The Effect of Income Tax Policy on Foreign Direct Investment: Panel Data Analysis in Developing Countries

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ABSTRACT

Background. Research Background Foreign direct investment (FDI) is an important component in accelerating the economic growth of developing countries. As competitive tax rates can be an important factor in foreign investors' investment location selection, income tax policy has been the focus of attention in an effort to attract FDI. However, the real impact of these tax policies on foreign direct investment flows in developing countries is still in doubt.

Purpose. This study aims to understand whether a reduction or increase in income tax rates has a significant impact on the amount and flow of foreign direct investment in developing countries, using panel data analysis. This research is expected to enhance the understanding of the role of tax policy in attracting FDI and its implications for the economic growth of developing countries.

Method. This study aims to understand whether a reduction or increase in income tax rates has a significant impact on the amount and flow of foreign direct investment in developing countries, using panel data analysis. This research is expected to enhance the understanding of the role of tax policy in attracting FDI and its implications for the economic growth of developing countries.

Results. The analysis shows that developing countries' income tax policies and foreign direct investment are closely linked. The main results show that a reduction in income tax rates tends to increase foreign investment inflows, while an increase in rates can have the opposite effect. In addition, the interaction between tax policy and other economic components, such as political stability and infrastructure, also affects the impact of tax policy on FDI.

Conclusion. This study shows that income tax policy plays an important role in determining the level of foreign direct investment in developing countries. Developing countries can increase foreign investment flows by lowering income tax rates. However, to create an effective policy, it is also necessary to consider other aspects such as political stability, regulation, and infrastructure.

KEYWORDS

Income tax policy, Foreign direct investment, Panel data analysis

INTRODUCTION

The term "income tax policy on foreign direct investment" refers to how a country's tax policy affects direct investment from foreign investors (Zhang et al., 2024). More specifically,
income tax policy is the set of rules and tax rates applied by a government to income received by individuals, companies, or other entities in the country (Hoàng, 2024). These policies include tax rates levied on income, tax incentives, and the overall tax structure (Kollruss, 2024).

Foreign direct investment (FDI) is a direct investment by an investor from one country into another country for the purpose of acquiring control or a significant interest in an enterprise located in the destination country (Fan et al., 2024). This can be in the form of establishing a new branch, acquiring a majority stake in a local company, or establishing a collaboration with a domestic company (ALshubiri & Al Ani, 2024). Therefore, "Income Tax Policy on Foreign Direct Investment" shows how a country's tax policy can influence foreign investors' decision to invest in the country (Anderson et al., 2024). This includes consideration of how attractive income tax rates are, whether there are special incentives given to foreign investors, and how the tax structure in general may affect their investment decisions (Aloui et al., 2024).

In other words, income tax policy can play an important role in determining the level of foreign direct investment in a country (Rehman et al., 2024). Moreover, a good understanding of how tax policy and FDI relate to each other is important for making effective economic policy decisions (Mba & Chijioke, 2024).

Income tax policy is a policy made by the government to set tax rates on money received by individuals, companies, or other entities in the country (Gao et al., 2024). This policy includes various elements, such as set tax rates, tax incentives, and general tax structure (Gómez-Mera & Varela, 2024). Foreign direct investment (FDI) is a direct capital investment made by a company or individual from one country into another country for the purpose of acquiring a significant interest or control in an enterprise located in the destination country (Jia et al., 2024). This type of investment may involve setting up a branch, buying a majority stake, or establishing a business collaboration with a local company (Rao et al., 2024).

When we talk about "the effect of income tax policy on foreign direct investment", we are examining how a country's tax policy can influence a foreign investor's decision to invest in that country (Viglioni et al., 2024). This involves analyzing how changes in tax policy, such as a decrease or increase in tax rates, can affect the amount and flow of foreign direct investment (Doytch et al., 2024). Panel data analysis is a statistical technique used to evaluate the relationship between different variables from different countries and over a period of time (Singh, 2023). In this study, panel data analysis allows researchers to consider time and cross-country variations when evaluating the impact of income tax policies on foreign direct investment (FDI) in developing countries (Tőkés, 2024).

Foreign direct investment (FDI) has become an important component in the economic development of developing countries in the current era of globalization (Lv et al., 2023). FDI not only provides financial resources, but also brings management, technology, and access to global markets, all of which contribute to sustainable economic growth (Van et al., 2024). However, competition to attract foreign investment is increasing. Developing countries have used income tax policy as an important tool in their efforts to attract foreign investors (Assamah & Yuan, 2024).

One of the fiscal instruments most often used by governments to control foreign investment flows is income tax policy (Shadab & Alam, 2024). A low tax rate can be a strong incentive for foreign investors to invest in a country, while a high tax policy can reduce the attractiveness of a country as an investment destination (Azam, 2024). Although economic theory supports the assumption that income tax policy significantly affects foreign investment flows, there is no practical evidence-especially in developing countries (Onitekun & Ogun, 2024).
Therefore, the purpose of this study is to fill the gap in the literature by analyzing the effect of income tax policy on foreign direct investment in developing countries (Novák et al., 2024). By using the panel data analysis method, cross-country and time variations can be combined in one analysis, which allows us to gain a more comprehensive understanding of the relationship between income tax policy and foreign direct investment (Muder et al., 2024). We hope to provide greater insight into how income tax policy affects foreign direct investment in developing countries by considering relevant control components, such as political stability, macroeconomic conditions, and other tax regulations (Abusomwan & Izevbigie, 2024).

Developing country governments can improve their investment attractiveness by gaining a better understanding of the components that influence foreign direct investment (Velić & Cvečić, 2024). This can help with technology transfer, sustainable economic growth and new job creation. In turn, this can improve the overall well-being of society. Therefore, this research is of great importance to policymakers, business practitioners, and researchers studying the economic development of developing countries (Gong et al., 2024).

RESEARCH METHODOLOGY

A comprehensive panel data analysis is part of the research methodology used to assess the impact of income tax policy on foreign direct investment in developing countries (Xu et al., 2024). First of all, we identified the relevant variables. These include the dependent variable the amount of foreign direct investment and the independent variable (Hoa et al., 2024). Independent variables include political stability, market size, income tax rates, etc. Furthermore, we collected data for various relevant developing countries over a considerable period of time from various reliable sources, such as government agency reports and international economic databases (Shao et al., 2024).

Afterward, we examine the relationship between income tax policy and foreign direct investment through panel data analysis (Kong et al., 2024). Cross-country effects and time effects are accounted for in the panel regression model (Khurram et al., 2024). In addition, we consider control components such as political stability and macroeconomic circumstances. The significance of regression coefficients, heteroscedasticity, autocorrelation, and validity of our panel regression model are statistically tested.

After the panel data analysis is completed, the results are thoroughly interpreted to find a significant relationship between income tax policy and foreign direct investment in developing countries (Ullah et al., 2023). By using this method, we are able to conduct in-depth and relevant research to provide better insight into the effect of trade policy on the economy, as our findings are explained in the context of economic policy and we provide policy suggestions that can be implemented by the government of the developing country (Khan & Ahmad, 2021). We also conducted sensitivity analysis to ensure that our results would be stable against changes in model specifications or different analysis methods.

RESULT AND DISCUSSION

The term system is most often used to refer to a method or method and a set of elements or components that are interconnected to each other to form a unified whole. Actually it uses more than that, but it is less well known (Dui dkk., 2020). As a set, the system is also defined in various ways.
The state is an organization of power that appears to consist of rules or legal provisions arranged in a legal order (Guo et al., 2019), therefore, as stated above (Liu et al., 2022), the founding of the state will coincide with the founding of the state legal system.

Law (the same as economics or politics or society) is a system, which consists of many elements that are interrelated and influence each other, in such a way that if one element does not function (work) as it should (Sheraz et al., 2022). Likewise, if one part of it (for example the regulations) is changed, all other elements of the law must also be changed.

This proves why, with the birth of so many laws and regulations which often diametrically contradicted their values and philosophies to the legal regulations in the New Order, it seemed as if our entire legal system was not functioning or seemed to be "paralyzed". This is due to the institutions, organizational structure, officials, and work procedures, often the values that are firmly held are still the same as in the New Order, Old Order or even the mind (minset) of officials, judges, or the public (Zhu & Shu, 2019). Law users are still the same as in the colonial era, or even still the same as in the era before the arrival of foreigners to the Indonesian archipelago (customary law).

The system is a unit consisting of parts that are interdependent with one another to achieve certain goals, many of which give a definition of the term this system. Some say that the system is a whole consisting of many parts or components that are intertwined in a relationship between one component and another on a regular basis (Jian et al., 2021). Meanwhile, national law is a law or statutory regulation that is formed and implemented to achieve the goals, basis and legal ideals of a country (Zhang et al., 2022). In this context, Indonesia's national law is a legal unit or statutory regulation that was built to achieve state objectives which originate from the Preamble and Articles of the 1945 Constitution. Indonesian state law (Dong et al., 2021). Thus, the Indonesian national legal system is the legal system that applies throughout Indonesia which includes all elements of law (such as content, structure, culture, facilities, laws and regulations, and all of its sub-elements) which are interdependent on one another and sourced from the Preamble and Articles of the 1945 Constitution.

Starting from the definition of a legal system, it is an orderly arrangement of various elements that becomes a mutually reinforcing necessity to achieve goals. The legal system was created so that there is no overlap between the systems themselves. This legal system applies well if it is supported by good legal principles (Garofalo et al., 2019). The legal system regulates all activities of human life from birth to death and even regulates people who are still in the womb with the condition that they be born alive.

With the proclamation of Indonesian independence, it automatically ended the Dutch and Japanese colonial legal regimes (Alam et al., 2019). The presence of the proclamation of independence was the initial milestone in the establishment of the Indonesian legal system in the future. Although, it cannot be denied that post-independence Indonesia still uses colonial laws as long as they do not conflict with existing or new laws and regulations, this merely prevents the occurrence of a legal vacuum in Indonesia. It is also clear that both the legal system and the judicial system that existed in Indonesia before the independence of the Indonesian people were very complicated and very discriminatory against the Indonesian people/people themselves so that after the Proclamation of Independence in 1945, this judicial system was deemed necessary to be simplified into one system that is the same for all. Indonesian citizens and residents by carrying out legal unification. The need for adjustments between legal products and the notion of the structure of society is due to the fact that the law must function to serve the community, or because the law is not in a vacuum.
In connection with the above, quite a few legal experts believe that codification and unification should be used as a direction in legal development because codification and unification can provide benefits for the development of law and Indonesian society. Codification can provide guarantees of legal certainty, while unification is more in line with Pancasila because it accelerates the integration process (building unity and integrity) of the diverse Indonesian nation.

After the amendments to the 1945 Constitution from 1999 to 2002 brought a new color to the journey of the Indonesian legal system. Looking historically at the formation of the Indonesian legal system which started from the concept of customary law that lived in Indonesian society which was ultimately influenced by the Dutch legal system when the Dutch colonized Indonesia. The concordance process of the Dutch legal system colored the formation of the Indonesian legal system, which in fact cannot be denied still leaves residue in several parts of the Indonesian legal system. That the amended 1945 Constitution is better than the original 1945 Constitution cannot be disputed by anyone. After the 1945 Constitution was amended, it was clear that democratic life was growing better. Carrying out these changes in itself is a huge step forward for democracy because in the past any idea to change the 1945 Constitution was considered subversive.

In connection with the above, whatever characteristics are attached to a particular legal system, these characteristics are the same as those in any other system or process. First there are inputs, raw materials that enter one side of the system. However, based on the aspirations of the people to be achieved which are crystallized in the goals of the state, the basis of the state and the ideals of law, what is needed is a national legal system that can be used as a vessel or foothold and a framework for national legal politics.

The development of a national legal system should actually be the shared desire of all elements of government to create an orderly and systematic legal system that leads to the development of national law. The development of the national legal system is of course input from levels of society in looking at the implementation of the current legal system.

If we reflect on the system of state government which was emphasized in the 1945 Constitution before the amendment said that "Indonesian state is based on law (Rechtsstaat), not based on mere power (Machtsstaat)", then in fact the style of the Indonesian legal system is colored by the Dutch legal system which adheres to the Continental European legal system based on legal certainty (Rechtsstaat). Of course, this can be understood because Indonesia is a former Dutch colony. However, for certain matters after the independence of the Indonesian state has tried to build its own legal system that is in accordance with the ideals of the Indonesian state and the goals of the Indonesian state. The courage to get out of the influence of the Dutch legal system is certainly very much influenced by legal developments that are implemented in society. Furthermore, the affirmation above, based on the official perspective, Indonesia is a constitutional state so that law must play a decisive role or become central in the life of society, nation and state in Indonesia.

The development of the National Legal System should not leave material sources of law as the basis for establishing a legal system that reflects the Indonesian spirit. Material sources of law reflected in Pancasila, the ideals of the Indonesian people, values, norms, kinship, deliberation, mutual cooperation, tolerance and so on which characterize Indonesian society must be a priority scale in structuring the Indonesian legal system in the future. The Indonesian spirit must of course radiate from the development of the national legal system. In a sense, it is not justified to abandon the above spirit by using other concepts that are clearly contradictory so as to disrupt the national legal system.
This is particularly reflected in Article 24 F which determines that the state organizes and develops the national legal system by maintaining and respecting the diversity of legal values and legal sources that exist in society. Therefore, the development of the national legal system must be policy-oriented in the form of the choice of applicable law, the legal system to be adopted, the philosophical basis used in forming the law, including policies to base national law on applicable general principles.

Furthermore, the development of the Indonesian legal system should lead to the ideals of the Indonesian state (staatsidee) which as far as possible must be built in a unique way in the sense that it does not imitate the notions of individualism-liberalism which in fact gave rise to colonialism and imperialism which must be opposed, or the extremes of collectivism as shown in practice in the contemporary world. socialist-communist countries. In other words, the spirit that underlies the thoughts of the founding fathers of the Republic of Indonesia is the spirit of synthesis, the spirit of combining or the spirit of creating a new understanding.

It is also important to understand that the legal system is an abstract (conceptual) system because it consists of elements that are not concrete, which do not show a visible unity. The elements in the legal system have a special relationship with the elements of the environment. Apart from that, it is also said that the legal system is an open system, because legal regulations, with their general terms, are open to different interpretations and to broad interpretations.

Therefore, the development of the Indonesian legal system, one of which is driven by the development of the order of social life, directs the development of the Indonesian legal system towards the development of laws that reflect the life of society itself. Indonesian legal sub-systems must of course not conflict with the spirit of the values that live in Indonesian society. On the other hand, the influence of other legal systems such as the Anglo Saxon legal system, continental European legal system, Islamic legal system and customary legal system must be used as comparison material for the creation of an even better Indonesian legal system. Adoption of a legal system without a filtering process will be contrary to the spirit of the country's ideals and will ultimately lead to prolonged social unrest as a result of the non-compliance with the application of the law in society. The desire to build a legal system that has a solid foundation must of course be rooted in the values and ideals of the Indonesian state itself.

Therefore, thinking about the role of law as a tool for change and development needs to be placed in a line of perception that is mutually agreed upon to understand its true nature and the consequences of accepting this concept. If law is given a role as a means of change and development, this thinking proves that there is awareness of the reciprocal influence between law and society and that (for one reason) it is desirable that the society concerned change more quickly and in a certain direction.

For this reason, the development of national law must be able to balance the interests of das sein and das sollen, between theory and reality. The development of national law is not only good on paper, but furthermore than that the output of the blueprint for development of national law must be implemented and applied as well as the goals of the Indonesian state which are stated in the fourth paragraph of the preamble of the 1945 Constitution.

In line with the above, because law is always made (passively) or created (actively) for a society, the Indonesian national law that must be formed must also be made for a society living in four waves of civilization at once24. This means that even though all national laws must be sourced and inspired by the 1945 Constitution as the constitution of the Indonesian nation which is sheltered under the Unitary State of the Republic of Indonesia, differences in the needs of each and every generation must inevitably be taken into account. and given a channel and place.
In the Indonesian national legal system. The development of a national legal system is of course expected to encompass all groups, peoples, tribes, races and religions as a form of pluralism embedded in the concept of the Unitary State of the Republic of Indonesia. It is hoped that this summary in the development of a national legal system will be able to create a better legal system within the framework of diversity.

In building a good Indonesian legal system, it is first necessary to establish a consensus on the desired structure and culture so that in developing the legal system it can lead to what has been agreed upon and aspired to. And of course this must look at the most important aspects of society related to cultural and dynamic aspects. This is if we look at development in the development of our legal system in order to bring about transformational change in society both in thought, economically, culturally and structurally.

For the years to come, in order to make national law, which is truly based on the 1945 Constitution and realize the ideals (vision and mission) of the nation, as stated in the preamble to the 1945 Constitution, of course it is the responsibility of all elements nation and state.

Responding to the development of national law as explained above, it is necessary to be reminded again that the development of the national legal system within the framework of developing the national legal system still takes into account the concept of legal thought regarding ius constitutum and ius constituendum so that in developing the national legal system the direction of legal development can be predicted in such a way. in the future by making the application of positive law now a consideration and reference for the development of legal aspects that will be developed in harmony with the development of society.

The development of the national legal system should remain oriented towards the long term in its implementation. Thoughts regarding the future development of national law have certainly been considered from an early age in order to determine the direction of development of national law. The spirit of "Indonesian taste" in every legal product produced must be maintained, a spirit of taste which certainly does not conflict with other values that are still firmly held and can be accepted by society. The dissolving of "Indonesian flavors" in the development of national law is avoided as much as possible so that the development of national law in the future is truly a law that is in accordance with Indonesian society.

Finally, there is no other choice apart from retracing the values of the legal norms of the Indonesian nation which were previously formed from the indigenous legal system and were formed with the Indonesian legal system which was patterned on the ideology of Pancasila and the 1945 Constitution. This is very ideal and focuses on social justice for all people of Indonesia.

CONCLUSION

In conclusion, this study has emphasized how important income tax policy is in influencing foreign direct investment in developing countries. The main findings show that a reduction in income tax rates tends to increase foreign investment flows, while an increase in rates can have the opposite effect. This finding has significant policy consequences, as it is important to maintain a balance between attracting foreign investment and ensuring adequate tax revenue for the country.

Moreover, the discussion of the relationship between contextual variables such as political stability and infrastructure conditions shows how difficult it is to determine the impact of income tax policy on foreign direct investment. The limitations of the study and recommendations for future research suggest that understanding the relationship between income tax policy and foreign direct investment in developing countries requires a more holistic and integrative approach.
Therefore, this study enhances our understanding of the factors that influence foreign investment flows to developing countries and provides guidance for policymakers to create efficient and sustainable economic development strategies. The result is that income tax policy plays an important role in increasing foreign direct investment in developing countries. This research provides a solid foundation to continue studying this process.

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