Inward FDI Subsidy and Technology Adoption

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Abstract

This paper presents a theoretical model with firm heterogeneity which analyzes impacts of Inward-FDI subsidy on FDI, performance of local suppliers and welfare.
On the equilibrium, FDI firms with high productivity form technology partnerships with some local suppliers where both the former and the latter bear the cost (technology adoption). These FDI firms source intermediate goods from these local suppliers, while FDI firms with low productivity source ones from the other local suppliers (without technology upgrading). The model reveals under what circumstances the scenarios targeted by the policy maker below will occur: a selective subsidy which targets FDI firms collaborating with local firms enhances the quality of FDI (defined by presence of high-tech investments), raises average productivity of local suppliers, and improves the welfare. This is also shown in the numerical calculations.

Keywords: Inward-FDI subsidy, Technology adoption, Local sourcing, Selective subsidy, Firm heterogeneity

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