Overall, the test results do not indicate any problems in either specification 1 or 2.

5.2. Protection of property rights and FDI reporting differences

We use a similar method to examine the relationships between property rights protection and the FDI reporting difference. Neither property rights index (the FI and WEF indexes) includes ratings for Armenia, Azerbaijan, Cambodia or Kazakhstan. Unfortunately, as shown in Table 1, three of these four countries, Armenia, Azerbaijan, and Cambodia, provide preferential tax incentives to foreign investment and highly over-report their FDI inflows.¹³ Therefore, after deleting these countries, only 8 countries that provide preferential tax incentives remain in our sample. This may reduce the power to analyze the tax-incentive effects. Similarly, we use the following two specifications.

$$\frac{Diff_{ij}}{Total_i} = \lambda_3 Propertyrights_i + \lambda_4 Tax_i + X_{ij}\beta + \varepsilon_{ij} \quad (3)$$

$$\log(inflows_{ij}) - \log(outflows_{ij}) = \gamma_3 Propertyrights_i + \gamma_4 Tax_i + X_{ij}\beta + \varepsilon_{ij} \quad (4)$$

where $propertyrights_i$ = the level of property rights protection in host county i .

Tables 6 and 7 report the regression results for specifications 3 and 4, respectively. Generally, the results are consistent with our expectations. The coefficients on two measures of property rights protection (the WEF index and the FI index) are always negative and statistically significant at 5%. On the other hand, in this sample with 46 countries, the coefficients on preferential tax incentives are always positive and generally statistically significant.¹⁴ Again, we use Ramsey RESET test to test for possible specification errors. While for all 11 regressions based on specification 4 we cannot reject the hypothesis of no specification error, 3 of our 11 regressions using specification 3 appear to have a misspecified functional form. We therefore focus on the results from regressions based on specification 4 with a dependent variable of $\log(\frac{inflows_{ij}}{outflows_{ij}})$. As expected, the coefficients on the FI and the WEF measures of

¹² One special case is the OLS 14 in table 5. The p-value is 0.126.

¹³ The $(Diff / Total)_i$ values for Armenia, Azerbaijan, and Cambodia are 3.282, 0.503, and 0.773.

¹⁴ As shown in table 6 and 7, there are 10 regressions with a tax dummy variable in the sample of 46 countries. Eight coefficients on the tax dummy are significant at 5% and one is significant at 10%. One special case is the OLS 4 in table 7. Its p-value is 0.179.

protection are significant at 1% and 5% levels, respectively. On the other hand, the coefficients on the preferential tax incentive are all positive and significant at 5% or 10% levels, respectively. However, compared to the results from the sample with 50 countries, the P-values of the coefficients on the tax incentives increase. In addition, the results from the regressions with source country dummies show that colonial links between host and source countries have a positive and statistically significant effect on FDI reporting difference.

In summary, our results imply that the FDI reporting difference between FDI host and source countries is positively related to the host countries' preferential fiscal incentives, and negatively correlated with the FDI host country's property rights protection and political stability. Overall, these results are statistically significant and robust to different specifications.

6. Conclusion and policy implications

Our study has two findings. First, the FDI reporting discrepancies may be caused not purely by measurement errors but also by round-tripping. Second, the scale of round-tripping between countries is negatively correlated with FDI host countries' property rights protection and political stability and positively related to the host countries preferential tax incentives.

These finding help to put the growth of FDI in certain countries, such as China, and policies to promote FDI in perspective. On the one hand, our results support Xiao's (2004) arguments that FDI competition between countries may not be a zero-sum game. That is, the growth in FDI to one country may not be at the expense of other countries. Therefore, the recent high growth in FDI to some countries such as China could be considered not only as a threat but also as an engine of growth to other countries.

On the other hand, the "success" of some countries' FDI preferential policy may have a cost in terms of social equity and long-term economic growth. First, preferential policies impose different effective tax treatment on round-tripping and non-round-tripping domestic firms. In particular, these preferential policies would impose higher effective tax rates on small domestic firms, which have fewer channels and less incentive for round-tripping. Second, round-tripping imposes real costs on firms. Xiao (2004) argues that "the costs of becoming a disguised private enterprise wearing a FIE (foreign invested enterprise) hat are also high in many cases" since domestic investors have to channel their capital abroad and bring them back. Third, while preferential-policy makers intended to attract FDI that brings new technologies and much needed capital, these policies lead to bogus FDI at the expense of tax-revenue losses.

In addition, as round-tripping and bogus FDI cannot bring new technologies from multinational corporations, it may not be able to generate productivity spillovers. This phenomenon may partially explain the empirical puzzle of FDI spillover effects. As described by Javorcik (2004), most studies on FDI spillovers "cast doubt on the existence of spillovers from FDI in developing countries. The researchers either fail to find a significant effect or produce evidence of negative horizontal spillovers...." This issue may be left for future investigation.

Our study implies possible options for government to reduce round-tripping FDI and then lower the costs it induces. First, governments can reduce the scale of round-tripping by improving property rights protection for domestic firms. However, in some cases, this improvement may be at the expense of

technology spillovers since domestic firms would be less likely to copy freely. Second, the dual tax treatment on domestic and foreign firms may be a very costly and in effective way of promoting FDI. Our results consistent with the conclusion of an OECD report (2003) that any attempt to unify the dual tax system “might have far larger consequences than would ordinarily be the case, because the ‘foreigners’ involved are not all foreign” (OECD, 2003, p179). This policy implication needs to be further investigated in the future.

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Figure 1. Reporting differences and political stability (aggregate data)

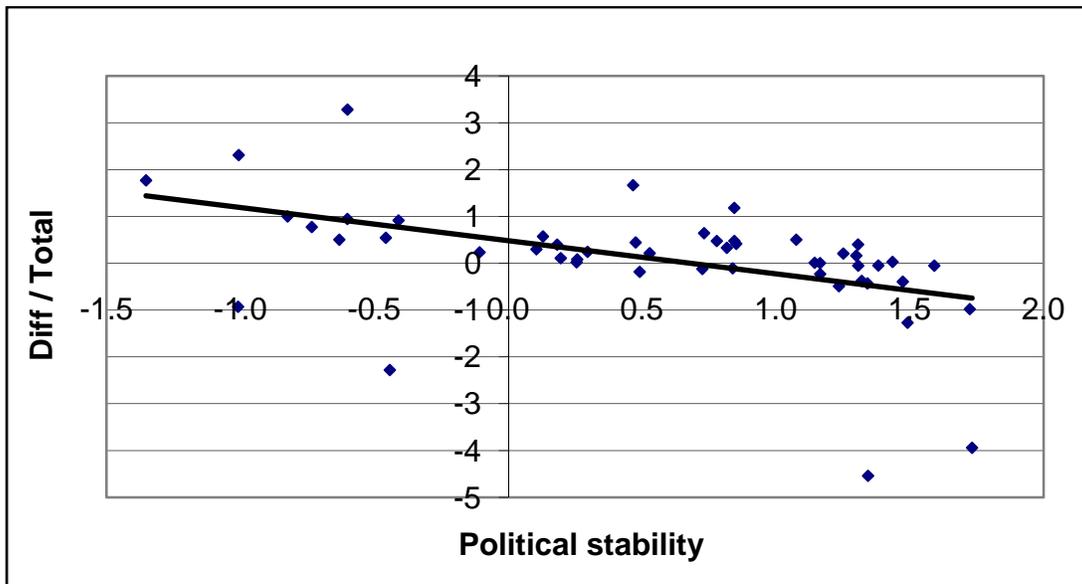


Figure 2. Reporting differences and preferential tax incentives (aggregate data)

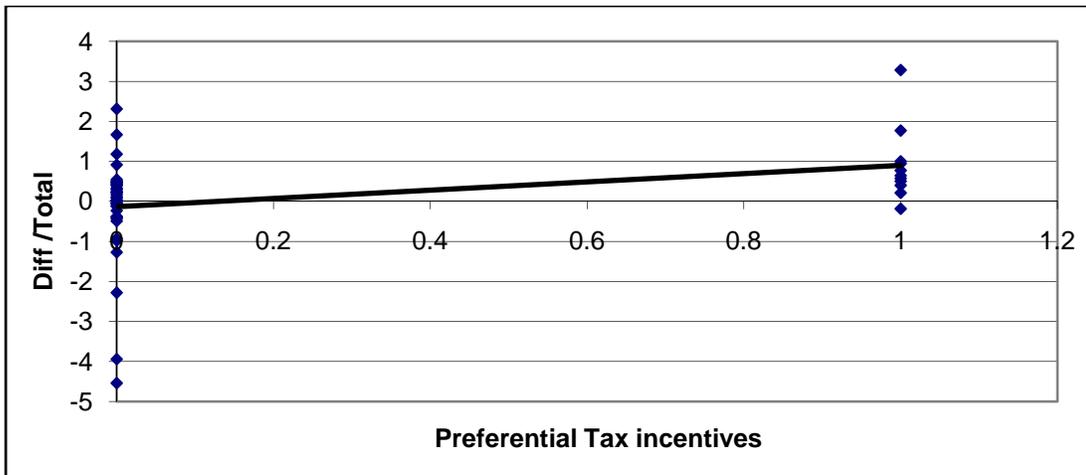


Figure 3. Reporting differences and property rights protection (WEF index, aggregate data)

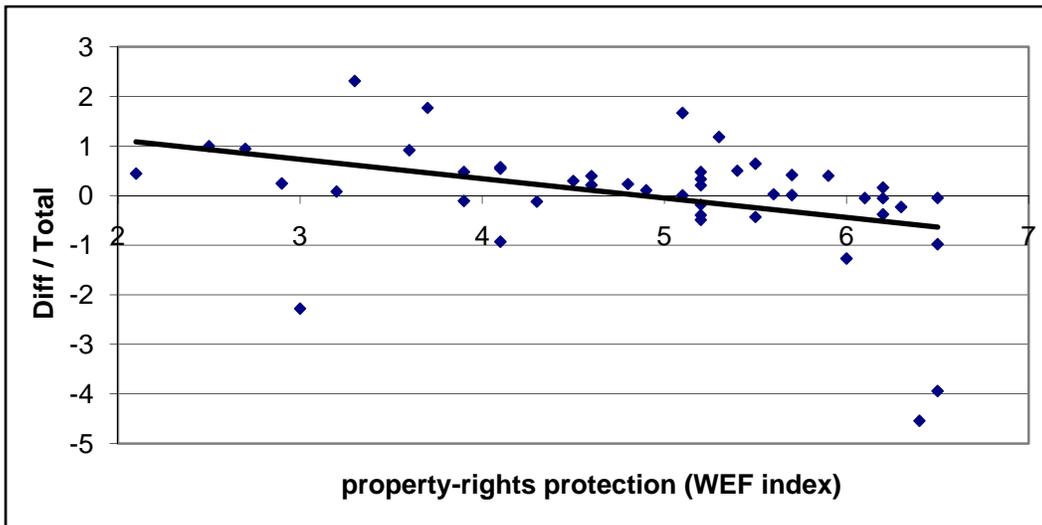
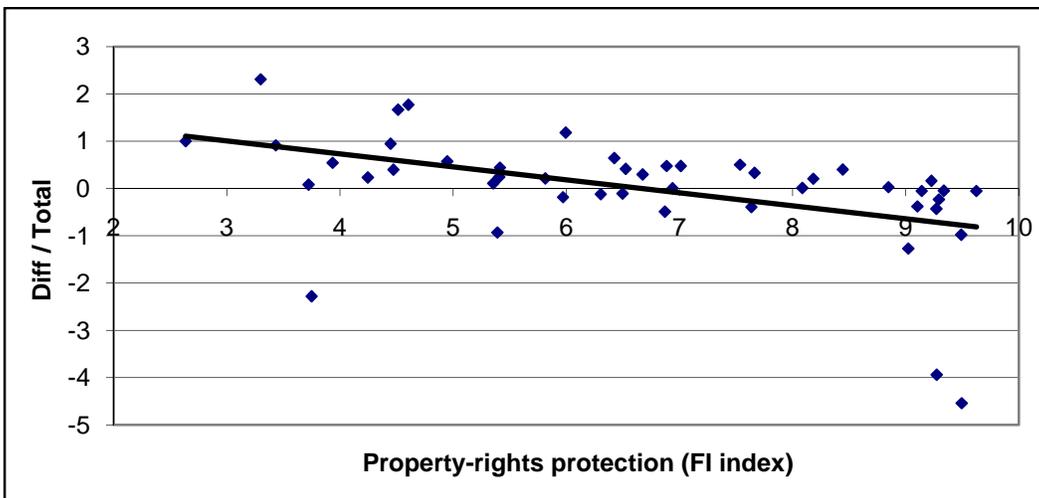


Figure 4. Reporting differences and property rights protection (FI index, aggregate data)



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Table 1. Aggregate reporting difference and related statistics for 50 countries

Host countries	Diffi / Total	Log (In/Out)	WEF index	FI index	WB index	Tax Incentives
Argentina	0.443	0.585	2.1	5.413	0.476	No
Armenia	3.282	-	-	-	-0.600	Yes
Australia	-4.541	-	6.4	9.495	1.344	No
Austria	-0.047	-0.046	6.5	9.338	1.383	No
Azerbaijan	0.503	0.699	-	-	-0.631	Yes
BLEU	0.400	0.511	5.9	8.443	1.307	Yes
Bolivia	0.914	2.454	3.6	3.432	-0.410	No
Brazil	0.107	0.114	4.9	5.355	0.196	No
Bulgarian	0.243	0.279	2.9	5.407	0.296	No
Cambodia	0.773	1.482	-	-	-0.733	Yes
Canada	-0.431	-0.358	5.5	9.271	1.342	No
Chile	0.415	0.536	5.7	6.525	0.852	No
China	0.572	0.875	4.1	4.948	0.130	Yes
Costa Rica	-0.491	-0.399	5.2	6.872	1.235	No
Czech Republic	0.476	0.646	3.9	6.888	0.845	No
Dominican Republic	0.396	0.505	4.6	4.472	0.183	No
Ecuador	2.310	-	3.3	3.299	-1.006	No
El Salvador	1.666	-	5.1	4.514	0.466	No
Estonia	1.181	-	5.3	5.995	0.844	No
Finland	-0.980	-0.683	6.5	9.491	1.724	No
France	0.010	0.010	5.7	8.086	1.145	No
Germany	-0.052	-0.051	6.2	9.141	1.307	No
Honduras	0.081	0.084	3.2	3.723	0.258	No
Hungary	0.475	0.644	5.2	7.012	0.779	No
Italy	0.330	0.401	5.2	7.665	0.817	No
Japan	0.207	0.232	5.2	8.183	1.252	No
Kazakhstan	0.020	0.020	-	-	0.255	No
Korea	-0.184	-0.169	5.2	5.971	0.491	Yes
Lithuania	0.213	0.239	4.6	5.815	0.528	Yes
Macedonia	1.000	-	2.5	2.636	-0.824	Yes
Mauritius	0.004	0.004	5.1	6.939	1.165	No
Mexico	0.233	0.265	4.8	4.247	-0.107	No
Morocco	0.297	0.352	4.5	6.675	0.105	No

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Netherlands	-0.052	-0.050	6.1	9.625	1.592	No
New Zealand	-0.378	-0.321	6.2	9.104	1.320	No
Norway	0.028	-	5.6	8.847	1.436	No
Peru	0.543	0.783	4.1	3.935	-0.457	No
Poland	-0.108	-0.103	3.9	6.498	0.838	No
Portugal	-0.395	-0.333	5.2	7.636	1.474	No
Russia	0.945	2.905	2.7	4.447	-0.601	Yes
Slovak Republic	-0.122	-0.115	4.3	6.304	0.725	No
Spain	0.503	0.698	5.4	7.536	1.076	No
Sweden	-1.271	-0.820	6.0	9.024	1.492	No
Switzerland	-3.941	-1.598	6.5	9.274	1.733	No
Tunisia	0.643	1.029	5.5	6.425	0.732	Yes
Turkey	-0.930	-0.658	4.1	5.392	-1.009	No
Uganda	1.769	-	3.7	4.605	-1.353	Yes
United Kingdom	-0.231	-0.207	6.3	9.294	1.165	No
United States	0.162	0.176	6.2	9.227	1.300	No
Venezuela	-2.281	-1.188	3.0	3.749	-0.442	No

Source: Diffi / Totali: author's calculation; Political Stability (the WB index): World Bank (2004); Property Rights (the FI index): Fraser Institute (2005); Property Rights (the WEF index): World Economic Forum (2003).

Table 2. Reporting difference for China and Russia (Millions US\$)

Host countries	Source countries	Reported by Hosts	Reported by S. C.	Reporting Difference
China	Australia	308.880	99.044	209.836
China	BLEU	79.600	9.216	70.384
China	France	853.160	324.394	528.766
China	Germany	1041.490	776.887	264.603
China	Italy	209.510	64.510	145.000
China	Japan	2915.850	1019.102	1896.748
China	Spain	34.000	55.294	-21.294
China	Switzerland	194.030	125.592	68.438
China	USA	4383.890	1817.000	2566.890
Russia	France	97.000	68.196	28.804
Russia	Germany	341.000	209.197	131.803
Russia	Japan	107.000	1.855	105.145
Russia	Switzerland	115.000	-4.147	119.147
Russia	USA	1241.000	-171.000	1412.000

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Source: Author's calculation by using data from UNCTD database, OECD International Direct Investment Statistics Yearbooks (2002, 2003), and Statistical Yearbook of China, (2001).

Table 3. Summary Statistics for aggregate data

NAME	N	MEAN	ST. DEV	VARIANCE	MINIMUM	MAXIMUM
Diff/Total	50	0.094	1.238	1.531	-4.541	3.282
Log (imports/exports)	42	0.224	0.806	0.650	-1.598	2.905
Political stability	50	0.549	0.831	0.690	-1.353	1.733
Tax dummy	50	0.220	0.418	0.175	0.000	1.000
The FI index	46	6.656	2.056	4.228	2.636	9.625
The WEF index	46	4.863	1.186	1.407	2.100	6.500

Correlation Matrix of variables (Based on 46 common observations)

Political stability	1.000			
TAX	-0.336	1.000		
FI index	0.881	-0.281	1.000	
The WEF index	0.782	-0.230	0.841	1.000
	Political stability	TAX	FI index	The WEF index

Table 4. Estimations by using aggregate FDI reporting differences

Independent Variables	Dependent variable = Diff i / Total i				Dependent variable = log (inflows)-log (outflows)			
	OLS (1)	OLS (2)	OLS (3)	OLS (4)	OLS (5)	OLS (6)	OLS (7)	OLS (8)
Political stability	-0.708*				-0.530**			
	(0.189)				(0.231)			
Tax dummy		1.035*				0.892*		
		(0.400)				(0.288)		
The WEF index			-0.391*				-0.294**	
			(0.140)				(0.144)	
The FI index				-0.275*				-0.190**
				(0.096)				(0.080)
Constant	0.483*	-0.134	1.903*	1.831*	0.567**	0.055	1.629**	1.488**
	(0.187)	(0.188)	(0.698)	(0.619)	(0.231)	(0.126)	(0.779)	(0.622)
R square	0.226	0.122	0.151	0.225	0.239	0.193	0.176	0.204
Breusch-Pagan Test (P-values)	0.718	0.287	0.112	0.100	0.000	0.271	0.000	0.000
Ramsey RESET test (P-value)	0.172	N/A	0.021	0.214	0.148	N/A	0.547	0.839
Observations	50	50	46	46	42	42	39	39

Note: (1) * and ** denote significant at the 1% and 5%.

(2) Standard errors are in parentheses

(3) We use heteroskedasticity-consistent covariance matrix in regressions 4, 5, 7, and 8.

(4) N/A means that result is unreliable because matrix inversion failed.

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Table 5. Bilateral reporting difference, political stability and preferential tax incentives

Independent Variables	Dependent variable = Diff ij / Total i							Dependent variable = log (inflows ij)-log (outflows ij)						
	OLS(1)	OLS(2)	OLS(3)	OLS(4)	OLS(5)	OLS(6)	OLS(7)	OLS(8)	OLS(9)	OLS(10)	OLS(11)	OLS(12)	OLS(13)	OLS(14)
Political stability (host country)	-0.171*		-0.153*		-0.162*		-0.139**	-0.298**		-0.258***		-0.286**		-0.217#
	(0.060)		(0.056)		(0.059)		(0.059)	(0.153)		(0.142)		(0.146)		(0.142)
Tax dummy		0.251*		0.236*		0.232*	0.149***		0.646*		0.598*		0.621*	0.527**
		(0.085)		(0.083)		(0.083)	(0.059)		(0.259)		(0.229)		(0.234)	(0.234)
Political stability (source country)	0.033							-0.261						
	(0.058)							(0.470)						
Contiguous	0.128	0.048			0.177	0.099	0.173	0.167	0.093			0.353	0.262	0.359
	(0.131)	(0.127)			(0.130)	(0.123)	(0.129)	(0.270)	(0.332)			(0.279)	(0.276)	(0.279)
Linguistic tie	-0.089	-0.069			-0.154	-0.137	-0.147	0.051	0.009			-0.087	-0.104	-0.093
	(0.185)	(0.189)			(0.179)	(0.185)	(0.179)	(0.257)	(0.286)			(0.289)	(0.295)	(0.291)
Colonial link	0.129	0.128			0.166	0.169	0.162	0.468	0.532			0.796*	0.826*	0.817*
	(0.120)	(0.122)			(0.111)	(0.116)	(0.111)	(0.289)	(0.383)			(0.296)	(0.326)	(0.316)
Constant	0.098	-0.022	0.245***	0.114	0.292**	0.154	0.247***	0.470	-0.169	0.584*	0.320	0.534**	0.259	0.392
	(0.099)	(0.028)	(0.138)	(0.148)	(0.127)	(0.132)	(0.136)	(0.590)	(0.116)	(0.220)	(0.207)	(0.239)	(0.229)	(0.241)
Source country dummies	No	No	Yes	Yes	Yes	Yes	Yes	No	No	Yes	Yes	Yes	Yes	Yes
R square	0.058	0.033	0.064	0.046	0.077	0.055	0.085	0.033	0.040	0.091	0.100	0.115	0.123	0.133
Breusch-Pagan test (P-value)	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.139	0.323	0.000	0.000	0.001	0.000	0.001
Ramsey RESET test (P-value)	0.006	0.312	0.101	0.240	0.280	0.242	0.606	0.143	0.326	0.998	0.999	0.612	0.242	0.510
Observations	276	276	276	276	276	276	276	207	207	207	207	207	207	207

Note: (1) *, ** and *** denote significant at the 1%, 5% and 10%; and # denotes P-values equal 0.126.

(2) Standard errors are in parentheses

(3) We use heteroskedasticity-consistent covariance matrix in regressions 1-7 and 10-14.

Table 6. Bilateral reporting difference and property rights protection (the WEF index)

Independent Variables	Dependent variable = Diff ij / Total i							Dependent variable = log(inflows ij)-log(outflows ij)						
	OLS(1)	OLS(2)	OLS(3)	OLS(4)	OLS(5)	OLS(6)	OLS(7)	OLS(8)	OLS(9)	OLS(10)	OLS(11)	OLS(12)	OLS(13)	OLS(14)
Property rights (host country)	-0.074** (0.032)		-0.067** (0.031)		-0.072** (0.033)		-0.065** (0.032)	-0.191** (0.088)		-0.179** (0.075)		-0.201* (0.075)		-0.189* (0.070)
Tax dummy		0.169** (0.071)		0.160** (0.066)		0.162** (0.068)	0.125** (0.063)		0.584** (0.271)		0.562** (0.237)		0.581** (0.241)	0.525** (0.230)
Property rights (source country)	0.073*** (0.042)							-0.093 (0.223)						
contiguous	0.098 (0.134)	0.050 (0.118)			0.156 (0.134)	0.110 (0.123)	0.159 (0.133)	0.180 (0.341)	0.098 (0.334)			0.399 (0.283)	0.283 (0.274)	0.425 (0.283)
Linguistic tie	-0.075 (0.189)	-0.056 (0.192)			-0.138 (0.184)	-0.140 (0.187)	-0.138 (0.183)	0.075 (0.295)	0.019 (0.289)			-0.097 (0.298)	-0.122 (0.298)	-0.113 (0.297)
Colonial link	0.148 (0.128)	0.127 (0.129)			0.186 (0.120)	0.184 (0.122)	0.186 (0.120)	0.506 (0.390)	0.538 (0.386)			0.859* (0.303)	0.847* (0.327)	0.873* (0.320)
Constant	-0.059 (0.265)	-0.025 (0.028)	0.477* (0.186)	0.127 (0.158)	0.540* (0.197)	0.170*** (0.143)	0.486** (0.200)	1.396 (1.360)	-0.174 (0.117)	1.312* (0.420)	0.367*** (0.223)	1.361* (0.422)	0.305 (0.251)	1.208* (0.405)
Source country dummies	No	No	Yes	Yes	Yes	Yes	Yes	No	No	Yes	Yes	Yes	Yes	Yes
R square	0.033	0.016	0.042	0.032	0.054	0.042	0.060	0.035	0.034	0.097	0.098	0.126	0.122	0.144

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Breusch-Pagan test (P-value)	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.172	0.312	0.000	0.000	0.000	0.000	0.000
Ramsey RESET test (P-value)	0.012	0.244	0.582	0.277	0.072	0.107	0.181	0.455	0.336	0.999	0.826	0.644	0.289	0.801
Observations	268	268	268	268	268	268	268	202	202	202	202	202	202	202

Note: (1) *, ** and *** denote significant at the 1%, 5% and 10%.

(2) Standard errors are in parentheses

(3) We use heteroskedasticity-consistent covariance matrix in regressions 1-7 and 10-14.

Table 7. Bilateral reporting difference and property rights protection (the FI index)

Independent Variables	Dependent variable = Diff ij / Total i				Dependent variable = log(inflows ij)-log(outflows ij)			
	OLS(1)	OLS(2)	OLS(3)	OLS(4)	OLS(5)	OLS(6)	OLS(7)	OLS(8)
Property rights in the host country	-0.053*	-0.057*	-0.056*	-0.051**	-0.134*	-0.143*	-0.143*	-0.122**
	(0.020)	(0.021)	(0.022)	(0.022)	(0.053)	(0.055)	(0.049)	(0.049)
Tax dummy				0.091##				0.440***
				(0.067)				(0.244)
Property rights in the source country	0.049	0.064***			0.033	0.048		
	(0.041)	(0.037)			(0.142)	(0.147)		
contiguous		0.137	0.187	0.186		0.264	0.445	0.447
		(0.135)	(0.135)	(0.134)		(0.343)	(0.277)	(0.277)
Linguistic tie		-0.102	-0.154	-0.153		-0.003	-0.130	-0.139
		(0.188)	(0.183)	(0.183)		(0.295)	(0.294)	(0.293)
Colonial link		0.157	0.181	0.182		0.535	0.834*	0.847*
		(0.127)	(0.127)	(0.119)		(0.388)	(0.297)	(0.314)
Constant	-0.041	-0.149	0.568*	0.523*	0.638	0.510	1.339*	1.137*

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	(0.364)	(0.321)	(0.190)	(0.201)	(1.280)	(1.308)	(0.400)	(0.408)
Source country dummies	No	No	Yes	Yes	No	No	Yes	Yes
R square	0.043	0.052	0.069	0.072	0.031	0.045	0.133	0.144
Breusch-Pagan test (P-value)	0.000	0.000	0.000	0.000	0.486	0.403	0.000	0.000
Ramsey RESET test (P-value)	0.382	0.040	0.549	0.577	0.752	0.459	0.975	0.824
Observations	268	268	268	268	202	202	202	202

Note: (1) *, ** and *** denote significant at the 1%, 5% and 10%; ## denotes P-values equal 0.179.

(2) Standard errors are in parentheses

(3) We use heteroskedasticity-consistent covariance matrix in regressions 1-4 and 7-8.

Appendix 1. Country profiles: preferential tax incentives to foreign investment.

1. Argentina

“Foreign and Argentine firms face the same tax liabilities Government incentives apply to foreign and domestic firms” (Country Commercial Guide, Chapter 7, 2000).

2. Armenia

“Specific privileges apply to corporate taxation if foreign investment in a company exceeds one million dollars. ... (Corporate) tax holidays: available for foreign investments over USD 1 million” (Country Commercial Guide, Chapter 7, 2002).

3. Australia

“Australia provides no direct federal tax incentives for investment in the country. Those incentives which are available apply equally to foreign and domestic investors” (Country Commercial Guide, Chapter 7, 2000).

4. Austria

“There no special tax incentives for encouraging inward investment” (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

5. Azerbaijan

“Various tax advantages are available to a foreign legal entity that qualifies for taxation under one of the various production-sharing agreements” (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

6. BLEU

a. Belgium

“Ireland and Belgium have preferential tax regimes targeted at foreigners. Ireland provides a reduced tax rate of 10% to foreign MNEs... Belgium grants near- complete tax relief to “centers de coordination”(making it a “headquarters tax haven”). (Avi-Yonah, Harvard Law Review, 2000).

b. Luxembourg

On the one hand, according to the Laws of 1923, 1972, and the Tax Reform Law of 1990, “No distinction is made between foreign or domestic investors” (Spitz’s 2001 International Tax Havens Guide). On the other hand, “there are no formalized legal regimes aimed at foreign investment as such but on an ad hoc basis the government offers a variety of types of assistance including guarantees, cash, tax incentives, subsidized loans, assistance with development and construction projects etc” (on-line source form <http://www.lowtax.net/lowtax/html/jlxcfir.html>) (last accessed date: Nov.22, 2005).

7. Bolivia

“There are no registration requirements for foreign direct investors in Bolivia or any special incentives for domestic or foreign investment” (Country Commercial Guide, Chapter 7, 2002).

8. Brazil

“The Federal Government does not grant special incentives for foreign investment, on principle. The only exception to this rule, however, is the possible granting of a reduction of the customs duty levied on imports of capital goods to be used in establishing the industry which is the subject of the foreign direct investment in question.” (Legislation for Foreign Investment Statutes in Countries in the Americas: Comparative Study, the Working Group on Investment (Free Trade Area of the Americas), the Inter-American Development Bank, 2001)

9. Bulgarian

Based on available information, no preferential incentives to foreign investment are found.

10. Cambodia

“The standard rate of corporate income tax is 20%. Under the Cambodian investment law, a reduced corporate tax rate of 9% may be granted to foreign enterprises on a case-by-case basis.” (World wide corporate tax guide 2000, Ernst & Young international Ltd, 2000)

11. Canada

“None of the federal incentives is specifically aimed at promoting or discouraging foreign investment in Canada” (Country Commercial Guide, Chapter 7, 2000).

12. Chile

“Chile does not subsidize or offer incentives specifically to attract foreign investment” (Country Commercial Guide, Chapter 7, 2000).

13. China

China provides preferential tax incentives to foreigners such as lower tax rates and tax holidays.

14. Costa Rica

No preferential incentives to foreign investment. “Special benefits (for investment) are afforded to foreigners who establish residence in Costa Rica, such as retirees and resident investors, as well as Costa Ricans....” (Country Commercial Guide, Chapter 7, 2000).

15. Czech Republic

“No tax incentives or tax holidays are currently available in the Czech Republic” (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

16. Dominican Republic

“Foreign and Dominican firms are afforded the same investment opportunities (both by law and in practice)” (Country Commercial Guide, Chapter 7, 2000).

17. Ecuador

“There are no special incentives (for foreign investment); the same incentives for national investors apply. Neither is there any investment insurance.” (Legislation for Foreign Investment Statutes in Countries in the Americas: Comparative Study, the Working Group on Investment (Free Trade Area of the Americas), the Inter-American Development Bank, 2001).

18. El Salvador

“As a general rule, the foreign investment regime in El Salvador does not provide any incentive that benefits foreign investment exclusively” (Legislation for Foreign Investment Statutes in Countries in the Americas: Comparative Study, the Working Group on Investment (Free Trade Area of the Americas), the Inter-American Development Bank, 2001).

19. Estonia

“Estonia has made a fundamental premise of its economic policy that foreign and domestic capitals are treated identically. To do otherwise would introduce distortions into the market. As a result, no special investment incentives are available to foreign investors, nor is any favored treatment accorded them” (Country Commercial Guide, Chapter 7, 2000).

20. Finland

“Foreign-owned companies are eligible for government incentives on an equal footing with Finnish-owned companies” (Country Commercial Guide, Chapter 7, 2000).

21. France

“No particular incentive is available to foreign investors in France” (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

22. Germany

“German law treats foreign firms in the same way as it does German firms” (Country Commercial Guide, Chapter 7, 2000).

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23. Honduras

“Equal treatment of foreign and local investors means that they both enjoy the same type of incentives. There are no special incentives for foreign investment” (Legislation for Foreign Investment Statutes in Countries in the Americas: Comparative Study, the Working Group on Investment, the Inter-American Development Bank, 2001).

24. Hungary

Hungary provided preferential incentives before 1994. “In 1994, Hungary replaced its blanket tax incentives for foreign investment with incentives open to all large investors, based on export promotion, reinvestment of profits, and job creation” (Country Commercial Guide, Chapter 7, 2000). Based on available information, no preferential incentives in 2000 are found. “There are a number of tax benefits on certain investments (in Hungary). “These are usually investments of a minimum sum. The benefits are granted both to local investors and foreign residents.” (Hungary foreign investments incentives, http://www.worldwide-tax.com/hungary/hun_invest.asp, last accessed date: Nov.22, 2005).

25. Italy

“The Italian government offers incentives designed to encourage private sector investment (by both Italian and foreign firms) in depressed areas” (Country Commercial Guide, Chapter 7, 2000).

26. Japan

Based on available information, there are generally no significant preferential tax incentives for foreign investors. “The calculations of taxable income and allowable deductions, and payments of the consumption tax (sales tax), are the same as those for domestic companies, with national treatment for foreign firms” (Country Commercial Guide, Chapter 7, 2000). However, “for certain designated inward investment enterprises, special rules for tax-loss carryforwards are provided (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

27. Kazakhstan

Based on available information, there are generally no significant preferential tax incentives for foreign investors. “The Foreign Investment Law provides for, inter alia, guarantees for national treatment and non-discrimination among foreign investors” (Country Commercial Guide, Chapter 6, 2000). However, there are some exceptions. On the one hand, “beginning in 1997, there has been a trend to grant preference to domestic investors over foreigners in most state contracts” (Country Commercial Guide, Chapter 6, 2000). On the other hand, some tax incentives are available through “negotiated foreign investment contracts” (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries)

28. Korea

“The Korean government grants various privileges, incentives and guarantees to certain foreign investors under the Foreign Capital Inducement Law” (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

29. Lithuania

“Company profits are exempt from taxation for the first three years. Thereafter for the next three years the tax rate is rebated by up to 50 percents provided the level of foreign capital does not exceed 30 per cent of the company's capital and the foreign investment element exceeds \$ 3.0 million” (Country Commercial Guide, Chapter 7, 2000). Some other special incentives for foreign investment can also be found in Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries.

30. Macedonia

“For the first three years of a foreign investment representing at least 20% of a company’s share capital, the company’s taxable income is reduced by the percentage of the share capital represented by foreign investment (World wide corporate tax guide 2000, Ernst & Young international Ltd, 2000).

31. Mauritius

“The government offers local and foreign investors the same incentives” (Country Commercial Guide, Chapter 7, 2002).

32. Mexico

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Mexico provides the investment incentives for both nationals and foreigners (Legislation for Foreign Investment Statutes in Countries in the Americas: Comparative Study, the Working Group on Investment, the Inter-American Development Bank, 2001). Based on available information, no preferential incentives to foreign investment are found.

33. Morocco

“The October 1995 investment code applies equally to foreign and Moroccan investors, with the exception of foreign exchange provisions, which favor foreign investors” (Country Commercial Guide, Chapter 7, 2000).

34. Netherlands

“Subsidies and incentives are available to foreign and domestic firms alike” (Country Commercial Guide, Chapter 7, 2000).

35. New Zealand

“There are no specific tax incentives designed to encourage the flow of investment funds into New Zealand” (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

36. Norway

In generally, there are no preferential incentives for foreign investment. Moreover, “While the Norwegian government officially endorses a level playing field for foreign investors, existing regulations, standards and practices often marginally favor Norwegian, Scandinavian and EEA investors, in that order” (Country Commercial Guide, Chapter 7, 2000).

37. Peru

In generally, there are no preferential incentives for foreign investment. “National and foreign investment are subject to the same terms”(Country Commercial Guide, Chapter 7, 2000).

38. Poland

Poland “provides generally equal treatment for domestic and foreign companies” (Country Commercial Guide, Chapter 7, 2000).

39. Portugal

Portugal provides many tax incentives for both resident and nonresident corporate entities. The Price Waterhouse’s Corporate Taxes 1999-2000 Worldwide Summaries introduced these incentives in details.

40. Russia

“Throughout the 1990s, the Russian Government has placed high priority on the attraction of foreign direct investment, and 45 regions have also developed laws and programs to attract it” (Country Commercial Guide, Chapter 7, 2000). For example, “enterprises with foreign investment that are engaged in material production are eligible for a two-year tax holiday” under certain conditions (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

41. Slovak Republic

Based on available information, while Slovak provided tax holidays for foreign investment before 1999, these incentives are available to both foreign and domestic investors after January 1 2000. In particular, in June 1999, Slovak “granted new foreign investors a five-year, 100 percent tax holiday for an investment of at least Euro 5 million, with a possible five-year extension...Parliament approved an amendment, effective January 1, 2000, which offered the tax holiday to any companies ‘that manufacture goods that were on the territory of the Slovak Republic only imported or were not manufactured or (for) the manufacture of goods for export’” (Country Commercial Guide, Chapter 7, 2001).

42. Spain

“There are no tax incentives specifically for the foreign investor” (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

43. Sweden

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Based on available information, generally there are no significant preferential incentives to foreign investment.

44. Switzerland

“The government offers few large-scale incentives to prospective investors, and those that exist are open to foreign and domestic investors alike” (Country Commercial Guide, Chapter 7, 2000).

45. Tunisia

“Investment legislation and subsequent amendments provide a broad range of incentives for foreign investors, including: tax relief on reinvested revenues and profits; VAT limitation to 10 percent on many imported capital goods; and optional depreciation schedules for production equipment”. “The preferential status (offshore, free trade zone) conferred upon some investments is linked to both foreign percentage of corporate ownership and limits on production for the domestic market. Moreover, foreign investors are “exempt from most exchange regulations” (Country Commercial Guide, Chapter 7, 2000).

46. Turkey

“Turkey provides a variety of investment incentives to both domestic and foreign investors” (Country Commercial Guide, Chapter 7, 2000).

47. Uganda

“Limited incentives in respect of first-arrival privileges are available to foreign investors” (Price Waterhouse’s Corporate Taxes 1999-2000: Worldwide Summaries).

48. United Kingdom

“Once established in the U.K., foreign-owned companies are treated no differently than U.K. companies” (Country Commercial Guide, Chapter 7, 2000).

49. United States

Based on available information, there are generally no significant preferential tax incentives for foreign investors.

50. Venezuela

“Foreign investment enjoys the incentives common to all investments; therefore there are no incentives in Venezuela for foreign investment exclusively” (Legislation for Foreign Investment Statutes in Countries in the Americas: Comparative Study, the Working Group on Investment, the Inter-American Development Bank, 2001).

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About the Author



Haozhen Zhang is a Senior Economist at Applied research & Analysis Directorate of Health Canada. He previously worked at Human Resources and Social Development Canada and the Finance Ministry of Alberta. He has a PhD degree in Economics from the University of Alberta. His research interests include applied econometrics, international trade and investment, health economics and labour economics.

Notes:

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Contact Information

Haozhen Zhang, Applied research & Analysis Division, Health Canada, Tel: 613-960-7350; E-mail: haozhen.zhang@hc-sc.gc.ca.