FDI Subsidies in a General Oligopolistic Equilibrium Model

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Abstract

We employ a general oligopolistic equilibrium model to analyze the welfare effect of FDI subsidies. Specifically, firms in the exporting industry produce under oligopolistic competition while a firm in the FDI industry produces under monopoly. We consider the welfare impact of the subsidies under different financing sources such as a labor income tax and a consumption tax. The results indicate that a small subsidy financed by consumption taxes may improve welfare. The reason is that small subsidies financed by labor income taxes do not affect the wage, and thus do not alter any other economic variables. On the other hand, small subsidies financed by consumption taxes influence the demand and supply condition, which subsequently decreases the wage. This reduction in the wage can improve welfare.