

Taxes and Entry Mode Decision in Multinationals: Export and FDI with and without Decentralization*

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Abstract

We use a duopoly model to simultaneously consider both foreign direct investment (FDI) and decentralization decisions, featuring transfer pricing. To investigate the relationship between corporate taxes and the optimal entry mode for the foreign market, we examine and compare firms' profit in each of three entry modes: export, FDI with decentralization, and FDI with centralization. We find that, even when a host country does not have any advantage, FDI can be undertaken because of a strategic incentive. We also find that trade liberalization promotes decentralization of multinationals, and centralization is dominated by decentralization in free trade.

Keywords: decentralization; foreign direct investment; transfer pricing

JEL Classification: F21, F23, H25

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