ABSTRACT

We develop a framework in which the host country productivity has a positive effect on the intensive margin (the size of FDI flows), but only an ambiguous effect on the extensive margin (the likelihood of FDI flows to occur). The source-country productivity has a negative effect on the extensive margin.
An increase in the host-country corporate tax rate reduces the actual FDI flows the likelihood of such flows to occur. An increase in the source-country corporate tax rate reduces the likelihood of FDI flows. These predictions are confronted with Data on FDI flows, drawn from the International Direct Investment dataset (Source OECD), covering the bilateral FDI flows among 18 OECD countries over the period 1987 to 2003. We find some support for the main predictions of the model.