

Foreign Aid Through Domestic Tax Cuts?

Evidence from Multinational Firm Presence in Developing Countries

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Abstract: This paper studies whether corporate tax cuts in developed countries affect economies in the developing world. We focus on one of the most prominent fiscal policies – the corporate income tax regime – and study a major U.K. tax cut as an exogenous shock to foreign investment in Africa. Difference-in-differences estimates show that multinational U.K. firms increase their subsidiary presence in sub-Saharan Africa by 17-24 percent following the 2010 announcement of U.K. tax rate reductions. Exploiting location-specific nighttime luminosity data as well as local data from the African Demographic and Health Surveys, we also document increased economic activity and higher employment rates of African citizens within close proximity (10 kilometers) of local U.K.-owned subsidiaries. Our findings imply that, beyond the goal of motivating home country investment, developed countries' corporate tax cuts have economic impact in developing nations.

Motivation & Setting

Multinational firms account for a significant part of resource allocation in the global economy. This is a particularly important issue in developing countries. Multinational firm investment in developing countries can often be associated with growth, however, these firms are often accused of exploiting local markets through resource extraction and the use of sweatshops. While prior research indicates that foreign direct investment (FDI) correlates with GDP at the aggregate level, it is unclear whether developing countries with weak institutions actually benefit from FDI.

Corporate Income Tax Rate Cuts in the U.K. since 2010

→ shock to U.K.-based multinational firms' investment abroad



Data

- Multinational firm ownership linkages from BvD Orbis (2005-2018)
- Hand-collected GPS coordinates for multinational subsidiaries in Africa
- Outcome measures:
 - *Number of Subsidiaries* in African countries as proxy for multinational firm investment
 - Geo-linked nighttime luminosity
 - Geo-linked employment data from DHS surveys

Results

after U.K. tax cuts starting in 2010...

- 20% greater subsidiary presence of U.K. multinational firms in Africa
- 2.5-4.6% greater economic activity around U.K. subsidiaries
- 2-4pp higher employment rates around U.K. subsidiaries

