

Abstract

Local tax incentives and behavior of foreign enterprises: evidence from a large developing country

By Jing Xing, Wei Cui and Xi Qu

We analyze how profit reporting and investment behavior of foreign enterprises respond to local tax incentives in China, a large developing country. Using firm-level data between 2000 and 2013 from China's industrial enterprise survey, we first provide strong evidence for tax competition among Chinese cities (especially cities within the same province) over the average effective income tax rate. We then find that, despite stringent capital controls, both reported pre-tax profits and investment of foreign firms respond strongly to local tax incentives, suggesting that subnational tax competition in China is oriented towards both mobile profits and real resources.