

Impacts of Endogenous Bribes on Foreign Direct Investment*

(Work in Progress)

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Abstract

To examine the effects of corruption on foreign direct investment, we develop a cooperative Nash bargaining game to model the negotiation process between firms and corrupt officials. We first analyze a firm's decision to bribe corrupt officials either to pay smaller settlement fixed costs than legally prescribed ones or to benefit from illegal preferential tax treatment. Then, we examine a firm's performance in a differentiated market with Bertrand competition to determine how a foreign firm's decision of going multinational depends on the intensity of corruption in a host country. Finally, we investigate how alternative anti-corruption policies may have different impacts on attracting or discouraging foreign direct investment.

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