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# How Taxation Affects Foreign Direct Investment in Cambodia

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**Abstract: Foreign direct investment (FDI) plays a vital role in promoting economic growth, especially for developing economies like Cambodia. Various empirical studies have found contradictory results regarding the relationship between taxation and FDI. This study seeks to determine the prevailing relationship between taxation—tax on income (TOI) and value added tax (VAT)—and FDI. This research utilized secondary data obtained from the Ministry of Economy and Finance and the National Bank of Cambodia, covering the period from 2018 to 2023, to illustrate the application of widely used statistical methods—specifically correlation and multi regression analysis. The findings propose that there is no significant relationship between taxation and foreign direct investment (FDI) in Cambodia. Specifically, it finds no significant association between tax on income (TOI) and FDI ($r = 0.237$, $p = 0.651$), nor between value added tax (VAT) and FDI ($r = 0.212$, $p = 0.686$). The regression analysis supports this proposition, showing that neither TOI ($B = 0.368$, $p = 0.831$) nor VAT ($B = 0.337$, $p = 0.901$) significantly predict FDI. The regression model was not statistically significant ($F(2,3) = 0.099$, $R^2 = 0.062$), explaining only 6.2% of the variance in FDI. Thus, the study concludes there is no significant predictive relationship between TOI, VAT, and FDI in the sample analyzed.**

***Keywords****: Tax on Income, Value Added Tax, Qualified Investment Project, Foreign Direct Investment.*

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## I. INTRODUCTION

Since transitioning to a market-based economy in the early 1990s, Cambodia has experienced impressive economic growth (World Bank, 2018). It is considered one of the most dynamic and open economies within the Association of Southeast Asian Nations (ASEAN). This economic progress is largely credited to its liberal trade policies and efforts to attract foreign direct investment (FDI). Thangavelu et al. (2023) investigated that FDI in Cambodia has primarily flowed into the labor-intensive garment industry, driven by factors such as low wages, abundant labor, and favorable access to markets in the European Union and the United States. In 2017, garment and textile exports reached USD 8 billion, increasing from only USD 3 billion in 2010.

Iammarino et al. (2024) indicates that FDI has played a crucial role in transforming Cambodia's economic landscape, making a substantial impact on both economic growth and employment generation. Major FDI-attracting sectors include real estate, financial services, and renewable or alternative energy, while industries such as textiles, real estate, and consumer goods stand out for their contribution to job creation. Nevertheless, the majority of FDI projects are concentrated in the capital and coastal regions and are primarily focused on low-tech manufacturing, which limits potential for knowledge spillovers and industrial advancement. Cambodia's outward FDI began in 2008, with a primary focus on other ASEAN nations. Also, Iammarino et al. (2024) reveals that recent trends in FDI inflows show increasing interest in sectors such as alternative and renewable energy, rubber, automotive original equipment manufacturing (OEM), leisure and entertainment, as well as the food, tobacco, beverage, and paper, printing, and packaging industries.

Since the enactment of Cambodia's first Law on Investment (LoI) in 1994, the Council for the Development of Cambodia (CDC) has served as the central authority in implementing the country's FDI regulatory framework. Revisions made in 2003 introduced the concept of 'Qualified Investment Project' (QIP) status, along with a range of investment incentives. In 2005, Sub-Decree No. 111 clarified the criteria for QIP status and established a "Negative List" outlining sectors not eligible for incentives. Later, Sub-Decree No. 33 ANK.BK in 2019 extended tax exemptions to existing QIPs and broadened the scope of investment promotion initiatives. In 2021, Cambodia enacted a revised Law on Investment (LoI) to modernize its FDI framework in line with global economic trends. The updated law seeks to identify and address barriers that discourage investment in high-tech industries, while also tackling issues faced by both domestic and foreign businesses operating in the country. A key goal of the new legislation is to enable the government to

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reevaluate existing regulations, reassess which sectors qualify for Qualified Investment Project (QIP) status, and reform the structure of investment incentives and tax exemptions.

Chapter 6 of the 2021 Law on Investment categorizes investment incentives into three groups: basic, additional, and special incentives. QIPs are granted basic incentives, which include exemptions from tax on income (TOI) or the option of accelerated depreciation. Both types of incentives cover exemptions from minimum tax, prepayment of tax on income (PTOI), export duties, and production-related costs such as customs duties, specific taxes, and value added tax (VAT). Additional incentives go further by offering VAT zero-rating on locally produced inputs, allowing 150 percent deductibility for expenses related to research and development (R&D), human capital development, and welfare initiatives. They also include exemptions from customs duties, specific taxes, and VAT on imported materials used to construct worker facilities.

## II. LITERATURE REVIEW

➢ *An Overview of Foreign Direct Investment in Cambodia*

Since the 1990s, FDI in Cambodia has been heavily concentrated in a few key areas—namely Phnom Penh, Sihanoukville, and Kandal province—which together have accounted for roughly 90% of total FDI. In contrast, only about 5% of investment has been directed toward agriculture in rural regions (Cuyvers et al., 2011; Thoraxy, 2003). The distribution of FDI across sectors has also been imbalanced, with many inflows going into manufacturing, particularly the garment industry. Between 1994 and 2003, Cambodia held a competitive edge in textile exports and tourism when compared to Lao PDR and Myanmar, although it continued to lag, behind Vietnam, other ASEAN countries, and the global market in the garment sector (Cuyvers et al., 2006, 2008).

Several researchers have emphasized the role of Cambodia's strong trade ties and bilateral investment agreements in boosting foreign direct investment (FDI) inflows (Cuyvers et al., 2008, 2011; Soeng et al., 2017). Inward FDI has been linked to higher wages and a rise in formal employment within the manufacturing sector, although women tend to receive lower wages. Interestingly, non-garment industries have shown relatively greater wage increases (Helble & Takeda, 2020). Macroeconomic data from the Cambodian Investment Board suggests that the country's Special Economic Zones (SEZs) may not be fully leveraged to maximize FDI attraction (Tam, 2019). Nevertheless, SEZs have been shown to contribute positively to both FDI inflows and the diversification of Cambodia's economy (Therith, 2022). According to Dang & Nguyen (2021), key market elements such as economic growth, tax burden, and economic freedom have played a crucial role in attracting FDI throughout ASEAN nations. They emphasize the importance of adaptable policies to keep pace with changes in the global economic landscape.

Investment laws and regulations in Cambodia are structured to promote investment through open, non-discriminatory policies, with few restrictions aside from land ownership. According to the study of Thangavelu et al. (2023), reveals that there are no nationality requirements, allowing a Qualified Investment Project (QIP) to take the form of a joint venture between Cambodian entities, between Cambodian and foreign entities, or solely between foreign entities—except in cases involving land ownership, which requires Cambodian partners to hold at least 50% of the shares. Under Articles 2 and 6 of the Amended Law on Investment, investors who obtain a final registration certificate are eligible for a range of generous incentives. These include extended tax on income exemptions as outlined in the Law on Taxation, duty-free import of production equipment, and exemptions from export tariffs, among others.

➢ *Empirical Review*

The country's economy relies on various factors for its stability and growth, such as foreign FDI, inflation, trade, imports, exports, and tax revenue. Attracting FDI is a common priority for nearly all governments. FDI contributes to a nation's economic growth by enhancing its human capital—an essential element in driving research and development. This, in turn, fosters greater innovation and competition, leading to technological advancement and increased productivity. Ultimately, these effects promote overall economic expansion (Grossman & Helpman, 1993). Several factors motivate one country to invest in another, including lower production costs, high-quality outputs, and shorter lead times. According to internationalization theory, a key driver of FDI is the pursuit of economies of scale, which helps lower production expenses (Siddique et al., 2017). Taxation plays a vital role as it finances essential government functions and provides benefits to the country's citizens (Holmes, 1898). As defined by the United Nations Conference on Trade and Development (UNCTAD), tax incentives are measures designed to lessen the tax burden on an entity, thereby encouraging investment in specific projects or sectors. These incentives can include lower tax rates, loss carryforwards, tax holidays, and reduced tariffs (Alegana, 2014). Conversely, tax expenditures represent the revenue the government forgoes through various tax breaks such as deductions, allowances, exemptions, credits, or preferential tax rates (Gruber, 2015).

Glaeser (2001) introduced the Tax Discrimination Theory, which suggests that governments apply varying tax rates depending on the region and type of investment. These tax rates are influenced by the demand for businesses to establish operations in specific areas. To promote development in rural or underdeveloped regions, governments often implement tax discrimination by offering incentives such as tax holidays and reduced tax rates, encouraging investors to move away from major urban centers. Mason (2006) adds that tax discrimination can also occur within the same jurisdiction, where residents and non-residents are subject to different tax rules. Typically, residents are taxed on their worldwide income, while non-residents are only taxed on income earned within the host

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country. Mason (2006) further notes that the European Court of Justice (ECJ) views tax discrimination to enhance economic efficiency and foster integration within the European common market.

Du et al. (2014) analyzed various shifts in China's industrial policies between 1998 and 2007. Firstly, the sole traderships were either restructured or dissolved, phasing out the sole proprietorship model. Secondly, to attract more foreign direct investment (FDI), the corporate tax rate for foreign companies was reduced to 15%, while domestic firms faced a higher rate of 33%. Additionally, after joining the World Trade Organization (WTO) in 2001, China lowered its average tariff rate by 9.4%. These favorable tax policies for foreign investors helped position China as a leading global destination for FDI. Furthermore, Mandinga (2015) using panel data from 22 Small Island Developing States (SIDS) covering the period 2004–2013, found that a 10% increase in the corporate tax rate led to a 3.5% decline in FDI in the short term and a 4.7% decline in the long term. Based on these findings, the study recommended that SIDS reduce their corporate tax rates to attract more FDI. Similarly, Demirhan & Masca, 2008, employing an econometric model on cross-sectional data from 38 less developed countries between 2000 and 2004, identified a significant negative relationship between FDI and both corporate tax and inflation rates. Supporting this, Ang (2008) also concluded that FDI inflows react negatively to increases in corporate tax rates.

Edo et al. (2020) examined the impact of corporate taxation on foreign direct investment (FDI) inflows in Nigeria from 1983 to 2017. Utilizing the Error Correction Model (ECM) for data analysis, the study revealed that approximately 77% of the variations in FDI could be explained by the collective influence of the variables included in the model. The findings showed that company income tax, value added tax, and customs and excise duties had a significant but negative effect on FDI. Conversely, the Tertiary Education Tax exhibited a positive correlation with FDI. Additionally, the Exchange Rate negatively and significantly impacted FDI, while Inflation showed a positive but statistically insignificant effect. On the other hand, both GDP growth and Trade Openness had a significant and positive relationship with FDI. These results differ from previous studies by highlighting the positive role of Education Tax in attracting FDI and by uncovering new insights into how non-tax factors influence FDI inflows.

Boly et al. (2019) conducted an empirical study to evaluate the effect of corporate income tax on foreign direct investment (FDI) inflows in Africa. Using a dynamic spatial Durbin model with fixed effects, the analysis showed that reductions in overall corporate income tax revenue led to increased FDI inflows both within the host country and its neighboring nations, in both the short and long term. These outcomes remained consistent even when alternative spatial weighting matrices were used, and additional control variables were incorporated into the baseline model. Furthermore, the study identified strategic complementarities in FDI inflows among the countries in the sample, indicating that a rise in FDI in one nation tends to encourage increased FDI inflows in surrounding countries.

Ugwu (2018) examined the role of tax incentives in attracting foreign direct investment (FDI) to Nigeria, Ghana, and South Africa, as well as the impact of FDI on these countries' exports following the adoption of International Financial Reporting Standards (IFRS) over the period 1999–2015. Using secondary data analyzed through descriptive and inferential statistics, the study found a positive relationship between tax incentives and FDI inflows. However, FDI was not shown to have a significant impact on exports in any of the three countries. Additionally, there was no notable difference in the effect of FDI on exports before and after the adoption of IFRS. The findings suggest that lowering corporate tax rates and increasing tax incentives help boost FDI inflows, and once a substantial level of FDI is reached, its influence on exports may become more pronounced.

Kiburi et al. (2017) investigated the link between tax burden and FDI inflows. The study considered various elements of taxation—such as the tax system, types of taxes, rates, base, and structure—as factors influencing overall tax revenue the tax burden. In this context, the tax burden was assessed both independently and through its components. The literature reviewed revealed two main perspectives on the relationship between tax burden and FDI: one indicating a negative correlation, and the other showing no significant relationship. However, these outcomes were largely influenced by the specific tax components examined and the particular country or economic region involved. The findings highlighted the absence of a global consensus on how tax burden impacts FDI inflows, suggesting that the tax competition theory, which argues for an inverse relationship between tax burden and FDI, may not hold true in all contexts.

➢ *Hypotheses and Research Framework*

- H1: Tax on income (TOI) has significant influence on foreign direct investment (FDI)
- H2: Value added tax (VAT) has significant influence on foreign direct investment (FDI)

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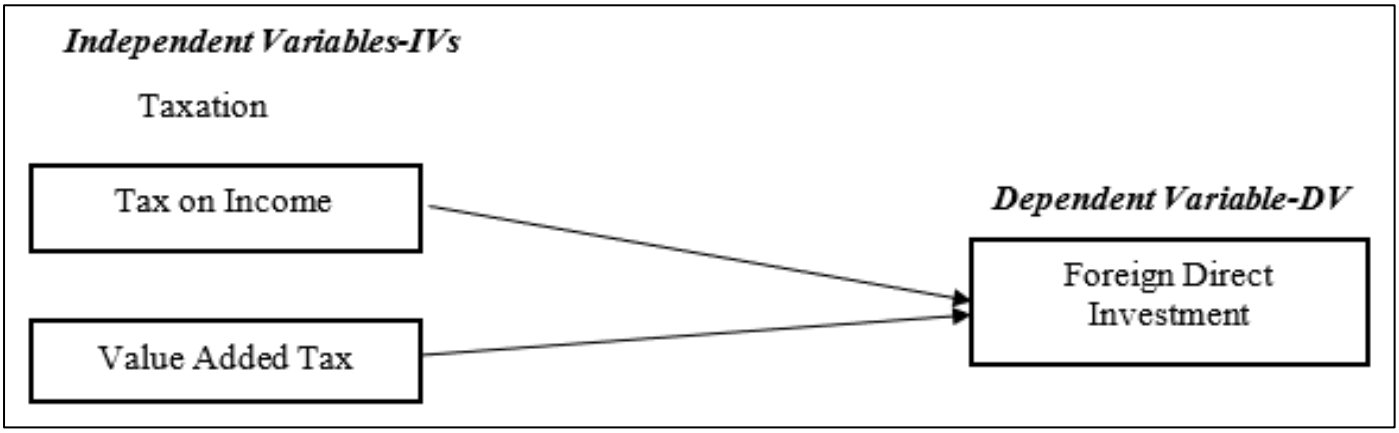


Fig 1 Research Framework

## III. RESEARCH METHODOLOGY

Bringula et al. (2017) employed a descriptive survey research design in their study. For the current analysis, data on FDI, TOI, and VAT were gathered from the Ministry of Economy and Finance and the National Bank of Cambodia for the period spanning 2018 to 2023. As noted by Dahami (2024) and Wooditch et al. (2021), the Ordinary Least Squares (OLS) method is a core statistical approach used to estimate linear regression models by minimizing the squared differences between actual and predicted values. According to Aiken et al. (2012), multiple regression analysis (MR), a highly flexible system for examining the relationship of a collection of independent variables (predictors) to a single dependent variable (criterion).

This method is effective in identifying the relationship between dependent and independent variables and is commonly used in both statistical analysis and machine learning to develop predictive models. Additionally, Mallik et al. (2011) stated that a p-value less than 0.05 ($p < 0.05$) signifies a statistically significant deviation from the baseline regression model, indicating the existence of a threshold. On the other hand, a p-value greater than 0.05 ($p > 0.05$) implies a lack of sufficient evidence to confirm such a threshold, suggesting that the regression model does not significantly differ from the baseline in that region. To analyze the data, Pearson's product-moment correlation was applied (Sekaran & Bougie, 2016). Furthermore, Frost (2021) noted that a p-value above 0.05 suggests the correlation is not statistically significant, meaning there is inadequate evidence of a linear relationship between the variables, as assessed using SPSS version 26.

The empirical model adopted for this study was based on the study of (Asih, 2020; Gao & Liu, 2021; Silva et al., 2024) as specified below.

$$FDI = \beta_0 + \beta_1 CIT + \beta_2 VAT + \beta_3 GDP + \beta_4 Trade + \mu \ldots \text{Equ 1}$$

Where,

FDI = Foreign Direct Investment
CIT = Company Income Tax
VAT = Value Added Tax
GDP = Gross Domestic Product

Trade

$\mu$ = Error Term

Consequently, the augmented structural model is below:

$$FDI = \beta_0 + \beta_1 TOI + \beta_2 VAT + \mu \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{Equ 2}$$

Where,

FDI = Foreign Direct Investment
TOI = Tax on Income
VAT = Value Added Tax
$\beta_0$ = Constant (intercept)
$\beta_1$, $\beta_2$ = Regression Coefficients
$\mu$ = Error Term

## IV. DATA ANALYSIS AND FINDINGS

Table 1 shows that 2018 and 2019 experienced double-digit YoY growth (11.8% and 13.5%, respectively), culminating in the highest annual FDI inflow in 2019 at KHR 16.4 trillion. However, in 2020, YoY growth declined sharply to 7.8%, with FDI inflows dropping to KHR 10.8 trillion—the lowest in the seven-year period—primarily due to the global disruptions caused by the COVID-19 pandemic. Following this downturn, there was a strong rebound in 2021, with a 12% increase and the highest post-pandemic inflow of KHR 17.9 trillion. Despite this recovery, growth slowed once more in 2022 and 2023, indicating a trend toward post-crisis normalization and highlighting possible structural constraints that may be limiting the sustainability of high FDI momentum.

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Table 1: Cumulative Foreign Direct Investment

| Years | Cumulative Foreign Direct Investment (Tril-KHR) | Year-on-Year % | Annual Foreign Direct Investment (Tril-KHR) |
|---|---|---|---|
| 2018 | 121.9 | 11.80 | 12.9 |
| 2019 | 138.3 | 13.50 | 16.4 |
| 2020 | 149.1 | 7.80 | 10.8 |
| 2021 | 167.0 | 12.00 | 17.9 |
| 2022 | 183.3 | 9.70 | 16.3 |
| 2023 | 197.8 | 7.90 | 14.5 |

(Source: National Bank of Cambodia)

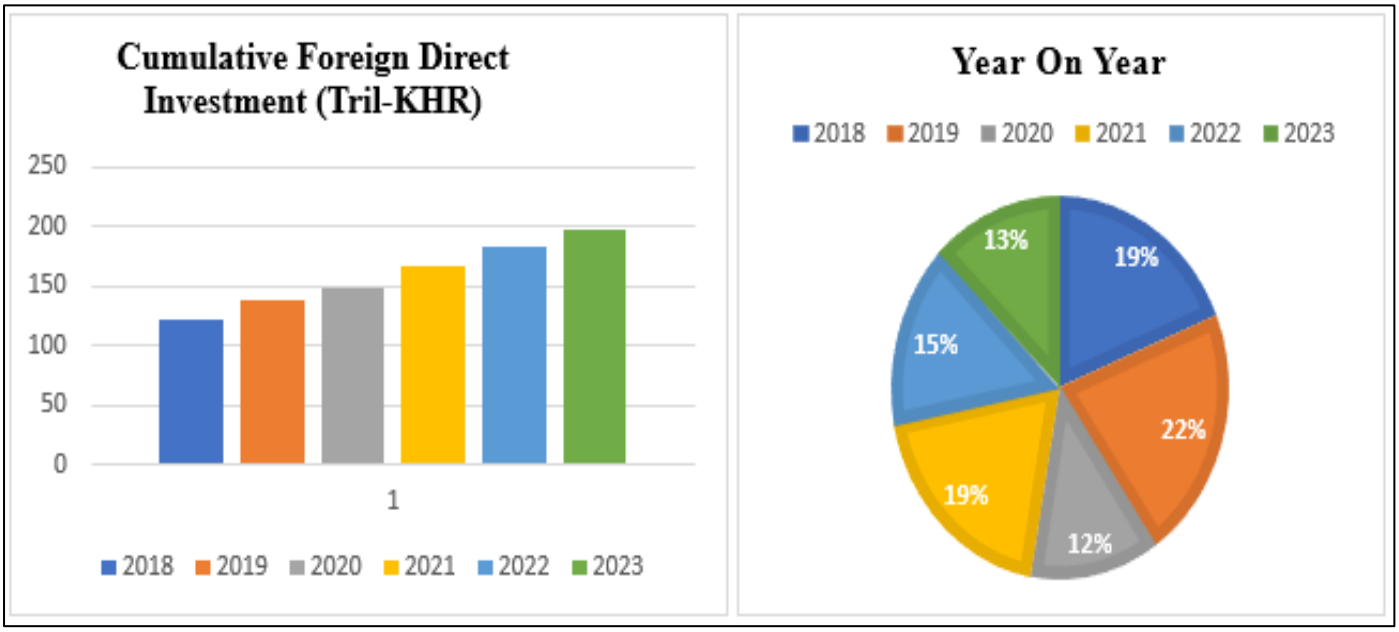


Fig 2 Cumulative Foreign Direct Investment

According to Table 2 below, the analysis of Cambodia's macro-fiscal indicators from 2018 to 2023 reveals a nuanced economic landscape shaped by both external shocks and internal policy adjustments. While FDI exhibited considerable volatility rising sharply prior to 2020, collapsing during the pandemic year, and recovering variably thereafter its fluctuations did not translate directly into equivalent shifts in tax revenue. This decoupling highlights a potentially maturing fiscal system less dependent on foreign capital flows.

In contrast, Tax on income (TOI) showed a robust and uninterrupted upward trajectory, more than doubling over the period. This sustained growth, even amid FDI contractions and pandemic-related disruptions, suggests significant improvements in tax policy enforcement, corporate compliance, and possibly the formalization of previously informal economic activities. as indicated in table 2 below.

Value added tax (VAT) followed a somewhat less linear path, reflecting sensitivity to consumption patterns and macroeconomic conditions. The VAT decline in 2020 and 2021 underscores reduced consumer demand during and immediately after the pandemic. Nevertheless, the strong rebound in 2022 and 2023 points to a revitalization of domestic consumption and successful reactivation of the demand side of the economy informal economic activities, as indicated in table 2 below.

Table 2 Annual Foreign Direct Investment, Tax on Income and Value Added Tax

| Years | Annual FDI (Tril-KHR) | Tax on Income (Tril-KHR) | Value Added Tax (Tril-KHR) |
|---|---|---|---|
| 2018 | 12.9 | 3.192 | 5.728 |
| 2019 | 16.4 | 4.055 | 7.409 |
| 2020 | 10.8 | 4.738 | 6.529 |
| 2021 | 17.9 | 4.879 | 5.997 |
| 2022 | 16.3 | 6.080 | 7.304 |
| 2023 | 14.5 | 6.450 | 7.521 |

(Source: National Bank of Cambodia and Ministry of Economy and Finance of Cambodia)

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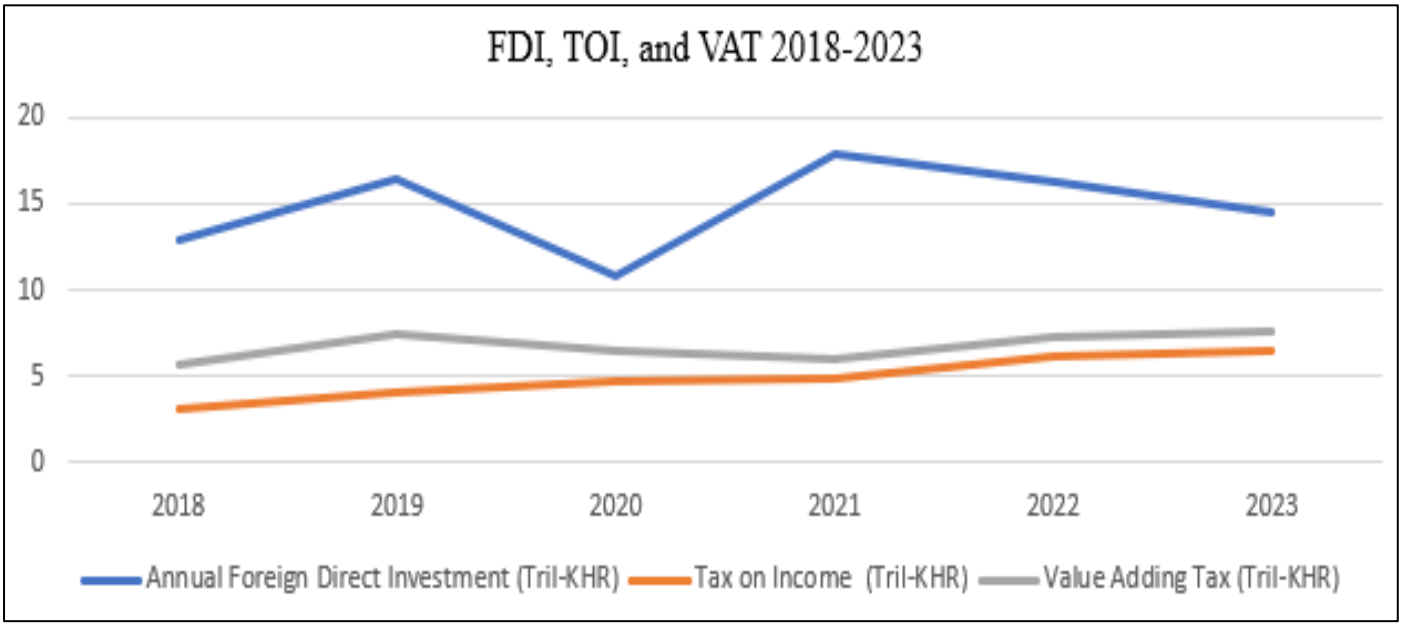


Fig 3 FDI, TOI, and VAT 2018-2023

*A. Hypotheses Tested*

➢ *Descriptive Statistics*

Table 3 reveals the descriptive statistics Tax on Income (TOI) and Value Added Tax (VAT) on Foreign Direct Investment (FDI), using data across six observations. Descriptive statistics indicated a moderate level of variability in FDI (Mean = 14.80, SD = 2.61) and TOI (Mean = 4.899, SD = 1.22), with VAT exhibiting relatively lower variation (Mean = 6.748, SD = 0.774).

Table 3 Summary of Descriptive Analysis

| | N | Min | Max | Mean | SD |
|---|---|---|---|---|---|
| **FDI** | 6 | 10.80 | 17.90 | 14.8000 | 2.61228 |
| **TOI** | 6 | 3.192 | 6.450 | 4.89900 | 1.220890 |
| **VAT** | 6 | 5.73 | 7.52 | 6.7480 | 0.77407 |
| **Total** | **6** | | | | |

FDI : Foreign Direct Investment, TOI : Tax on Incomr, VAT : Value Added Tax

➢ *Correlation Analysis*

Table 4 reveals the Pearson correlation analysis revealed weak positive relationships between tax on income and foreign direct investment (r = 0.237), as well as between value added tax and foreign direct investment (r = 0.212). However, both correlations were not statistically significant, with p-values exceeding the conventional 0.05 threshold (p = 0.651 > 0.05 and p = 0.686 > 0.05, respectively). Therefore, the data do not support the hypotheses that tax on income (Hypothesis 1) and value added tax (Hypothesis 2) have significant effects on foreign direct investment. This is in line with the findings of Silva et al. (2024).

➢ *Pearson Correlation Analysis*

Table 4 Pearson Correlation Matrix for Foreign Direct Investment (FDI), Tax on Income (TOI), and Value Added Tax (VAT)

| | | FDI | TOI | VAT |
|---|---|---|---|---|
| **FDI** | Pearson Correlation | 1 | | |
| | Sig. (2-tailed) | | | |
| | N | 6 | | |
| **TOI** | Pearson Correlation | 0.237 | 1 | |
| | Sig. (2-tailed) | 0.651 | | |
| | N | 6 | 6 | |
| **VAT** | Pearson Correlation | 0.212 | 0.654 | 1 |
| | Sig. (2-tailed) | 0.686 | 0.159 | |
| | N | 6 | 6 | 6 |

**. Correlation is significant at the 0.01 level (2-tailed).

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➢ *Multiple Linear Regression*

Table 5 Multiple Linear Regression Results on the Effect of Tax on Income (TOI), and Value Added Tax (VAT) on Foreign Direct Investment (FDI)

| Variables | Unstandardized Coefficient (B) | Standard Error | t-value | Sig. |
|---|---|---|---|---|
| Constant | 10.724 | 13.211 | 0.812 | 0.476 |
| TOI | 0.368 | 1.581 | 0.232 | 0.831 |
| VAT | 0.337 | 2.494 | 0.135 | 0.901 |
| | | | | |
| R = 0.249 | | | | |
| R Square = 0.062 | | | | |
| Adjust R Square = - 0.563 | | | | |
| F = 0.099 | | | | |

The results are summarized in Table 5 above, The F-test statistic for the model was F (2,3) = 0.099 with a p-value well above 0.05 (not provided explicitly but implied), indicating that the overall regression model is not statistically significant. This implies that TOI and VAT, taken together, do not significantly predict FDI.

- Tax on Income (TOI): The unstandardized coefficient (B) was 0.368 with a standard error of 1.581. The corresponding t-value was 0.232 and the p-value was 0.831 (> 0.05), indicating that TOI does not significantly predict FDI when controlling for VAT.

- Value Added Tax (VAT): The unstandardized coefficient (B) was 0.337 with a standard error of 2.494. The t-value was 0.135 and the p-value was 0.901 (> 0.05), demonstrating that VAT also does not significantly predict FDI when controlling for TOI.

Given the non-significant regression coefficients and overall model, the data provide no statistical support for *Hypothesis 1* and *Hypothesis 2*. Specifically, the results indicate that neither tax on income nor value added tax has a significant effect on foreign direct investment within the sample studied. This is in line with the findings of Silva et al. (2024) and Kiburi et al. (2017).

Therefore, the regression model suggests no significant predictive effect of TOI or VAT on FDI, and the model overall is weak ($R^2 = 0.062$), explaining just 6.2% of FDI variation.

➢ *Regression Equation*

Based on the unstandardized coefficients, the estimated regression equation can be expressed as:

$$FDI = -10.724 + 0.368\ (TOI) + 0.337\ (VAT)$$

This equation can be interpreted as follows: when both TOI and VAT are zero (hypothetically), FDI would be –10.724 units. However, for each additional unit increase in TOI and VAT, FDI increases by 0.368 and 0.337 units, respectively assuming the other variable remains constant, by Gujarati & Porter (2009).

## V. CONCLUSION, LIMITATION OF STUDY, AND FUTURE RESEARCH

This study examined how taxation affects FDI in Cambodia. Descriptive statistics revealed moderate variability in FDI and TOI, with VAT showing lower variation. However, the inferential analysis did not yield statistically significant results. Further, Pearson correlation analysis indicated weak positive but non-significant relationships between both TOI and FDI (r = 0.237, p = 0.651), and VAT and FDI (r = 0.212, p = 0.686). Regression analysis further reinforced these findings, as neither TOI (B = 0.368, p = 0.831) nor VAT (B = 0.337, p = 0.901) significantly predicted FDI. The overall regression model was also not statistically significant (F (2,3) = 0.099, $R^2$ = 0.062), explaining just 6.2% of the variance in FDI. In conclusion, the study finds no significant predictive relationship between taxation variables (TOI and VAT) and foreign direct investment in the sample analyzed.

Despite the robust results, several limitations should be acknowledged small sample size, limited control variable (such as political stability, labor market conditions, infrastructure, and regulatory quality).

While this study focused only on taxation (TOI and VAT) affects FDI in Cambodia, future research could expand on several important areas. First, longitudinal studies that examine how changes in taxation policy over time affect FDI could provide more robust causal insights. Second, incorporating qualitative approaches—such as interviews with foreign investors and policymakers—could enrich understanding of the perceptions and real-world decision-making processes behind FDI responses to taxation.

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