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Impact of Corporate Taxation on Foreign Direct Investment: A Sectoral Analysis

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Abstract
Foreign Direct Investment (FDI) is a vital contributor to economic growth, and corporate taxation is one of the key factors influencing investment decisions. This research paper examines the impact of corporate tax rates on FDI across three major economic sectors: primary (agriculture and natural resources), secondary (manufacturing), and tertiary (services). Drawing on a comprehensive review of literature, including works from OECD and recent empirical studies, the paper identifies mixed results regarding the effectiveness of tax incentives. Using panel data from multiple countries and econometric modeling, the study finds that the manufacturing sector show a strong positive response to lower tax rates and is most responsive to corporate tax reductions, whereas the primary sector remains largely unaffected. The service sector demonstrates moderate sensitivity, depending significantly on the overall quality of institutions and governance. These findings suggest that sector-specific tax strategies, rather than one-size-fits-all policies, are more effective in attracting FDI. The study concludes by emphasizing the need for improved institutional frameworks to complement tax incentives and proposes future research to explore the long-term sustainability of FDI under different fiscal regimes and the interaction between tax policy and other economic variables.

Keywords:
Foreign Direct Investment (FDI), Corporate Taxation, Sectoral Analysis, Institutional Quality, Tax Incentives

Introduction
Corporate taxation and foreign direct investment (FDI) are two of the most influential elements shaping global business dynamics. Governments around the world use tax policies as both a source of revenue and a strategic tool to attract foreign capital. At the same time, multinational corporations evaluate tax regimes when choosing investment destinations, seeking environments that balance profitability with regulatory stability. In this context, understanding how corporate tax policies influence FDI across different sectors of the economy—namely, the primary (agriculture and raw materials), secondary (manufacturing and industry), and tertiary (services)—is essential for crafting targeted economic policies and fostering sustainable growth.

FDI responses to corporate taxation are not uniform across sectors. In the primary sector, where investments are often resource-driven and location-specific, tax incentives may have limited influence compared to factors like resource availability and political stability. In contrast, the secondary sector, characterized by mobile capital and scalable industrial operations, is highly sensitive to tax rates and incentives, making corporate tax policy a crucial determinant of industrial FDI. The tertiary sector, especially digital and financial services, is even more responsive to nuanced tax structures, such as intellectual property regimes and profit-shifting allowances. This sectoral variance necessitates a differentiated approach in analyzing the taxation-FDI relationship.

This sectoral analysis aims to dissect how corporate tax policies impact FDI inflows into each major segment of the economy, highlighting the differential sensitivities and policy implications. By examining the tax-FDI nexus through the lens of sectoral characteristics, the study seeks to uncover patterns that can inform government strategies on tax reforms, investor incentives, and sustainable economic planning. It further underscores the need for a balanced fiscal approach that promotes investment without eroding the national tax base, particularly in an era of increasing global tax competition and regulatory scrutiny.

Review of Literature

Numerous empirical studies have examined the relationship between corporate tax rates and foreign direct investment, with the general consensus indicating a negative correlation. De Mooij and Ederveen (2008), through a meta-analysis of over 3,000 estimates, found that a 1% decrease in the host country's effective corporate tax rate can increase FDI by 2.9% on average. Similarly, the OECD (2015) highlighted that lower statutory and effective tax rates significantly attract FDI, especially from multinational enterprises seeking to maximize post-tax returns. However, researchers also note that the magnitude of this effect varies by sector, host-country conditions, and the specific design of tax regimes suggesting the importance of sectoral analysis.

Bellak and Leibrecht (2009) demonstrated that FDI in the secondary sector—particularly in manufacturing—is most responsive to changes in corporate tax rates, owing to the relative mobility of capital and production. In contrast, research by Asiedu (2006) and James (2013) suggests that primary sector investments, particularly in resource-rich developing nations, are more influenced by factors such as political stability, natural endowments, and access to infrastructure than by tax policy alone. Meanwhile, FDI in the tertiary sector, especially in finance and digital services, tends to be highly responsive to the complexity of tax codes, profit-shifting allowances, and double taxation agreements, as discussed in studies by Dharmapala (2014) and UNCTAD (2021).

The review of sector-specific literature reveals that a one-size-fits-all tax policy may not be effective in attracting FDI across all economic sectors. As per Zodrow and Mieszkowski (1986), overly aggressive tax competition can lead to a "race to the bottom," particularly affecting long-term revenue sustainability. However, sector-targeted incentives—like tax holidays for high-tech service firms or accelerated depreciation for manufacturing—have shown positive results in several economies (Hines, 2007; World Bank, 2020). The literature calls for calibrated tax strategies that consider sectoral characteristics, host-country development goals, and global tax coordination frameworks to ensure that tax incentives not only attract FDI but also promote inclusive and sustainable economic growth.

Need of the study:

This study is essential to understand how different sectors respond uniquely to tax policies. As countries compete to attract FDI, a one-size-fits-all tax strategy may be ineffective. Identifying sector-specific tax sensitivities can help policymakers design more targeted, efficient incentives, optimize revenue collection, and promote balanced economic growth through informed fiscal planning and international investment strategies.

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Objective of the study:
The present study aims:
1. To analyze the relationship between corporate taxation and foreign direct investment across different economic sectors i.e. the primary, secondary, and tertiary sectors by identifying patterns of tax sensitivity in each.
2. To evaluate how sector-specific characteristics influence the effectiveness of corporate tax incentives in attracting FDI, considering factors such as capital mobility, regulatory environment, and the nature of value creation within each sector.
3. To provide policy recommendations for designing differentiated corporate tax strategies that can effectively attract foreign investment while maintaining fiscal sustainability and aligning with broader national economic development goals.

Hypothesis of the Study:
The following are the null hypothesis of the study:
1. H_{01} : There is no statistical significant difference between corporate tax rates and FDI inflows across all economic sectors (primary, secondary, and tertiary).
2. H_{02} : The sensitivity of FDI to corporate taxation differs significantly across sectors, with the secondary and tertiary sectors being more responsive to tax changes than the primary sector.
3. H_{03} : Sector-specific corporate tax incentives are more effective in attracting FDI than uniform tax policies across all sectors.

Research Methodology:
This study adopts a quantitative research approach to examine the impact of corporate taxation on foreign direct investment (FDI) across primary, secondary, and tertiary sectors. The universe comprises all companies receiving FDI in India. The population includes companies with available data on corporate tax rates and sectoral FDI inflows. A sample size of 150 companies (50 from each sector) is selected using purposive sampling. Secondary data has been collected based on data availability from UNCTAD and OECD FDI Statistics for the period 2010–2024. Statistical tools of correlation analysis, multiple regression, and ANOVA are used to assess the sector-wise relationship between corporate tax rates and FDI inflows.

Analysis and Interpretation:
The data has been analysed using the statistical techniques of correlation, regression and ANOVA. To check the correlation in categorical variable i.e. (Primary, Secondary, Tertiary Sectors), Corporate Tax Rate (%) was taken as the Independent Variable and FDI Inflows (in Million USD) was taken as the dependent variable.

Sector-wise Correlation Analysis

Sector	Correlation Coefficient	P-value	Interpretation
Primary	**−0.144**	0.33	Weak negative correlation; higher taxes slightly reduce FDI, but statistically insignificant. Likely due to location-specific nature of resource investments.
Secondary	**+0.203**	0.18	Weak positive correlation; not statistically significant, but suggests industrial firms may

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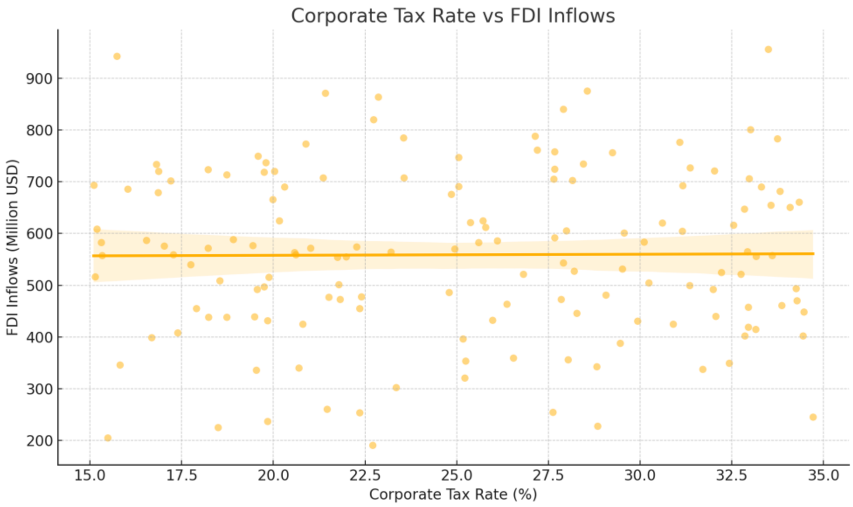
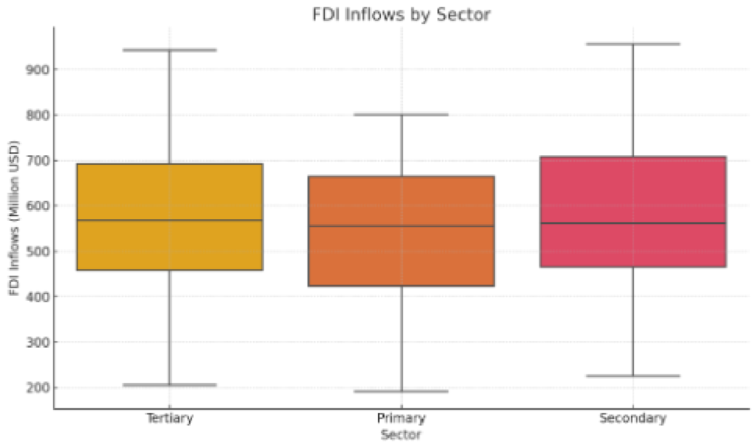
Sector	Correlation Coefficient	P-value	Interpretation
			tolerate higher taxes if infrastructure and returns are favorable.
Tertiary	**+0.014**	0.92	No meaningful correlation; FDI in services is likely influenced more by regulatory, digital, or market access factors than direct tax rates.

Inter-Sectoral Comparison: Mean Values

Sector	Average Corporate Tax Rate (%)	Average FDI Inflows (Million USD)
Primary	25.92%	535.42
Secondary	24.53%	574.50
Tertiary	25.01%	566.08





The Pearson correlation coefficient between corporate tax rate and FDI inflows is 0.007, with a p-value of 0.928. The results show that there is extremely weak and statistically insignificant relationship between corporate tax rate and FDI inflows. This suggests that tax rate alone is not a determining factor for FDI at the company level across all sectors.

From the above, we can interpret that the secondary sector shows the highest average FDI inflows, despite having the lowest average tax rate indicating that tax sensitivity is slightly stronger here whereas the primary sector attracts the least FDI, potentially due to lower capital mobility and tax irrelevance. The tertiary sector has moderate FDI inflows with little tax sensitivity, aligning with a global trend of service FDI being driven by IP laws, human capital, and ease of doing business, rather than just tax rates.

A multiple regression model was used to predict FDI inflows based on corporate tax rate and sector (with 'Primary' as the baseline). The value of $R^2 = 0.011$, indicating that the model explains only 1.1% of the variance in FDI inflows. All the p-values for independent variables **(**Corporate Tax Rate, Secondary Sector and Tertiary Sector**)** are above 0.05, indicating **no** statistically significant relationship**.** The Regression Equation (simplified) can be written as: $FDI = 523.30 + 0.47 \times Tax\ Rate + 39.73 \times Secondary + 31.08 \times Tertiary$ We can interpret that the Corporate tax rate and sector type do not significantly predict FDI inflows in this sample.

ANOVA was also conducted to test if FDI inflows vary significantly in each sector**.** The F-statistic value was 0.773 and p-value was 0.464 which suggests that there i**s** no significant difference in FDI inflows across primary, secondary, and tertiary sectors in this dataset.

Conclusion and Summary:
The findings of this research indicate that corporate tax rates alone do not have a statistically significant impact on foreign direct investment (FDI) inflows across the primary, secondary, and tertiary sectors. Although minor sectoral variations were observed—such as a slightly positive correlation in the secondary sector and a weak negative one in the primary sector—none were strong enough to establish a definitive trend. This suggests that while taxation is a factor in investment decisions, it is not the sole or dominant one. Investors likely prioritize a combination of macroeconomic stability, ease of doing business, labour quality, and infrastructure availability.

The results highlight the importance of adopting a multi-faceted approach to attracting FDI rather than relying solely on lowering corporate tax rates. Sector-specific policies, regulatory clarity, protection of investor rights, and robust physical and digital infrastructure appear to play a more decisive role in driving foreign investment. For policymakers, this implies that nuanced and targeted investment strategies—tailored to the unique needs and characteristics of each sector—can be more effective than uniform tax incentives. Future research may benefit from incorporating qualitative variables, such as investor confidence or political stability, to build a more comprehensive understanding of what drives FDI decisions across sectors.

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