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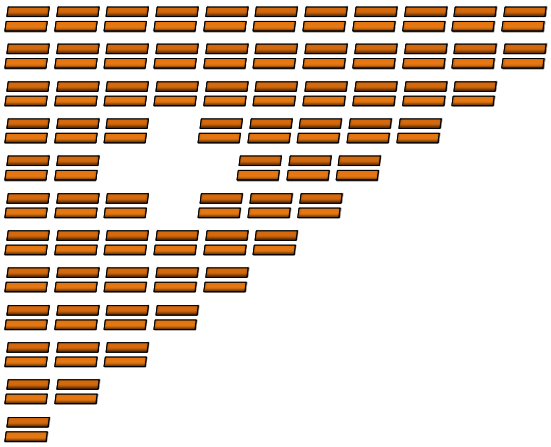
KVL Economic Policy Research

August 2022



Testing the knowledge-capital model of foreign direct investment: New evidence

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August 2022

KVL Discussion Paper

No. 2022-04

KVL Economic Policy Research

Colophon

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Abstract:

The knowledge-capital (KC) model of FDI explains the international distribution of FDI, assuming that firms own proprietary knowledge assets that can at low costs also be exploited in foreign subsidiaries. The model's implication is that countries with much outward FDI should have a relative abundance of proprietary knowledge assets, which has up to now not been adequately tested, partly due to a lack of data. This paper extends the KC model by a module that formalises the encapsulation of public national knowledge assets into proprietary firm-level assets. It provides a way to test the basic tenet of the KC model. We exploit a new dataset (80 indicators, 209 countries, period 2000-2020) to identify the impact and statistical significance of national knowledge assets for explaining outward FDI. Our test confirms the validity of the KC model for explaining patterns of outward FDI. Several robustness tests confirm the stability of our findings.

Keywords: foreign direct investment, national knowledge-capital, empirical testing, world-wide

JEL codes: D25, E22, F21, O34

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1. Introduction

This paper subjects the knowledge-capital model of foreign direct investment (FDI) to an empirical test. For firms, knowledge capital is a catch phrase for firm-specific proprietary know-how, including intangible assets like patents, in-house skills, blueprints, procedures, reputations and trademarks.[1] Sometimes, these knowledge-capital assets may be separated from the original location and be applied –on a non-rival basis– in foreign subsidiaries, thus increasing the returns to such assets. In a nutshell, this is the knowledge-capital interpretation of FDI. However, this basic assumption about separable knowledge assets as the basis for outward FDI have hardly been tested so far. We provide a new way to test this assumption and apply it to over 200 countries covering the period 2000-2020.

Does the abundance of separable knowledge assets in firm headquarters indeed forms a key driver for investing in foreign subsidiaries, as proposed in Markusen (2002: 17-19, 133). Testing for this requires an unambiguous measure for the abundance of separable knowledge assets. Using firm-level data is difficult, due to the lack of reliable and internationally comparable data on intangible knowledge assets of firms. This may be due to strategic secrecy, country-specific factors, and the inherently tacit nature of some knowledge-capital elements.[2] Measuring the intangible assets of firms could be done via the difference between market value and historic cost (cf. Hall, 2000; Corrado *et al.*, 2009). However, this procedure is problematic in the case of FDI, because data on market values of foreign subsidiaries and their parents are not separately available, not even for the USA (McGrattan and Prescott, 2010). Moreover, if the intangible assets can be used both at home and in the foreign subsidiaries, the risk of double counting is large when using market values.

Several empirical tests of the knowledge-capital model have restricted themselves to a very narrowed-down empirical measure for intangible knowledge assets, namely the skill-related wage differences between countries.[3] The discussion in the literature on this proposal has shown that this was not a lucky choice. Firstly, the difference in skilled labour costs between the origin and host country may give biased results, when national averages are used. Micro-econometric studies with firm-level data have shown that multinational firms often pay premium wages above the national averages.[4] Secondly, and more disturbing, is the fact that wage differences form a separate motive for FDI decisions, quite apart from intangible knowledge assets.[5] Wage differences are particularly important in relation to some vertical FDI decisions, to global value-chain investments, and to

[1] Cf. Markusen (2002, 2001); Carr *et al.* (2001); Markusen and Maskus (2003) .
[2] Cf. Morck and Yeung, 1991; Ali and Hwang, 2000; Foster *et al.*, 2012; Chan and Cheung, 2022.
[3] Cf. Carr *et al.*, 2001; Blonigen *et al.*, 2002; Braconnier *et al.*, 2005; Tanaka, 2007; Mariel *et al.*, 2009; Chellaraj and Mattoo, 2009; Kristjansdottir, 2010.
[4] Cf. Aitken *et al.*, 1996; Bernard *et al.* 2008; Wagner, 2012; Kox and Rojas, 2010; Egger and Kreickemeier, 2013; Tanaka, 2015.
[5] The wage differences apply both to unskilled and skilled labour, as the successful rise of the software production in India and other emerging countries shows (Arora and Gambardella, 2005).

export-platform types of FDI. However, for horizontal FDI transactions between developed countries, which form the bulk of all FDI transactions, such wage differences may be next to irrelevant. Hence, the skill-related wage gap may give biased results and it should be considered as unfit for testing whether separable knowledge assets are an important driver for outward FDI.

McGrattan and Prescott (2009) opt for a more comprehensive interpretation of the knowledge capital of FDI, calling it technology capital ("*unique know-how from investing in research and development, brands, and organization capital*"). But they do not provide an empirical estimate for it. Later, McGrattan and Prescott (2010) show that the available data do not allow a direct test of the model. To show the plausibility of their model they use a numeric model exercise, calibrated on FDI stock data of the USA. McGrattan (2012: 3-4) remarks that "*the main findings of my analysis rely critically on the existence of intangible capital, both technology capital accumulated by multinational parents and plant-specific intangible capital used by their foreign subsidiaries* ". However, she assumes this rather than proving and quantifying it, only using scattered evidence from the USA. Anderson, Larch and Yotov adopt the technology-capital approach of McGrattan and Prescott, but offer no solution to the attached measurement problems: "*Technology transfer in our model can be viewed as a reduced form of a richer model where the details of transfer are linked to equilibrium plant location decisions subject to imperfect property rights. A full treatment is beyond the scope of this paper* " (2019: 2).

The present situation is still that we have the knowledge-capital model of FDI, with an intuitive appeal, but without a thorough empirical test regarding its basic assumption. Our paper provides a completely new strategy for testing this.[6] Given the problems with firm-level data on intangible and separable knowledge assets, we leave the firm-level data for what they are. Instead, we focus on measurable inputs into the firm-level knowledge assets coming from national knowledge or innovation systems (OECD, 1997).[7] Multinationals form part of the national knowledge systems in their countries of origin. At a national level, firms benefit from public and semi-public investments in human capital, science and technology. Firms encapsulate knowledge elements from public and semi-public origin and recombine them with their private know-how. On this basis they create proprietary knowledge assets. The firms may commercially apply these in their home market and, if the knowledge assets are separable, also in foreign countries via FDI. Our proposition is that indicators for public knowledge capital might effectively capture the relative abundance of knowledge assets of a country's multinational firms. If so, these indicators may be used as predictor for the magnitude of a country's outward FDI. This is the line of investigation that we will pursue here.

The paper contributes in several ways to the literature. Firstly, it introduces a supplement to the knowledge-capital model regarding the interaction between public and private knowledge development that may have a value of its own. It helps to derive a number of testable hypotheses on the validity of the knowledge-capital model of FDI. Secondly, we solve an identification problem that has so far encumbered empirical tests of the knowledge-capital model. The problem is that both national knowledge stocks and the volume of outward FDI are intimately linked with the

[6] The paper restricts itself to testing these basic assumptions; it ignores the specificities of different types of FDI (horizontal, vertical, GVC, or export platform) because that would require industry-specific data.
[7] Freeman (1987) defines them as "the network of institutions in the public and private sectors whose activities and interactions initiate, import, modify and diffuse new technologies".

scale of a national economy, thus giving rise to biased international comparisons. We solved this problem by distinguishing between the intensive and the extensive margin of knowledge creation. Indicators for the intensive margin of knowledge creation are 'de-scaled' and provide a measure of knowledge creation per unit of economic activity (e.g. total export, total employment, total GDP). This allows a direct comparison between the performance of individual countries. Conversely, indicators for the extensive margin of knowledge creation are purely scale-based and they measure the impact of a country's economic mass, which tends to drive the results of gravity-based studies. The third contribution is that we provide a data profile of national knowledge-creation systems (both public and private) for over 200 countries and geographical entities for the period 2000-2020. The database includes 80 indicators for the intensive and extensive knowledge-creation margin of countries. The fourth contribution is that, exploiting the international variation among countries, we find a strong pattern of statistically significant rank correlation between outward FDI stocks of countries. This key result supports the basic assumption of the knowledge-capital model of FDI. The fifth contribution is that we provide several robustness checks for our findings, in particular by applying the tests to different country samples. One of them allows to exclude that our results are driven by countries that are intensively involved in tax evasion or tax sheltering. Our results remained standing after removing these countries from the dataset. Finally, we tested whether the knowledge-capital also applies to inward FDI; the model implicitly assumes that it does not.[8] We find convincing statistical evidence that a country's knowledge indicators almost always correlate stronger with outward FDI than with inward FDI.

The paper has the following structure. Section 2 presents a background model for formalising the relations between national knowledge systems and FDI, and for deriving derive testable hypotheses that would be in line with the Markusen approach. Section 3 deals with the setup of the empirical test and the data issues. It also provides some descriptives. Section 4 presents the main empirical results of the rank correlation analysis. Section 5 checks the robustness of the findings by redoing the analysis with alternative country samples. Because FDI patterns might also be driven by tax motives,[9] we remove countries that offer tax-sheltering or tax-evasion facilities. Secondly, we remove the (mostly small) countries that did not have traceable outward FDI in all years of the observation period (2000-2020). Section 6 investigates the question whether the knowledge-capital also applies to inward FDI. Section 7 wraps up the main findings and their implications. The annexes provide detailed results and descriptives on the FDI stocks data and the knowledge-system indicators that were used in the paper.

2. Interaction of FDI and national knowledge systems

This section provides a formal framework for analysing the interaction between the national knowledge 'systems' and the firms' proprietary knowledge assets. The latter form the heart of Markusen's knowledge capital model.[10] His firms command a unique stock of proprietary technology capital (patents, blueprints, management skills, product recipes, and tacit production knowledge). This requires fixed-cost investments by its headquarters, but once created, the knowledge may also be applied in foreign subsidiaries. Markusen (2002:19) fails to appreciate that closeness to national sources of public knowledge production forms a key location advantage for

[8] Cf. Markusen (2002: Ch.7); Kose *et al.*, 2009.
[9] Cf. UNCTAD, 2022; Beer *et al.*, 2020; Keen *et al.*, 2022; Damgaard *et al.*, 2019..
[10] Cf. Markusen, 2002: XV: "*My focus [..] is to incorporate the multinational firm into the general-equilibrium theory of international trade. This requires me to assume simple technologies and models of the firm itself*"

firms with international ambitions. This blind spot is ripe for a reappraisal. Not only that: its correction also provides the possibility to test the basic assumptions of the knowledge-capital model, as we will show.

A fast-rising volume of literature focusses on the knowledge interaction between individual firms and their environment. It shows that the competitive edge of individual firms at least partly rests on the knowledge products from public sector, especially the basic science research that it initiates and finances.[11] The public and semi-public sector includes universities, specialised scientific, technical and creative institutes, think-tanks, government bodies, education system, and public frameworks for knowledge transfer. The public knowledge system can be seen as a process with an input side, a throughput and processing phase where efficiency, focusing, and creativity incentives matter, and an output side where knowledge products and technologies pop out. Countries can differ a lot in these aspects. The public knowledge system forms an important source of free knowledge externalities, by generating and disseminating innovations and discoveries via publications, congresses, staff mobility, intermediary supplier networks, and education-related activities.[12] The commercial exploitation of public-held patents is still a rare phenomenon.[13] Often, such patents are before expiration given away to national firms, or are sold via auctions.[14] Hence, the public knowledge sector tends to be generous with its products. Effectively, this means that most knowledge products from the public and semi-public sector can be characterised as non-proprietary and outside the market domain. By contrast, firms work almost exclusively on the basis of proprietary knowledge capital. After absorbing free knowledge produced by the public and semi-public sector, firms recombine and encapsulate these input elements with firm-specific knowledge, thus creating marketable products, technologies, brands, and even new business models. The firm can use their proprietary knowledge assets simultaneously in more than one country, at relatively low costs and without negative impacts on domestic production.

M_{it} is the currently *active* knowledge-capital stock of country i at time t. It is a cumulative product of current and past innovation and knowledge development. "Active" means that knowledge from the past forms a perishable 'good', requiring constant refreshment, (re-)education, reappropriation, (re-) transfer, documentation and dissemination actions by the current generation, otherwise it decays and becomes dead knowledge.[15]

The interactions between FDI and the public knowledge-generation system in a country are complex and manifold. We develop a toy model that, although sketchy, may assist in formulating testable hypotheses regarding the knowledge-capital model of FDI. The model zooms in on the interaction between FDI and national knowledge systems. Knowledge has no self-evident dimension of measurement; it is complex and multi-dimensional. We perceive the knowledge (re-) production process as an economic input-output system, counting the material efforts used in that process. We assume that a national economy has just two sectors, the public sector (suffix p) and the firm sector (suffix f). The public sector produces all public, non-proprietary knowledge, while the firm sector accounts for all proprietary or private knowledge. For simplicity, we assume that all

[11] Cf. Sheer, 2022; Arora *et al.*, 2021; Fagerberg *et al.*, 2012.
[12] Cf. van Elk *et al.*, 2019; Gerbin and Drnovsek, 2016; Audretsch and Stephan, 1996, 1999; Arundel *et al.*, 2013; Breschi and Catalini, 2010; Toole and Czarnitzki, 2010; Verhoogen, 2021; Keller, 2004.
[13] Cf. Agrawal and Henderson, 2002; Calderini *et al.*, 2007; Perkmann *et al.*, 2013.
[14] Cf. Mazzucato, 2014; Arundel *et al.*, 2013; Escalona Reynoso, 2010; Maskus and Reichman, 2004; Boyle, 2003a, 2003b; Carlsson and Fridh, 2002; Henderson *et al.*, 1998.
[15] Many historic examples can be found for this. On lost knowledge, cf. Debenham, 2002; Liu and Kuan, 2016.

foreign knowledge assets are acquired by the public knowledge sector. The production process in the public knowledge sector is described in Table 1.

The parameters β_{it}, φ_{it} and ψ_{jit} all deal with knowledge-capital growth and upgrading in the current period. $\beta_{it} > 0$ represents the GDP fraction dedicated to domestic knowledge creation (e.g. university research, public R&D, basic research). Parameter φ_{it} depicts public efforts to attract foreign proprietary knowledge assets M_{fRit} through the channel of inward FDI.[16] Similarly, ψ_{jit} represents the input costs of accessing and using foreign non-proprietary knowledge (M_{pRit}). A very important part of the knowledge system is formed by all activities that are focussed on keeping 'old' knowledge assets active through education, knowledge transfer, documentation, idea

Table 1 The production process of the public knowledge sector in country i

Sub-processes	Input resources, expressed as fraction of GDP (Y_{it})	Through-put effi-ciency	Output aggregates
creation new domestic knowledge	β_{it}	v_{it}	M_{piit} (new-created public knowledge)
obtaining foreign (R) proprietary knowledge	φ_{it}	v_{it}	M_{fRit} (new-acquired foreign proprietary knowledge)
obtaining foreign (R) public knowledge	ψ_{it}	v_{it}	M_{pRit} (new-acquired foreign public knowledge)
re-activation earlier obtained old knowledge	ε_{it}	v_{it}	M_{io} (re-activated old knowledge)
All public effort	$\beta_{it} + \varphi_{it} + \psi_{it} + \varepsilon_{it}$	v_{it}	$M_{pit} = M_{piit} + M_{fRit} + M_{pRit} + M_{io}$

diffusion and dissemination activities.[17] This effort is represented by GDP fraction $\varepsilon_{it} > 0$. M_{io} represents country *i*'s knowledge capital stock that is built up before the current period *t*. It represents the path-dependent historical continuity in a country's national knowledge system.[18] The older knowledge assets are subject to a depreciation rate δ_{it}. A higher depreciation rate can be regarded as a form of creative destruction; it reduces the weight of older knowledge stocks, contributing to rejuvenation of public knowledge stocks.

The final row of Table 1 gives the aggregated public knowledge-producing inputs into the knowledge system and their joint results in the form of M_{pit}. In between both, is a factor $v_{it} > 0$ that is called national throughput efficiency. It is assumed to be identical for all sub-processes of a national knowledge system. It measures the efficiency with which financial inputs are converted into knowledge outputs, which may for instance depend on available knowledge-absorption capabilities, creativity incentives, legal and institutional framework, labour productivity, connectivity, and the national efficiency.

[16] Cf. Vujanovic *et al.*, 2022; Lu *et al.*, 2017.
[17] The parameters φ_{it} and ψ_{jt} deal with international diffusion. Benhabib *et al.* (2021) elaborate on the aspect of knowledge diffusion. Like in Benhabib *et al.* (2021) we do not require a fixed international knowledge frontier. Instead, the frontier is constantly moving; national frontiers may even collapse due to shocks in Y_{it} , ε_{it} or β_{it}.
[18] M_{io} is important for knowledge diffusion; it may reach all domestic firms that operate below the productivity and innovation frontiers, thus narrowing the gaps in domestic productivity and knowledge-capital distributions.

So far for the public knowledge sector. The production function of firm-owned proprietary knowledge assets is described in Table 2. Country *i* has s ∈ $1,..,S$ firms that differ by organisational creativity, productivity, and management capabilities, embodied in fixed effect $z_s > 0$. Firms in country *i* are subject to the same national throughput efficiency v_{it}, but at firm level this is mitigated by their z_s factor.[19] Hence the firm-level throughput factor becomes $z_s.v_{it}$.

The parameters $(a_{ist}, \omega_{ist}, \varepsilon_{ist})$ are firm-specific and strictly positive; they depict the inputs into the sub-processes of the firm's knowledge-related activities. The first two parameters describe inputs into the creation of new proprietary knowledge assets. Parameter a_{ist} captures firm-level R&D, and the development of new product varieties, marketing concepts or business models. Parameter ω_{ist} deals with the absorption of recent knowledge developments from the public sector;[20] it may include networking activity, setting up learning projects, or the hiring of specialists to master new knowledge areas. G_{iso} summarises older proprietary knowledge stocks of a firm. These older intangible assets are subject to depreciation rate δ_{ist} and a phasing-out process after *N* years. Parameter ε_{ist} in Table 2 is comparable to ε_{it} activities in the public sector; at firm level it may include activities such as in-company training of new employees, documenting of procedures and business models in the form of protocols, performance standards, and refreshment courses.

Table 2 Production of proprietary knowledge by firms in country i

Sub-processes	Input resources, as fraction of GDP (Y_t)	Through-put effi-ciency	Output aggregates
internal creation of new knowledge assets	a_{ist}	$z_s.v_{it}$	G_{siit} (internal, newly-created private knowledge)
absorbing of public knowledge inputs	ω_{ist}	$z_s.v_{it}$	$G_{spit} = f(\omega_{ist}M_{pi,t-1})$ (newly encapsul-ated domestic public knowledge inputs)
re-activation of 'old' private knowledge	ε_{ist}	$z_s.v_{it}$	G_{iso} (re-activated 'old' private knowledge)
aggregate effort of firms	$\sum_s \alpha_{ist} + \omega_{ist} + \varepsilon_{ist}$	$z_s.v_{it}$	$G_{fit} = \sum_s G_{siit} + G_{spit} + G_{iso} = \sum_s G_{sit}$

G_{siit} is proprietary new knowledge that results from the firm's own activities (R&D, design, in-house specialists, process or product expertise). G_{spit} is the firm-level result from encapsulating knowledge products from domestic public sources. G_{iso} summarises older proprietary knowledge stocks of a firm.[21] The parameters $(a_{ist}, \omega_{ist}, \varepsilon_{ist})$ are firm-specific and strictly positive; they depict the inputs into the sub-processes of the firm's knowledge-related activities. The first two parameters describe inputs into the creation of new proprietary knowledge assets. Parameter a_{ist} captures firm-level R&D, and the development of new product varieties, marketing concepts or business models. Parameter ω_{ist} deals with the absorption of recent knowledge developments from the public sector; it may include networking activity, setting up learning projects, studying

[19] A typical result from micro studies at firm level is that firms with multinational activities have a higher productivity than most exporting firms, and substantially higher than firms that operate solely on their national market. Cf. Wagner, 2012; Kox and Rojas, 2010; Bernard *et al.*, 2007, 2013; Helpman *et al.*, 2004.

[20] Note that firms use not the very latest public knowledge, but a recent knowledge consort as input.

[21] It is plausible that firms use not the very latest public knowledge, but a recent knowledge stock as input.

registered patents or the hiring of specialists to master new knowledge areas.[22] Older intangible firm assets are subject to a firm-specific depreciation rate δ_{ist}. They are fully discarded after N years. Parameter ε_{ist} in Table 2 is comparable to ε_{it} activities in the public sector; at firm level it may include activities such as in-company training of new employees, documenting of procedures and business models in the form of protocols, performance standards, and refreshment courses.

G_{fit} represents the aggregate active proprietary knowledge of all firms in country *i* at time *t*. It can be expressed as a function of the throughput efficiency and real input costs. Following Markusen (2002), it is assumed that the inputs of G_{fit} mainly consist of fixed-cost items with an investment nature. National knowledge stocks consist of public and proprietary elements and may now be defined as:

$$M_{it} \equiv G_{fit} + M_{pit} \tag{1}$$

Both G_{fit} and M_{pit} are decomposable. Tables 1 and 2 describe the components of the right-hand-side variables. Each of them contains a lagged component (M_{io}, G_{iso}) stemming from years before time *t*. M_{io} defines the path-dependent component of a country's public knowledge capital, while G_{io} stands for proprietary knowledge assets of firms that were created in earlier periods. Both variables have a vintage structure, to which each year a new knowledge 'cohort' is added while older 'cohorts' are depreciated and eventually discarded.[23] The vintage structure creates a historical inertness of a country's knowledge stocks with respect to real-time GDP changes. Time dynamics of knowledge stocks can be complicated due to the time variance of GDP and behavioural parameters (specified in Tables 1 and 2). We may however take out the time variance of the behavioural parameters to clarify the time dynamics.

Proposition 1 *If behavioural parameters are time invariant, the development of public knowledge stocks (M_{pit}) has the following dynamics:*[24]

$$M_{pit} = v_i\,(\beta_i + \varphi_i + \psi_i)\;A_i\;Y_{it} \tag{2}$$

in which X_Y is a chain index that describes scale changes over time (GDP) and A_i is a factor that abbreviates the amortisation and re-activation efforts for older vintages of knowledge assets in country *i*'s public sector: $A_i \equiv \{1 + \varepsilon_i\,(1 - \delta_i)\,X_{Yt}\}$.

The time pattern for the development of proprietary knowledge stocks of firms (G_{fit}) is slightly more complicated. The sub-process G_{spit} has our main attention, namely the firm's absorbing of public knowledge inputs. This sub-process adds an additional time lag to the dynamic cycle.

Proposition 2 *If behavioural parameters are time invariant, the development of proprietary knowledge stocks of firms (G_{fit}) has the following dynamics:*

$$G_{fit} = v_i\,Y_{it}\,\textstyle\sum_s\, z_s\,A_{is}\big[\,\alpha_{is} + \omega_{is}\,v_i\,(\beta_i + \varphi_i + \psi_i)\,A_i\,Y_{i,t-1}\big] \tag{3}$$

[22] Cf. Atkin *et al*. 2022; Alcacer and Gittelman, 2006.

[23] Annual cohorts of country *i* 's stock of older knowledge capital can be consistently aggregated by a CES aggregator, as proposed by Benhabib (2019): $M_{io} = [\,a_1\,M_{i,t-1}^{1-\sigma} + a_2\,M_{i,t-2}^{1-\sigma} + \ldots + a_{N-1}\,M_{i,t-(N-1)}^{1-\sigma}]^{\,(1/1-\sigma)}$ in which $\sigma > 1$ is the elasticity of substitution and $a_1 \ldots a_n$ represent the size shares of the annual knowledge stock cohorts, which sum to one. The aggregator for G_{io} can be treated analogously.

[24] The proof is given in Annex II.

The term A_{is} abbreviates the amortisation and re-activation for older proprietary knowledge cohorts at the level of firms: $A_{is} \equiv \{1 + \varepsilon_{is}\ (1 - \delta_{is})\ X_{Yt}\}$. The proof is given in Annex II. Proposition 2 formalises the crux of our extension to Markusen's knowledge-capital model of FDI, i.e. how proprietary knowledge assets of firms form a joint product of the firms' interaction with the public sector in their origin country.

Firms exploit their proprietary knowledge assets (G_{sit}) in the domestic market. But, if this increases their expected profits (ΔR^*_{is}), they also use it abroad via outward FDI. If the profit condition is satisfied, the firm's willingness to supply its proprietary knowledge assets to foreign subsidiaries is almost unbounded. From this conjecture we derive a simple function for outward bilateral FDI stocks supply (from country *i* to country *j*):

$$FDI^{outw}_{ijt} = \begin{cases} q_{ij}\ (G_{fit})^h & if\ \sum_s \Delta R_{ijst} \geq 0 \\ 0 & otherwise \end{cases} \qquad \forall\ i,j,s \qquad (4)$$

with q_{ij} as a constant for each country pair that accounts for factors like language, culture, or remoteness, while h is a general reaction parameter holding for all countries. All time-variant bilateral factors like taxes, subsidies, regulations, and country size influence bilateral FDI decisions through their (expected) effects on ΔR_{ijs}. In line with the IMF definition, foreign direct investment are those situations in which the firm uses its G_{sit} for setting up equity-controlled foreign production ('having a controlling interest'). Cumulative bilateral FDI stocks form the summation of all firm-level FDI stocks.

Given the firms' own assessment of the foreign market potential of G_{sit}, the expected profit change depend on bilateral FDI barriers, on the fixed setup costs for a foreign subsidiary, on the value of any investment facilities offered by the host country, and on possible effects for own export sales after setting up the foreign subsidiary. The model's reduced-form equation for outward FDI stocks in case of positive foreign profits can be derived as:

$$FDI^{outw}_{ijt} = q_{ij}\ {G_{fit}}^h = q_{ij} \left\{ v_i Y_{it} \sum\nolimits_{s=1}^{S} z_s\ A_{is} \left[\alpha_{is} + \omega_{is}\ v_i\ (\beta_i + \varphi_i + \psi_i)\ A_i\ Y_{i,t-1} \right] \right\}^h \qquad (5)$$

This specification offers all elements that are important for our test of the knowledge-capital model. A general zero hypothesis is that h has no statistical significance or has a negative sign. If the general zero hypothesis is rejected, a lot more specific tests become feasible. The RHS specification of equation (5) shows the important role of scale effects ($Y_{it},\ Y_{i,t-1}$).[25] We must explicitly de-scale all empirical indicators for $v_i, \beta_i, \varphi_i, \psi_i, \varepsilon_{it}$ (public knowledge system), in order to prevent that the scale effects blur the statistical picture. The same recipe holds for the indicators that measure aspects of the corresponding firm-level knowledge aggregates ($\sum_s \alpha_{ist}$, $\sum_s \omega_{ist}$, $\sum_s \varepsilon_{ist}$).

The present-day state of international statistics does not allow to calculate the monetary weights (expressed as GDP fraction) for all individual elements of the national knowledge systems, as was

[25] Another scale effect is hidden in the so far implicit assumption that the number of firms ($s \in 1,2,..,S$) is equal in all countries ($S = S_i = S_j\ \ \forall\ i,j$), while in reality it holds that S is always a positive function of economic scale. To keep the model transparent we will assume henceforth that all national S are scale-corrected.

proposed in the second column of Tables 1 and 2. It is plausible that the national knowledge re-activation efforts (ε_{it}) represents the largest GDP share, certainly in the OECD countries where the cumulative knowledge capital may still include some components that date back hundreds of years.

We conclude this modelling section by formulating a set of falsifiable predictions from our model that would be in line with the knowledge-capital model of FDI:

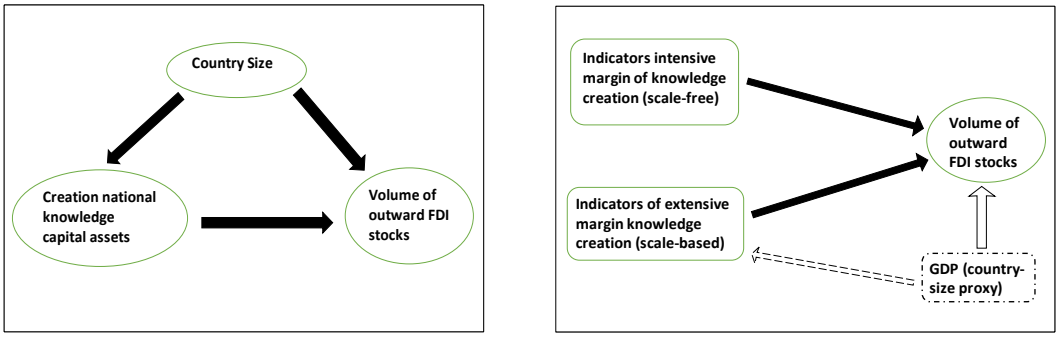
1. Firm-specific knowledge assets (G_{fit}) have a positive impact on a country's outward FDI.
2. Public knowledge inputs (M_{pit}) into firm-level proprietary knowledge assets have a positive impact on a country's outward FDI.
3. Knowledge-capital elements have a positive separate impact on outward FDI. When made scale-free, empirical indicators for knowledge-capital elements correlate stronger with outward FDI than with domestic GDP.

3. Design of empirical tests and data issues

Many aspects of knowledge-capital development, foreign direct investment and national economic scale are closely intertwined. Seen from the perspective of the knowledge-capital model, this creates two identification problems. The first problem is to assess what part of outward FDI stocks of any country *k* is driven by the country's economic scale. The country variation in the outward FDI stocks can be used to control for such scale effects, using GDP size as a general proxy for overall scale effects. The second identification challenge is detect the role of scale effects for a country's knowledge creation. This second issue will be dealt with via the concepts of intensive and extensive margins of knowledge creation. The absolute size of a country's economy tends to increase its total knowledge output through the number of firms, magnitude of investment funds, number of students, public research budgets, numbers of domestic researchers, patenting activities or the number of universities. This is the extensive margin of knowledge creation. If the presence of knowledge-creating hotspots in countries is randomly distributed, a larger country is likely to have a larger number of these hotspots within its borders compared to a small country, even when the rest of the large country is just middle-of-the-road or relatively backward in terms of developing new knowledge. For a proper understanding of knowledge-creating performance of countries, the country-scale effect must be identified, quantified and filtered out. Otherwise, it will never be possible to compare the knowledge-system performance of countries with different economic sizes. For this purpose we develop scale-free indicators for the *intensive margin of knowledge creation* that measure aspects of knowledge creation *per unit of domestic activity*. The intensive-margin indicators are always normalised by a relevant activity aggregate like total employment, gross domestic product, or total exports. However, the scale effects are important, also for the knowledge-capital model of outward FDI. They may be quantified by indicators for the *extensive margin of knowledge creation* that are deliberately scale-based, for instance by taking the log of a scale-dependent measure of knowledge creation. Figure 1 depicts the identification strategy in brief.

We subject the five predictions from our model to different tests. The first non-parametric test concentrates on ordinal association between a country's knowledge-creation variables and its outward FDI. It tests the strength of the relationship between country rankings for both variables. Rank correlation coefficients measure the degree of similarity between two rankings, and assess the statistical significance of this relation. We calculated the Kendall's *tau-b* coefficients for the

Figure 1 Identifying the roles of knowledge assets and economic scale



indicator-by-outward FDI combination of all countries. The *tau-b* coefficient is well-suited for small samples like ours (maximum number of country observations is 209) in which ties (equal rankings) may exist.[26] The Kendall *tau-b* coefficient is defined as:[27]

$$\tau_B = \frac{n_c - n_d}{\sqrt{(n_o - n_1)(n_o - n_2)}},$$

in which: $n_o = n(n-1)/2$ is the maximum number of possible pairwise combinations, n_c is the number of concordant pairs (correspondance between rank of FDI and indicator score), n_d is the number of discordant pairs (different rank for FDI and indicator score), $n_1 = \sum_i t_i(t_i - 1)/2$ is the occurrence of ties (equal rankings) for FDI, $n_2 = \sum_j u_j(u_j - 1)/2$ is the occurrence of ties for indicator j, t_i is the number of tied values in the ith group of ties for FDI, and u_j is the number of tied values in the jth group of ties for the ranked indicator that is compared with FDI. The intensive-margin indicators measure different, but sometimes partially overlapping elements of a country's knowledge system. Hence, a substantial correlation between the knowledge-capital indicators may be expected and we must run the rank correlation test with outward FDI separately for each indicator.

Considerable effort was invested in setting up a database with indicators for the firm-level and public knowledge-assets. As discussed in the introduction of this paper, it is almost impossible to find internationally comparable data on knowledge assets that are specific at the country-by-firm level. The best available data refer to national aggregates (patenting activity, business expenditure on R&D, investment in high-skilled personnel). Variables that measure aspects of public knowledge-capital assets are more easy to find. Referring to equation (5), we searched for empirical indicators with respect to the following model elements: (a) re-activation of existing public knowledge (ε_i) via education system, universities, labour quality; (b) creating of new public knowledge (β_i) through public R&D, state-driven innovation, basic research and scientific output; (c) acquisition of foreign public and private knowledge (φ_{it}, ψ_{it}) via incoming FDI; imports of knowledge-intensive services, and scientific exchange; (d) national productivity and knowledge-

[26] *Tau-b* can be applied if the underlying scale of both ranked variables has the same number of possible values. Values of Kendall's *tau-b* range from −1 (perfect inversed or negative correlation) to +1 (full perfect positive correlation). A value of zero indicates the absence of any association.
[27] E.g. Agresti (2010).

throughput efficiency (v_i) with indicators for labour productivity, internet connectivity, legal and governmental efficacy, freedom of movement, and the protection of intellectual property rights; (e) business research and knowledge-creation efforts ($\sum_s \alpha_{ist}$) via business R&D, commercial export quality, patenting activity and registered trade marks; (f) firms' absorbing of public knowledge inputs ($\sum_s \omega_{ist}$) via high-skilled employments, research networks with public institutions, and imports of knowledge-intensive business services.

The dataset for the comparison of national knowledge systems includes 80 empirical indicators, related to the input and output sides of Tables 1 and 2. Table 3 presents 52 scale-corrected empirical indicators (intensive margin of knowledge creation) that allows a direct comparison of different countries, sub-divided per analytical component of national knowledge systems. Annex I provides the data sources and further details per indicator.

Table 3 Intensive margin of national knowledge creation: Scale-free indicators

Knowledge system component	Variable description	Variable name
(Re-)activation of existing public knowledge (a)	Females with advanced education, as % of female working-age population	ADEDU_F
	Males with advanced education, as % of male working-age population	ADEDU_M
	Contribution of labour quality to GDP growth (growth accounting)	LQ_CONTR
	Women researchers as % of total researchers	FEM_RESR
	Number of researchers in R&D (per million people)	TOT_RESR
	Number of technicians in R&D (per million people)	TOT_TECH
Creating of new public knowledge: input indicators (b)	Global Innovation Index 2020, normalised by GDP in PPP$ 2019	GII_MAIN
	Global Innovation subindex for inputs 2020, normalised by GDP in PPP$ 2019	GII_INPUT
	Research and development expenditure (% of GDP, curr. prices, USD)	GERCGDP
	Gross domestic expenditure on R&D (GERD) as % of curr. GDP (PPP$)	GERPGDP
	Gross domestic expenditure on R&D (in PPP$), per capita of population	GERD_CAP
	Governm. intramural expenditure on R&D (GOVERD) as % of curr. GDP (PPP$)	GVE_XGDP
	Higher-education expenditure on R&D (HERD) as % of current GDP (PPP$)	HED_XGDP
	Total researchers per thousand of domestic labour force	ALLRES_LF
	Total R&D personnel (incl. staff) per thousand of domestic labour force	RDPERS_LF
	Total researchers per thousand of domestic total employment	ALLRES_EM
	Total R&D personnel (incl. staff) per thousand of dom. total employment	RDPERS_EM
	Gross domestic expenditure on R&D (in PPP$), per capita of population	GERD_CAP
idem: output-related indicators (b)	Global Innovation subindex for outputs 2020, normalised by GDP in PPP$ 2019	GII_OUTPUT
	Number of papers in economics, normalised by size of domestic GDP	ECONPAP
	Number of articles in scientific journals, normalised by size of domestic GDP	JRN_ART
	Judicial independence of government, mean score 2000-2019 *)	JUDINDEP
	Impartiality of legal courts, mean score 2000-2019 *)	IMPART_C
	Impartiality of public administration, mean score 2000-2019 *)	IMP_PUBL

	Protection of property rights, mean score 2000-2019 *)	PROTPROP
	Effectiveness legal enforcement, mean score 2000-2019 *)	LEG_FORCE
Acquisition of foreign public and private knowledge (c)	Total inward FDI stocks, normalised by size of domestic GDP	INFDI_GDP
	import of business and financial services, as % of total services import	BF_IMSRV
	import of knowledge-intensive business services, as % of total services import	KIBS_IMSRV
	Number of patent applications by non-residents, normalised by GDP	PAT_NRES
National productivity and knowledge-throughput efficiency (d)	Individuals using the Internet, as % of population	INT_USER
	Number of secure Internet servers, per million people	INTSECUR
	Number of fixed broadband subscriptions, per million people	BBND_SUB
	Contribution of ICT assets to GDP growth (growth accounting)	ICT_CONTR
	Labour productivity p. person employed, converted to 2020 PPP$	LP_EMPL
	Labour productivity p. hour worked, converted to 2020 PPP$	LP_HOUR
	Freedom of foreigners to visit, mean score 2000-2019	FORGN_MV
	Freedom to setup up a business, mean score 2000-2019	STARTABUS
Business research and knowledge-creation efforts (e)	Total business expenditure on R&D (BERD) as % of current GDP (PPP$)	BERD_GDP
	% of GERD that is performed by the business enterprise sector	BUX_GERD
	% of higher-education expend. on R&D that is financed by the business sector	BFIN_HERD
	Total business enterprise R&D personnel as a percentage of national total	BRES_TOT
Firms' absorbing of public knowledge inputs (f)	High-technology exports, as % of total manufacturing exports	HT_MFGEX
	Exports of ICT goods, as % of total merchandise exports	ITPROD_EX
	Exports of ICT services, as % of total services exports	IT_SERVEX
	Export of business and financial services, as % of total services export	BF_SRVEX
	Export of knowl.-intensive business services, as % of total services export	KBS_SRVEX
	No. of patents filed under the PCT (priority yr), per 1000 ppp$ of GDP	PATP_GDP
	No. of ICT patents filed under the PCT (priority yr), per 1000 ppp$ of GDP	PATI_GDP
	No. of biotech patents filed under the PCT (priority yr), per 1000 ppp$ of GDP	PATB_GDP
	Number of patent applications by residents, normalised by GDP	PATP_RES
	Number of trademark applications by direct residents, normalised by GDP	TM_DRES
	Total number of trademark applications, normalised by GDP	TM_TOT
Note: *) Classified as elements of governance-related knowledge output.		

Similarly, Table 4 presents a list of knowledge-creation variables that allow to assess the impact of the extensive knowledge-creation margin. We have taken the log of count variables and value-based variables in order to 'flatten' the country scores. These variables may also serve in gravity-based estimation of knowledge capital as a driver of outward FDI.

The dependent variable is total outward stocks per country provided by annual UNCTAD statistics (UNCTAD, 2022). Bilateral FDI stock data tend to be more reliable, less volatile and more

Table 4 Extensive margin of national knowledge creation: Scale-based indicators

National knowledge system component	Variable description	Variable name
(Re-)activation of existing public knowledge	Log of higher-education expenditure on R&D (curr. PPP$)	HERD_S
	Log of total no. of researchers in higher-education sector (headcount)	HRES_S
	Log of total number of higher-education R&D personnel, incl. staff headcount)	HPER_S
	Log of total number of national researchers in higher-education sector (FTE)	HFTE_S
	Log of total number of female researchers (headcount)	FEMRES_S
Creating of new public knowledge: input indicators	log of Global Innovation Index 2020 (not normalised for economic scale)	GII_MAIN_S
	log of Global Innovation Inputs subindex 2020 (not normalised for econ. scale)	GII_INPT_S
	Log of gross domestic expenditure on R&D (curr. PPP$)	GERD_S
	Log of governm. intramural expenditure on R&D (curr. PPP$)	GOVERD_S
	Log of total number of researchers (headcount)	TOTRES_S
	Log of total number of researchers in government sector (headcount)	GVRES_S
	Log of total number of R&D personnel, incl. staff (headcount)	TOTPER_S
	Log of total number of governm. sector R&D personnel, incl. staff (headcount)	GVPER_S
	Log of total number of national researchers (FTE)	TOTFTE_S
	Log of total number of national researchers in government sector (FTE)	GVFTE_S
Creating of new public knowledge: output indicators	log of Global Innov. Outputs subindex 2020 (not normalised for econ. scale)	GII_OUTP_S
	Log of number of patent applications by residents	PAT_R_S
	Log of number of articles in scientific journals	JRNART_S
Acquisition of foreign public and private knowledge	Log of number of patent applications by non-residents	PAT_NR_S
Business research and knowledge-creation efforts	Log of total business expenditure on R&D (curr. PPP$)	BERD_S
	Log of total number of researchers in busin. enterprise sector (headcount)	BRES_S
	Log of total number of busin. sector R&D personnel, incl. staff (headcount)	BPER_S
	Log of total number of national researchers in business sector (FTE)	BFTE_S
Firms' absorbing of public knowledge inputs	Log of no. of patents filed under the PCT (priority year)	PCTPAT_S
	Log of no. of ICT patents filed under the PCT (priority year)	ICTPAT_S
	Log of no. of biotech patents filed under the PCT (priority year)	BIOPAT_S
	Log of number of trademark applications by direct residents	TMDRES_S
	Log of total number of trademark applications	TM_TOT_S

widely available than FDI flow data.[28] Moreover, FDI stocks are in line with the knowledge-capital approach. We use data on total FDI positions with immediate partner countries, irrespective of their

[28] Cf. Wacker, 2016; Kox and Rojas, 2020; Anderson *et al.*, 2019, 2020.

financing. Current FDI data standards of IMF, OECD and Eurostat advance the concept of the 'ultimate beneficial owner' of foreign subsidiaries, as a response to tax-routing and tax-evasion constructions. However, such data refining is still only available for a small set of countries. FDI stocks can be financed by equity or by debt-based instruments. We regard the financing decision as a secondary problem, subsumed under the FDI decision that is explained by the knowledge-capital model. In the robustness test we correct for the possible impact of tax routing and tax evasion on our results.

The full data set covers the period 2000 to 2020, but with a substantial number of missing annual observations, especially for the small countries with a limited statistical apparatus. However, the annual variation for knowledge-system indicators tends to be quite small (Van Elk *et al*., 2019). This should not be surprising, because the knowledge system is based on long-term processes. It takes more than twenty years to educate engineers or university students with a masters degree. In order to get a balanced data set we have calculated, per indicator and country, the mean value of all available annual observations over the period 2000-2020. An advantage is that annual measurement errors in country data are 'averaged out'. However, it also implies that the mean for developed countries is sometimes based on more annual observations than holds for the small developing countries.[29] The period means have been used to calculate the rank the performance of all countries per indicator, which is then compared with their rank for outward FDI. The number of country observations per indicator is 106, with the minimum and maximum number of observations being, respectively, 36 and 209.

4. Results

This section provides the results of testing the first three model predictions of section 2, using rank correlation analysis. The results presented here are based on the preferred Kendall *tau-b* rank correlation coefficient. We also calculated the rank correlation also with alternative rank correlation measures (Pearson's rho, pairwise correlation); the latter outcomes converge with the pattern of Kendall *tau-b* scores, but they are often higher.[30] We prefer the Kendall *tau-b* coefficient, because of its superior performance and robustness. Table 5 presents the rank correlation results with outward FDI stocks for the 52 intensive-margin indicators (sub-divided by knowledge domain) using the full country sample.

The indicators for business research and knowledge-creation efforts refer to the entire business community in a country, not only to multinationals. As expected, we find that most of these direct indicators are positively correlated with outward FDI. This did not hold for BFIN_HERD (% of higher-education expenditures on R&D that is financed by the business sector). The average *tau-b* score of the other three business indicators is 0.356. This supports the first hypothesis.

Scale-free indicators for public knowledge creation and reactivation were in most cases (23) significantly and positively correlated with outward FDI. In eleven cases, the *tau-b* for these indicators were higher than the average (0.356) for the three business-related indicators. These are important results, supporting the second hypothesis and our approach for testing the basic

[29] In the robustness test we check whether the period-averaging procedure influences our results.
[30] The results for pair-wise correlation are at request available from the author. Results for Pearson's rho are found in Annex III.

Table 5 Rank correlation between outward FDI and intensive-margin indicators, by knowledge domain (full country sample)

Knowledge system component	Indicator name	No. of country observa-tions	Rank correlation, Kendall's tau-b	Signifi-cance &)	PM: rank corr. of indicator with GDP (tau-b)
(Re-)activation of existing public knowledge	ADEDU_F	175	0.101	**	0.042
	ADEDU_M	175	0.102	**	0.106**
	LQ_CONTR	128	0.212	***	0.213***
	FEM_RESR	36	–0.384	***	–0.232**
	TOT_RESR	135	0.517	***	0.394***
	TOT_TECH	121	0.478	***	0.345***
Creating of new public knowledge: input indicators	GII_MAIN	131	0.591	***	0.413***
	GII_INPUT	131	0.592	***	0.404***
	GERCGDP	149	0.450	***	0.399***
	GERPGDP	42	0.336	***	0.196*
	GERD_CAP	42	0.375	***	0.171**
	GVE_XGDP	42	0.109		0.108
	HED_XGDP	42	0.240	**	0.106
	ALLRES_LF	39	0.236	**	0.074
	RDPERS_LF	38	0.306	***	0.112
	ALLRES_EM	39	0.223	**	0.072
	RDPERS_EM	38	0.309	***	0.115
Creating of new public knowledge: output-related indicators	GII_OUTPUT	130	0.551	***	0.399***
	ECONPAP	164	0.570	***	0.546***
	JRN_ART	195	0.298	***	0.279***
	JUDINDEP	165	0.390	***	0.231***
	IMPART_C	165	0.420	***	0.273***
	IMP_PUBL	162	0.356	***	0.222***
	PROTPROP	165	0.407	***	0.278***
	LEG_FORCE	165	0.329	***	0.252***
Acquisition of foreign public and private knowledge	INFDI_GDP	197	0.071		.
	BF_IMSRV	157	0.245	***	0.225***
	KIBS_IMSRV	193	0.354	***	0.313***
	PAT_NRES	153	0.096	*	0.011
National productivity and knowledge-throughput efficiency	INT_USER	205	0.472	***	0.268***
	INTSECUR	209	0.441	***	0.219***
	BBND_SUB	204	0.451	***	0.248***
	ICT_CONTR	126	0.167	***	0.115*
	LP_EMPL	128	0.566	***	0.368***
	LP_HOUR	128	0.575	***	0.373***

	FORGN_MV	165	0.117	**	0.031
	STARTABUS	165	0.347	***	0.222***
Business research and knowledge-creation efforts	BERD_GDP	42	0.340	***	0.220**
	BUX_GERD	42	0.299	***	0.187*
	BFIN_HERD	42	0.122		0.048
	BRES_TOT	38	0.428	***	0.303***
Firms' absorbing of public knowledge inputs	HT_MFGEX	178	0.348	***	0.256***
	IT_SERVEX	185	–0.019		0.056
	ITPROD_EX	185	0.262	***	0.170***
	BF_SRVEX	162	0.380	***	0.267***
	KBS_SRVEX	198	0.159	***	0.244***
	PATP_GDP	42	0.398	***	0.213**
	PATI_GDP	42	0.489	***	0.285***
	PATB_GDP	42	0.429	***	0.201*
	PATP_RES	145	0.174	***	0.175***
	TM_DRES	150	0.064		0.073
	TM_TOT	159	0.028		0.057
Overall count statistics:					
Significant and positive rank correlation with outward FDI				45	indicators
Non-significant or negative rank correlation with outward FDI				7	indicators
Rank correlation with outward FDI stronger than with domestic GDP				41	indicators
Note: &) Coding of confidence levels: *** p<0.01, ** p<0.05, * p<0.10.					

assumptions of the knowledge-capital model. A few negative results are remarkable. The FEM_RESR indicator (Women as % of total researchers) has a significantly negative correlation with outward FDI. And GVE_XGDP (Expenditure on in-house governmental R&D) appears to have no significant impact on outward FDI.

Indicators for national productivity and knowledge-throughput efficiency appear to have a strong positive correlation with outward FDI, with an average *tau-b* of 0.392. Especially the national productivity and connectivity indicators appear to be very important. Productivity can to some extent be interpreted as a proxy for national capabilities for process and organisational innovation, with a positive impact on overall business climate. Micro-econometric studies have however time and again found that multinational firms mostly have a higher productivity performance than firms that only operate in the domestic market,[31] so the direction of causation from national productivity averages to the FDI decision is not *a priori* clear.

The last category of intensive-margin indicators measures how firms use knowledge-creation inputs as proprietary assets. It includes the export share of high-tech, knowledge-intensive goods and services, patenting activity and the registering of trade marks. Most items appear to be strongly

[31] Cf. Battisti *et al*., 2021; Mataloni, 2011; Bernard *et al*., 2013; Wagner, 2012; Girma *et al*., 2005.

correlated with outward FDI. This appears not to hold for trade mark registrations, but they are important for inward FDI, as will be seen in Section 6.

Table 5 provides some count statistics to summarise the main results across all indicators. Of the 52 intensive-margin indicators, 45 were positively associated with outward FDI during the 2000-2020 period. Although these indicators are scale-free, expressed per unit of economic activity, they may still be correlated with GDP. And if they would correlate stronger with GDP than with outward FDI, this could raise doubts as to the de-scaling. The last column of Table 5 therefore gives also the correlation of the indicator with the home country's GDP. It appears that many indicators are indeed positively correlated with GDP, but in the far majority of cases (41 out of 52) their correlation with outward FDI is stronger than with GDP. This result solidifies our outcomes, and it also confirms the third prediction/hypothesis from section 2.

In Table 6 we give the rank correlation results for the extensive-margin indicators. All have a count or value dimension and are expressed in logs. All 28 scale-based indicators have a statistically significant rank correlation with outward FDI stocks. And, with exception of GVFTE_S, this rank correlation has the highest statistical confidence level. This result shows that the scale of national knowledge-creation activities (extensive margin) matters very much for outward FDI. The most noteworthy result comes from comparing the fourth and sixth column in Table 6. In all but four cases, the knowledge-creation indicators correlate more strongly with the home country's GDP than with outward FDI. This shows the relevance of the de-scaling operation that was described in Figure 1. What we measure when using extensive-margin indicators is predominantly the impact of the home country's relative economic size on outward FDI. It is also this effect that to a large extent drives the results of gravity-based studies of international FDI patterns.

5. Robustness tests

This section introduces three tests to investigate the robustness of primary results that were presented in the preceding section. The results that we found might be caused by other drivers of outward FDI patterns (like tax routing motives) or by the incidental composition of our country sample.[32] We test in both cases by shaking up our country sample, which also shocks the country rankings.

The first test is to restrict the sample to countries which had non-zero inward and outward FDI in all years over the period 2000-2020. This removes a number of small countries and island states, which had erratic annual patterns in reported FDI stocks. The reduction of the sample to all-time FDI countries drops the average number of country observations per indicator to 77 (was 106), with the minimum and maximum being, respectively, 34 (was 36) and 126 (was 209).

The second test removes countries from the sample that have a proven reputation for having policies that facilitate tax routing of FDI. This can be done by offering excessively low tax rates, or by facilitating tax-sheltering by allowing foreign investors to use their system of bilateral tax treaties. A simple identification tool for most of such countries is to look at the ratio of incoming (or outward) FDI over total domestic firm-related investment. If either of both ratios is higher than say 15%, this almost certainly is due to tax routing. Total domestic firm-related investment is calculated as total investment minus government and housing investment. By adding weights for

[32] Some indicators have less than fifty country observations (in particular some OECD-derived indicators).

Table 6 Rank correlation between outward FDI and extensive-margin indicators, by knowledge domain (full country sample)

National knowledge system component	Indicator name	No. of country observa-tions	Rank correlation, Kendall's tau-b	Signifi-cance &)	PM: rank corr. of indicator with GDP (tau-b)
(Re-)activation of existing public knowledge	HERD_S	42	0.628	***	0.677***
	HRES_S	37	0.402	***	0.694***
	HPER_S	40	0.497	***	0.779***
	HFTE_S	40	0.497	***	0.744***
	FEMRES_S	36	0.460	***	0.759***
Creating of new public knowledge: input indicators	GII_MAIN_S	131	0.591	***	0.414***
	GII_INPT_S	131	0.592	***	0.403***
	GERD_S	42	0.624	***	0.814***
	GOVERD_S	42	0.436	***	0.677***
	TOTRES_S	37	0.487	***	0.734***
	GVRES_S	37	0.282	***	0.586***
	TOTPER_S	38	0.514	***	0.787***
	GVPER_S	39	0.304	***	0.606***
	TOTFTE_S	39	0.544	***	0.776***
	GVFTE_S	39	0.282	**	0.584***
Creating of new public knowledge: output indicators	GII_OUTP_S	130	0.551	***	0.399***
	PAT_R_S	145	0.514	***	0.639***
	JRNART_S	195	0.612	***	0.756***
Acquisition of foreign public and private knowledge	PAT_NR_S	153	0.528	***	0.632***
Business research and knowledge-creation efforts	BERD_S	42	0.619	***	0.745***
	BRES_S	38	0.565	***	0.727***
	BPER_S	41	0.561	***	0.746***
	BFTE_S	40	0.569	***	0.728***
Firms' absorbing of public knowledge inputs	PCTPAT_S	42	0.677	***	0.686***
	ICTPAT_S	42	0.642	***	0.656***
	BIOPAT_S	42	0.728	***	0.668***
	TMDRES_S	159	0.565	***	0.757***
	TM_TOT_S	159	0.565	***	0.757***

Overall count statistics:

Significant and positive rank correlation with outward FDI	28 cases
Non-significant or negative rank correlation with outward FDI	0 cases
Rank correlation with outward FDI stronger than with domestic GDP	4 cases

Note: &) Coding of confidence levels: *** p<0.01, ** p<0.05, * p<0.10.

the size of domestic firm-related investment one may also identify larger tax-sheltering countries like The Netherlands, Switzerland or Ireland that themselves may easily attract substantial 'real' FDI stocks. In total we identified 18 countries and geographical entities: Netherlands Antilles, American Samoa, Bahamas, Bermuda, Switzerland, Cayman Islands, Cyprus, Iceland, Liberia, Luxembourg, Marshall Islands, Malta, Mauritius, Netherlands, Panama, Seychelles, British Virgin Islands, and US Virgin Islands. However, some of them had no outward FDI data or knowledge-creation data. Effectively, this second test implies that the average number of country observations per indicator falls to 98 (was 106), with the minimum and maximum being, respectively, 32 (was 36) and 192 (was 209).

The third test is the toughest one, it combines the preceding two filtering criteria. The average number of country observations per indicator drops to 71, with 31 as minimum and 113 as maximum. Note that this third test is arbitrary, because the first country filter (only all-time-FDI countries) is not needed for achieving reliable outcomes.

Table 7 summarises the results of the sample-shocking tests, applying the count statistics that were also used at the bottom of Tables 5 and 6.

Table 7 Comparing results for alternative country samples, separately for intensive-margin and extensive-margin indicators (count statistics)

	Full country sample (cases, %)	Only countries with all-time outward FDI stocks (cases, %)	Full country sample, minus countries with tax evasion / tax-sheltering policies (cases, %)	Countries with all-time outward FDI stocks, minus countries with tax evasion / tax-sheltering policies (cases, %)
Intensive-margin indicators (52)				
Significant and positive rank correlation with outward FDI	45 (87%)	45 (87%)	44 (85%)	44 (85%)
Non-significant or negative rank correlation with outward FDI	7 (13%)	7 (13%)	8 (15%)	8 (15%)
Rank correlation with outward FDI stronger than with domestic GDP	41 (79%)	42 (81%)	39 (75%)	41 (79%)
Extensive-margin indicators (28)				
Significant and positive rank correlation with outward FDI	28 (100%)	28 (100%)	28 (100%)	28 (100%)
Non-significant or negative rank correlation with outward FDI	0 (0 %)	0 (0 %)	0 (0 %)	0 (0 %)
Rank correlation with outward FDI stronger than with domestic GDP	4 (14%)	6 (21%)	5 (18%)	7 (25%)

Note: The count statistics are based on the number (and percentage) of indicators for which the rank-correlation results comply with the condition that is mentioned in the left-most column. Full results are given in Annex III.

It shows that the main rank correlation results differ only marginally between the four country samples for which the ranking variables were compared. Also the performance of indicators for the extensive and intensive knowledge-creation margin remains stable. The share of intensive-margin

indicators that have significant and positive rank correlation with outward FDI is steady between 85-87%. Also the share of indicators that are correlated stronger with outward FDI than with domestic GDP remains in the 75-81% range. A similar story holds for the extensive margin indicators. Our main rank correlation results may therefore be regarded as robust across the four different country samples.

6. The knowledge-capital model and inward FDI

The knowledge capital model explains that firm-level separable knowledge assets are important for outward FDI, but the model does not say anything about inward FDI. So we enter a scientific territory that has not yet been charted by the knowledge-capital model. A standard assumption in the literature is that market scale, represented by GDP, is the prime driver of inward FDI. Traditional gravity models of FDI mostly confirm this.[33] But what about the role of national knowledge assets.

At least five elements of the host country's knowledge system could have a positive impact on inward FDI stocks. A foreign multinational entering the country often requires local complementary skills (education) and knowledge of employees, so it needs at least some public knowledge assets (G_{spit}), depending on industry and conditional on the type of investment (horizontal, vertical, export platform, global value chain). Moreover, protection of the firm's proprietary knowledge assets (G_{sit}) it is necessary that the host country has an effective system for the protection of intellectual property rights, like patents and trademarks. The same holds for its need for a legal environment and enforcement of property rights that is not biased against foreign firms. The introduction of the foreign firm's proprietary knowledge assets (G_{sit}) may need occasional assistance of its headquarter employees, so freedom of travel by foreigner personnel is important. And finally, the expected profitability of the foreign subsidiary increases by a higher local productivity, and a good connectivity infrastructure. All these locational requirements for inward FDI may be represented by some elements of our indicator set.

At a more general level, our set of indicators can also quantify the role of a potential knowledge gap between the FDI origin country i and the FDI host country j. A real bilateral knowledge gap, corrected for GDP size, can be calculated from our model for every possible country pair:[34]

$$\Delta M_{ij}{}^{*} = \frac{1}{Y_j}\left[\frac{M_i}{Y_i/Y_j} - M_j\right] \qquad \forall\, i,j \tag{6}$$

The *ex ante* effect of a positive knowledge gap ($\Delta M_{ij}{}^{*}$) makes it more likely that host country j has active policies in place to attract and facilitate inward FDI. Such policies are represented by M_{fRit} and quantified by their GDP-weight φ_{it} in Table 1. They affect inward FDI. Current international statistics do not yet allow to calculate and aggregate the bilateral quantity $\Delta M_{ij}{}^{*}$, but it must be borne in mind that this mechanism related to national knowledge-capital may play an active role in the country pattern of inward FDI.

[33] Cf. Tanaka, 2009; Kleinert and Toubal, 2010; Blonigen and Piger, 2014. In more recent structural gravity models of FDI (like Anderson *et a*l., 2019; Kox and Rojas, 2020), the time-variant GDP impact on inward FDI is fully absorbed in the set of estimation dummies (origin-time, host-time).

[34] Earlier FDI gravity tests (cf. Blonigen and Piger, 2014) often used the bilateral GDP gap between two countries to explain inward FDI, but what they actually estimated was probably the effect of a mix of the scale-corrected bilateral knowledge gap $\Delta M_{ij}{}^{*}$ and the bilateral GDP gap strictu sensu.

Overall, we expect that national knowledge assets have a significant and positive impact on inward FDI, but smaller than the impact on outward FDI. We test two additional (falsifiable) predictions:

4. Scale-free (intensive-margin) and scale-based (extensive-margin) indicators of domestic knowledge-capital creation have a stronger correlation with outward FDI than with inward FDI.
5. The correlation with of scale-free (intensive-margin) knowledge-capital indicators with inward FDI is stronger than the correlation with GDP.

The fifth predictions implies that national knowledge-capital assets have a separate role from market size. The test procedure remains the same. Data on total inward FDI stocks per country are also drawn from annual UNCTAD statistics (UNCTAD, 2022). Table 8 provides the summary results for the two most important country samples. The detailed results per indicator can be perused in Annex III.

Table 8 Comparing the magnitude of rank correlation of knowledge-creation indicators with inward and outward FDI stocks, and with GDP (count statistics, by country sample)

	Full country sample (cases, %)	Full country sample, minus countries with tax evasion / tax-sheltering policies (cases, %)
Intensive-margin indicators (52)		
Rank correlation of indicators with outward FDI is stronger than their rank correlation with inward FDI	35 (67%)	34 (65%)
Rank correlation of indicators with inward FDI is stronger than their rank correlation with GDP	36 (69%)	33 (63%)
Extensive-margin indicators (28)		
Rank correlation of indicators with outward FDI is stronger than their rank correlation with inward FDI	20 (71 %)	21 (75 %)
Rank correlation of indicators with inward FDI is stronger than their rank correlation with GDP	3 (11%)	4 (14%)

Note: The count statistics are based on the number (and percentage) of indicators for which the rank-correlation are positive and statistically significant, and for which the results comply with the condition that is mentioned in the left-most column. Full results are given in Annex III.

The evidence is that the indicators in 65-75% of cases correlate stronger with outward FDI stocks than with inward FDI stocks. This holds for scale-free and scale-based indicators, and for both country samples, confirming our expectation. The results for the extensive-margin indicators appear to be driven mostly by the country's market size (GDP). The score for the intensive-margin indicators shows that the correlation with inward FDI stocks is not driven by market size, but that domestic knowledge-capital elements in the host country do also play a significant and independent role for inward FDI stocks. This is new, because the original knowledge-capital models do not account for this effect.

7. Summary and conclusions

The knowledge-capital model of FDI by Markusen, Maskus, McGrattan and Prescott provides a plausible theory for explaining international patterns of bilateral FDI stocks. Its basic tenet is that firms own proprietary knowledge assets or technology capital that are in many cases not tied to a home-country location, but may as well be exploited in a foreign subsidiary, thereby increasing the returns to such assets. If knowledge capital is the prime driver of outward FDI, then one would expect that countries with much outward FDI have a relative abundance of such proprietary knowledge assets. So far, however, there has -to our knowledge- not been a convincing empirical test of this consequence, partly due to a lack of reliable and internationally comparable data on firm-level knowledge assets. This paper follows a new way to investigate this matter, focusing on the abundance of public knowledge assets that are encapsulated in the proprietary knowledge assets of firms. First we complemented the knowledge-capital model with a new module that formalises this encapsulation process and that allowed us to derive testable predictions from it. The test requires one additional step: correcting for the impact that a country's economic mass has on both the scale of domestic knowledge-creation activities and on the magnitude of outward FDI. For that purpose we introduced the distinction between the intensive and the extensive margin of knowledge creation. All indicators for the intensive margin of national knowledge-creation activities are de-scaled, i.e. expressed per unit of economic activity. We created a database with 80 empirical indicators that quantify the most important aspects of national knowledge-creation efforts, covering 209 countries over the period 2000-2020. In this way, the wide country variation allows to identify the impact of each aspect of national knowledge creation for explaining outward FDI. We applied international rank correlation analysis to quantify the statistical significance of each indicator's impact. To check for the robustness of findings we applied the test for four different country samples.

The main results are as follows. Both business knowledge-creation efforts and public knowledge-creation efforts have a positive and significant impact on a country's outward FDI. The impact of public knowledge-creation indicators is in a substantial number of cases stronger than for the average of business-specific knowledge-creation indicators. Scale-free indicators for national knowledge-creation correlate stronger with outward FDI than with domestic GDP, indicating that they have a separate role that is independent of a country's economic mass.

The knowledge capital model of FDI does not say anything about the impact of national knowledge-creation activities on inward FDI. However, it is plausible to argue that at least some of these knowledge creation efforts will also have a positive impact on inward FDI. We tested the hypothesis that the empirical indicators would correlate stronger with outward FDI stocks than with inward FDI stocks. This was confirmed for a wide majority of the indicators, and we regard this as an important result for the validity of the knowledge-capital of FDI. With regard to inward FDI, we also found that the positive rank correlation of scale-free indicators with inward FDI stocks is not only driven by market size, i.e. that domestic knowledge-capital elements also play a significant and independent role for inward FDI stocks.

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Annex Table 1 Description of national knowledge-capital variables

Indicator	Description	Source + codename in original source
Intensive knowledge-creation margin		
ADEDU_F	Female with advanced education, as % of female working-age population	WDI (SL_TLF_ADVN_FE_ZS)
ADEDU_M	Male with advanced education, as % of male working-age population	WDI (SL_TLF_ADVN_MA_ZS)
LQ_CONTR	Contribution of labour quality to GDP growth (growth accounting)	TED (LQ_contr)
FEM_RESR	Women researchers as % of total researchers	MSTI (TH_WRXRS)
TOT_RESR	Researchers in R&D (per million people)	WDI (SP_POP_SCIE_RD_P6)
TOT_TECH	Technicians in R&D (per million people)	WDI (SP_POP_TECH_RD_P6)
GII_MAIN	Global Innovation Index 2020, normalised by GDP in PPP$ 2019	WIPO (GII)
GII_INPUT	Global Innovation subindex for inputs 2020, normalised by GDP in PPP$ 2019	WIPO (GII inputs subindex)
GERCGDP	Research and development expenditure (% of GDP, curr. prices, USD)	MSTI (GB_XPD_RSDV_GD_ZS)
GERPGDP	Gross domestic expenditure on R&D (GERD) as % of curr. GDP (PPP$)	MSTI (G_XGDP)
GERD_CAP	Gross domestic expenditure on R&D (in PPP$), per capita of population	WDI (G_XPOP)
GVE_XGDP	Governm. intramural expenditure on R&D (GOVERD) as % of curr. GDP (PPP$)	MSTI (GV_XGDP)
HED_XGDP	Higher-education expenditure on R&D (HERD) as % of current GDP (PPP$)	MSTI (H_XGDP)
ALLRES_LF	Total researchers per thousand of domestic labour force	MSTI (TP_RSXLF)
RDPERS_LF	Total R&D personnel (incl. staff) per thousand of domestic labour force	MSTI (TP_TTXLF)
ALLRES_EM	Total researchers per thousand of domestic total employment	MSTI (TP_RSXEM)
RDPERS_EM	Total R&D personnel (incl. staff) per thousand of dom. total employment	MSTI (TP_TTXEM)
GII_OUTPUT	Global Innovation subindex for outputs 2020, normalised by GDP in PPP$ 2019	WIPO (GII output subindex)
ECONPAP	Number of papers in economics, normalised by size of domestic GDP	REPEC (r_econpap_n1)
JRN_ART	Number of articles in scientific journals, normalised by size of domestic GDP	WDI (IP_JRN_ARTC_SC)
JUDINDEP	Judicial independence of government, mean score 2000-2019	FRASER (judicialindep)
IMPART_C	Impartiality of legal courts, mean score 2000-2019	FRASER (impartcourt)
IMP_PUBL	Impartiality of public administration, mean score 2000-2019	FRASER (impartpubad)
PROTPROP	Protection of property rights, mean score 2000-2019	FRASER (protpropr)
LEG_FORCE	Effectiveness legal enforcement, mean score 2000-2019	FRASER (legalenforc)
INFDI_GDP	Total inward FDI stocks, normalised by size of domestic GDP	UNCTAD (inst_gdp)
BF_IMSRV	import of business and financial services, as % of total services import	KVL (ocs_impsh_n4)

KIBS_IMSRV	import of knowl.-intensive business services, as % of total services import	KVL (kibs_impsh_n4)
PAT_NRES	Number of patent applications by non-residents, normalised by GDP	WDI (IP_PAT_NRES_n1)
INT_USER	Individuals using the Internet, as % of population	WDI (IT_NET_USER_ZS)
INTSECUR	Number of secure Internet servers, per million people	WDI (IT_NET_SECR_P6)
BBND_SUB	Number of fixed broadband subscriptions, per million people	WDI (IT_NET_BBND_P2)
ICT_CONTR	Contribution of ICT assets to GDP growth (growth accounting)	TED (ICT_contr)
LP_EMPL	Labour productivity p. person employed, converted to 2020 PPP$	TED (LP_eksL)
LP_HOUR	Labour productivity p. hour worked, converted to 2020 PPP$	TED (LP_eksH)
FORGN_MV	Freedom of foreigners to visit, mean score 2000-2019	FRASER (forgn_move)
STARTABUS	Freedom to setup up a business, mean score 2000-2019	FRASER (startabus)
BERD_GDP	Total business expenditure on R&D (BERD) as % of current GDP (PPP$)	MSTI (B_XGDP)
BUX_GERD	% of GERD that is performed by the business enterprise sector	MSTI (G_XEB)
BFIN_HERD	% of higher-education expend. on R&D that is financed by the business sector	MSTI (H_XFB)
BRES_TOT	Total business enterprise R&D personnel as a percentage of national total	MSTI (BP_TTXTT)
HT_MFGEX	High-technology exports, as % of total manufacturing exports	WDI (TX_VAL_TECH_MF_ZS)
IT_SERVEX	Exports of ICT services, as % of total services exports	WDI (BX_GSR_CCIS_ZS)
ITPROD_EX	Exports of ICT goods, as % of total merchandise exports	WDI (TX_VAL_ICTG_ZS_UN)
BF_SRVEX	Export of business and financial services, as % of total services export	KVL (ocs_expsh_n4)
KBS_SRVEX	Export of knowl.-intensive business services, as % of total services export	KVL (kibs_expsh_n4)
PATP_GDP	No. of patents filed under the PCT (priority yr), per 1000 ppp$ of GDP	MSTI (P_PCT_n1)
PATI_GDP	No. of ICT patents filed under the PCT (priority yr), per 1000 ppp$ of GDP	MSTI (P_ICTPCT_n1)
PATB_GDP	No. of biotech patents filed under the PCT (priority yr), per 1000 ppp$ of GDP	MSTI (P_BIOPCT_n1)
Extensive knowledge-creation margin		
HERD_S	Log of higher-education expenditure on R&D (curr. PPP$)	MSTI (H_PPP_s)
HRES_S	Log of total no. of researchers in higher-education sector (headcount)	MSTI (HH_RS_s)
HPER_S	Log of total number of higher-education R&D personnel, incl. staff (headcount)	MSTI (HP_TT_s)
HFTE_S	Log of total number of national researchers in higher-education sector (FTE)	MSTI (HP_RS_s)
FEMRES_S	Log of total number of female researchers (headcount)	MSTI (TH_WRS_s)
GII_MAIN_S	log of Global Innovation Index 2020 (not normalised for economic scale)	WIPO (GII)
GII_INPT_S	log of Global Innovation Inputs subindex 2020 (not normalised for econ. scale)	WIPO (GII inputs)

GERD_S	Log of gross domestic expenditure on R&D (curr. PPP$)	MSTI (G_PPP_s)
GOVERD_S	Log of governm. intramural expenditure on R&D (curr. PPP$)	MSTI (GV_PPP_s)
TOTRES_S	Log of total number of researchers (headcount)	MSTI (TH_RS_s)
GVRES_S	Log of total number of researchers in government sector (headcount)	MSTI (GH_RS_s)
TOTPER_S	Log of total number of R&D personnel, incl. staff (headcount)	MSTI (TP_TT_s)
GVPER_S	Log of total number of governm. sector R&D personnel, incl. staff (headcount)	MSTI d (GP_TT_s)
TOTFTE_S	Log of total number of national researchers (FTE)	MSTI (TP_RS_s)
GVFTE_S	Log of total number of national researchers in government sector (FTE)	MSTI (GP_RS_s)
GII_OUTP_S	log of Global Innov. Outputs subindex 2020 (not normalised for econ. scale)	WIPO (GII inputs)
PAT_R_S	Log of number of patent applications by residents	WDI (IP_PAT_RESD_s)
JRNART_S	Log of number of articles in scientific journals	WDI (IP_JRN_ARTC_SC_s)
PAT_NR_S	Log of number of patent applications by non-residents	WDI (IP_PAT_NRES_s)
BERD_S	Log of total business expenditure on R&D (curr. PPP$)	MSTI (B_PPP_s)
BRES_S	Log of total number of researchers in busin. enterprise sector (headcount)	MSTI (BH_RS_s)
BPER_S	Log of total number of busin. sector R&D personnel, incl. staff (headcount)	MSTI (BP_TT_s)
BFTE_S	Log of total number of national researchers in business sector (FTE)	MSTI (BP_RS_s)
PCTPAT_S	Log of no. of patents filed under the PCT (priority year)	MSTI (P_PCT_s)
ICTPAT_S	Log of no. of ICT patents filed under the PCT (priority year)	MSTI (P_ICTPCT_s)

Legends: FRASER: Economic Freedom of the World (Gwartney *et al*, 2021). KVL: World Services Trade Matrix (KVL Economic Policy Research). MSTI: Main Science and Technology database (OECD). TED: The Conference Board Total Economy Database™ (The Conference Board, De Vries, 2022). UNCTAD: World Investment Report 2021. WDI: World Development Indicators (World Bank). WIPO: The Global Innovation Index 2020 (Dutta *et al.* 2020)

ANNEX II TIME DYNAMICS OF NATIONAL KNOWLEDGE STOCKS

Proof of Proposition 1

If behavioural parameters described in Table 1 (β_i, ε_i, φ_i, ψ_i and δ_i) are time-invariant, the proof of Proposition 1 (time dynamics of public knowledge stocks) is as follows. Old vintages of public knowledge stocks are fully discard after N years ($M_{io,t-N} = 0$). Vintages from younger annual cohorts ($\theta < N$) are depreciated by δ_i, hence:

(A1) $M_{io,t-\theta} = (1-\delta_i)\, M_{io,t-(\theta-1)} \qquad \forall\, \theta < N$

From Table 1 we further have:

(A2) $M_{piit} = v_i\, \beta_i\, Y_{it}$ (A3) $M_{fRit} = v_i\, \varphi_i\, Y_{it}$ (A4) $M_{pRit} = v_i\, \psi_i\, Y_{it}$

(A5) $\Delta M_{pit} = v_i\, (\beta_i + \varphi_i + \psi_i)\, Y_{it}$

(A6) $M_{pit} = \Delta M_{pit} + \varepsilon_i\, M_{io,t}$

Suppose that the build-up of public knowledge stocks starts in year $t-N$, so that $M_{io,t-N} = 0$, and equation (A6) reduces to: $M_{pi,t-N} = \Delta M_{pi,t-N}$, and that same $\Delta M_{pi,t-N}$ will become the first of old vintage knowledge stock that has to be re-activated like in (A6) and depreciated like in (A1) at the end of the next year $t-(N-1)$, so that:

(A7) $M_{pi,t-(N-1)} = \Delta M_{pi,t-(N-1)} + \varepsilon_i\, (1-\delta_i)\, \Delta M_{pi,t-N}$

Because of (A5) that gives:

(A8) $$\begin{aligned} M_{pi,t-(N-1)} &= v_i\, (\beta_i + \varphi_i + \psi_i)\, Y_{i,t-(N-1)} + \varepsilon_i\, (1-\delta_i)\, v_i\, (\beta_i + \varphi_i + \psi_i)\, Y_{i,t-N} \\ &= v_i\, (\beta_i + \varphi_i + \psi_i)\, \left[Y_{i,t-(N-1)} + \varepsilon_i\, (1-\delta_i)\, Y_{i,t-N}\right] \\ &= v_i\, (\beta_i + \varphi_i + \psi_i)\, Y_{i,t-(N-1)}\, \left[1 + \varepsilon_i\, (1-\delta_i)\, \frac{Y_{i,t-N}}{Y_{i,t-(N-1)}}\right] \end{aligned}$$

If we define $X_{Y,t-(N-1)} = \frac{Y_{i,t-N}}{Y_{i,t-(N-1)}}$ as the chain index of GDP, we get:

(A9) $M_{pi,t-(N-1)} = v_i\, (\beta_i + \varphi_i + \psi_i)\, Y_{i,t-(N-1)}\, \left[1 + \varepsilon_i\, (1-\delta_i)\, X_{Y,t-(N-1)}\right]$

And because this same pattern repeats itself for all later vintages of old public knowledge assets, we may generalise the pattern for all years, thus obtaining:

(A10) $M_{pi,t} = v_i\, (\beta_i + \varphi_i + \psi_i)\, .\, \left[1 + \varepsilon_i\, (1-\delta_i)\, X_{Y,t}\right].\, Y_{i,t}$ QED ■

Proof of Proposition 2

If behavioural parameters described in Table 2 (α_{is}, ε_{is}, ω_{is}) and firm-level depreciation parameter δ_{is} are time-invariant, we prove Proposition 2 (time dynamics of proprietary knowledge stocks of firms in country *i*). Old vintages of proprietary private knowledge assets are fully discarded after N years ($G_{iso,t-N} = 0$). Stocks from younger annual knowledge cohorts ($\theta < N$) are depreciated by δ_{is}:

(A11) $G_{iso,t-\theta} = (1-\delta_{is})\, G_{iso,t-(\theta-1)} \qquad \forall\, \theta < N\, ;\, \forall\, s$

From Table 2 we further have:

(A12) $G_{sit} = v_i\, z_s\, \alpha_{is}\, Y_{it} \qquad \forall\ s$

(A13) $G_{spit} = v_i\, z_s\, \omega_{is}\, (M_{pi,t-1})\, Y_{it} \qquad \forall\ s$

so that annual new proprietary knowledge of all firms amounts to:

(A14) $\Delta G_{fit} = \sum_s v_i\, z_s Y_{it}\, [\, \alpha_{is} + \omega_{is}\, (M_{pi,t-1})]$

Re-activated older proprietary knowledge assets are the result of the following sub-process:

(A15) $G_{isot} = \sum_s v_i\, z_s\, \varepsilon_{is}\, (G_{iso})\, Y_{it}$

Suppose that in year $t - N$ the knowledge stock of firms starts to build up. There are no old vintages of proprietary knowledge stocks yet ($G_{iso,t-N} = 0$) and total knowledge stocks at the end of the first year amount to:[35]

(A16) $G_{fi,t-N} = \Delta G_{fi,t-N} = \sum_s v_i\, z_s\, Y_{i,t-N}\, [\, \alpha_{is} + \omega_{is}\, (M_{pi,t-N-1})]$

That same $\Delta G_{fi,t-N}$ will become the first of old vintage of proprietary knowledge that has to be re-activated like in (A15) and depreciated like in (A11) at the end of the next year $t - (N - 1)$, so that:

(A17) $G_{fi,t-(N-1)} = \Delta G_{fi,t-(N-1)} + \sum_s \varepsilon_{is}\, (1 - \delta_{is})\{\Delta G_{fi,t-N}\}$

After some substitutions, this becomes:

(A18) $G_{fi,t-(N-1)} = v_i \sum z_s\, [\, \alpha_{is} + \omega_{is}\, (M_{pi,t-N-1})]\, Y_{i,t-(N-1)}\, \left\{1 + \varepsilon_{is}\, (1 - \delta_{is})\, \frac{Y_{i,t-N}}{Y_{i,t-(N-1)}}\right\}$

If we define $X_{Y,t-(N-1)} = \frac{Y_{i,t-N}}{Y_{i,t-(N-1)}}$ as the chain index of GDP, we get:

(A19) $G_{fi,t-(N-1)} = v_i \sum z_s\, [\, \alpha_{is} + \omega_{is}\, (M_{pi,t-N-1})]\, Y_{i,t-(N-1)}\, \{1 + \varepsilon_{is}\, (1 - \delta_{is})\, X_{Y,t-(N-1)}\}$

And because this same pattern repeats itself for all later vintages of old proprietary knowledge assets of firms, we may generalise the pattern for all years, thus obtaining:[36]

(A20) $G_{fi,t} = v_i \sum z_s\, [\, \alpha_{is} + \omega_{is}\, (M_{pi,t-1})].\{1 + \varepsilon_{is}\, (1 - \delta_{is})\, X_{Y,t}\}.\, Y_{i,t}$

Finally, using Proposition 1, $M_{pi,t-1}$ can be substituted into (A20):

(A21) $G_{fi,t} = v_i\, Y_{i,t} \sum_s z_s\, A_{is}[\, \alpha_{is} + \omega_{is}(\beta_i + \varphi_i + \psi_i)\, A_i\, v_i\, Y_{i,t-1}]$

with $A_{is} \equiv \{1 + \varepsilon_{is}\, (1 - \delta_{is})\, X_{Y,t}\}$ and $A_i \equiv \{1 + \varepsilon_i\, (1 - \delta_i)\, X_{Y,t}\}$ QED ■

[35] Because $M_{pi,t-N-1}$ is an indepent process, we assume that $M_{pi,t-N-1}$ does already exist;

[36] Note that the structure is the same as (A10) in the proof of Proposition 1.

ANNEX III DETAILED RANK CORRELATION RESULTS

Table AIII.1 Rank correlation of intensive-margin knowledge-capital indicators with (outward and inward) FDI stock and with GDP, 2000-2020 period, full country sample

Indicator name	No. of country observa-tions	Rank corrrelation with outward FDI		Rank corrrelation with inward FDI		PM: Kendall rank corr. (tau-b) with own GDP
		Spearman's rho	Kendall's tau-b	Spearman's rho	Kendall's tau-b	
ADEDU_F	175	0.152**	0.101**	0.157**	0.105**	0.042
ADEDU_M	175	0.157**	0.102**	0.153**	0.104**	0.106**
LQ_CONTR	128	0.322***	0.212***	0.352***	0.232***	0.213***
FEM_RESR	36	-0.540***	-0.384***	-0.441***	-0.305***	-0.232**
TOT_RESR	135	0.721***	0.517***	0.659***	0.457***	0.394***
TOT_TECH	121	0.669***	0.478***	0.603***	0.423***	0.345***
GII_MAIN	131	0.790***	0.591***	0.749***	0.553***	0.413***
GII_INPUT	131	0.794***	0.592***	0.731***	0.536***	0.404***
GERCGDP	149	0.642***	0.450***	0.621***	0.438***	0.399***
GERPGDP	42	0.514***	0.336***	0.248	0.164	0.196*
GERD_CAP	42	0.585***	0.375***	0.368**	0.231**	0.171**
GVE_XGDP	42	0.148	0.109	-0.003	0.006	0.108
HED_XGDP	42	0.368**	0.240**	0.237	0.157	0.106
ALLRES_LF	39	0.415***	0.236**	0.141	0.077	0.074
RDPERS_LF	38	0.481***	0.306***	0.179	0.115	0.112
ALLRES_EM	39	0.395**	0.223**	0.120	0.058	0.072
RDPERS_EM	38	0.493***	0.309***	0.194	0.118	0.115
GII_OUTPUT	130	0.749***	0.551***	0.729***	0.537***	0.399***
ECONPAP	164	0.763***	0.570***	0.823***	0.618***	0.546***
JRN_ART	195	0.464***	0.298***	0.478***	0.300***	0.279***
JUDINDEP	165	0.559***	0.390***	0.461***	0.316***	0.231***
IMPART_C	165	0.598***	0.420***	0.524***	0.365***	0.273***
IMP_PUBL	162	0.511***	0.356***	0.441***	0.307***	0.222***
PROTPROP	165	0.579***	0.407***	0.507***	0.351***	0.278***
LEG_FORCE	165	0.465***	0.329***	0.417***	0.290***	0.252***
INFDI_GDP	197	0.110	0.071	.	.	-0.138***
BF_IMSRV	157	0.343***	0.245***	0.352***	0.248***	0.225***
KIBS_IMSRV	193	0.498***	0.354***	0.544***	0.388***	0.313***
PAT_NRES	153	0.122	0.096*	0.121	0.092*	0.011
INT_USER	205	0.664***	0.472***	0.529***	0.365***	0.268***
INTSECUR	209	0.622***	0.441***	0.497***	0.348***	0.219***
BBND_SUB	204	0.633***	0.451***	0.516***	0.366***	0.248***
ICT_CONTR	126	0.255**	0.167***	0.316***	0.204***	0.115*
LP_EMPL	128	0.762***	0.566***	0.649***	0.468***	0.368***
LP_HOUR	128	0.769***	0.575***	0.658***	0.474***	0.373***
FORGN_MV	165	0.171**	0.117**	0.145*	0.102*	0.031
STARTABUS	165	0.498***	0.347***	0.450***	0.319***	0.222***
BERD_GDP	42	0.522***	0.340***	0.269*	0.182*	0.220**
BUX_GERD	42	0.434***	0.299***	0.153	0.182*	0.187*
BFIN_HERD	42	0.153	0.122	0.057	0.043	0.048
BRES_TOT	38	0.592***	0.428***	0.402**	0.300***	0.303***
HT_MFGEX	178	0.504***	0.348***	0.461***	0.323***	0.256***
IT_SERVEX	185	-0.027	-0.019	0.003	0.000	0.056
ITPROD_EX	185	0.396***	0.262***	0.370***	0.242***	0.170***
BF_SRVEX	162	0.544***	0.380***	0.492***	0.345***	0.267***
KBS_SRVEX	198	0.237***	0.159***	0.352***	0.239***	0.244***
PATP_GDP	42	0.600***	0.398***	0.385***	0.254**	0.213**

PATI_GDP	42	0.689***	0.489***	0.488***	0.354***	0.285***
PATB_GDP	42	0.626***	0.429***	0.426***	0.303***	0.201*
PATP_RES	145	0.265***	0.174***	0.297***	0.187***	0.175***
TM_DRES	150	0.115	0.064	0.169**	0.100*	0.073
TM_TOT	159	0.046	0.028	0.104	0.063	0.057

Table AIII.2 Rank correlation of extensive-margin knowledge-capital indicators with (outward and inward) FDI stock and with GDP, 2000-2020 period, full country sample

Indicator name	No. of country observa-tions	Rank corrrelation with outward FDI		Rank corrrelation with inward FDI		PM: Kendall rank corr. (tau-b) with own GDP
		Spearman's rho	Kendall's tau-b	Spearman's rho	Kendall's tau-b	
HERD_S	42	0.805***	0.628***	0.792***	0.436***	0.677***
HRES_S	37	0.574***	0.402***	0.539***	0.402***	0.694***
HPER_S	40	0.697***	0.497***	0.675***	0.500***	0.779***
HFTE_S	40	0.693***	0.497***	0.661***	0.495***	0.744***
FEMRES_S	36	0.629***	0.460***	0.574***	0.438***	0.759***
GII_MAIN_S	131	0.790***	0.591***	0.749***	0.553***	0.414***
GII_INPT_S	131	0.794***	0.592***	0.730***	0.536***	0.403***
GERD_S	42	0.806***	0.624***	0.736***	0.559***	0.814***
GOVERD_S	42	0.607**	0.436***	0.570***	0.408***	0.677***
TOTRES_S	37	0.657***	0.487***	0.583***	0.438***	0.734***
GVRES_S	37	0.411**	0.282**	0.374**	0.270**	0.586***
TOTPER_S	38	0.709***	0.514***	0.647***	0.482***	0.787***
GVPER_S	39	0.440***	0.304***	0.407**	0.279**	0.606***
TOTFTE_S	39	0.730***	0.544***	0.666***	0.505***	0.776***
GVFTE_S	39	0.404**	0.282**	0.367**	0.247**	0.584***
GII_OUTP_S	130	0.749***	0.551***	0.729***	0.537***	0.399***
PAT_R_S	145	0.698***	0.514***	0.7690***	0.573***	0.639***
JRNART_S	195	0.803***	0.612***	0.866***	0.686***	0.756***
PAT_NR_S	153	0.720***	0.528***	0.765***	0.578***	0.632***
BERD_S	42	0.806***	0.619***	0.707***	0.540***	0.745***
BRES_S	38	0.748***	0.565***	0.758***	0.502***	0.727***
BPER_S	41	0.748***	0.561***	0.679***	0.510***	0.746***
BFTE_S	40	0.758***	0.569***	0.684***	0.505***	0.728***
PCTPAT_S	42	0.857***	0.677***	0.768***	0.584***	0.686***
ICTPAT_S	42	0.832***	0.642***	0.727***	0.568***	0.656***
BIOPAT_S	42	0.887***	0.728***	0.783***	0.617***	0.668***
TMDRES_S	159	0.765***	0.565***	0.844***	0.654***	0.757***
TM_TOT_S	159	0.760***	0.565***	0.841***	0.654***	0.757***

Table AIII.3 Rank correlation of intensive-margin knowledge-capital indicators with (outward and inward) FDI stock and with GDP, 2000-2020 period, full country sample, but without tax-sheltering countries

Indicator namel	No. of country observa-tions	Rank corrrelation with outward FDI		Rank corrrelation with inward FDI		PM: Kendall rank corr. (tau-b) with own GDP
		Spearman's rho	Kendall's tau-b	Spearman's rho	Kendall's tau-b	
ADEDU_F	163	0.116	0.076	0.123	0.084	0.042
ADEDU_M	163	0.139*	0.090*	0.149*	0.101*	0.129**
LQ_CONTR	121	0.313***	0.209***	0.359***	0.240***	0.243***
FEM_RESR	32	-0.493***	-0.343***	-0.373***	-0.250**	-0.234*
TOT_RESR	125	0.716***	0.515***	0.661***	0.459***	0.415***
TOT_TECH	112	0.658***	0.467***	0.609***	0.423***	0.386***
GII_MAIN	123	0.775***	0.575***	0.751***	0.552***	0.445***
GII_INPUT	123	0.783***	0.581***	0.735***	0.536***	0.433***
GERCGDP	137	0.637***	0.449***	0.625***	0.443***	0.414***
GERPGDP	38	0.525***	0.346***	0.235	0.158	0.218*
GERD_CAP	38	0.599***	0.380***	0.358**	0.226**	0.218*
GVE_XGDP	38	0.212	0.158	0.015	0.021	0.155
HED_XGDP	38	0.386**	0.243**	0.250	0.164	0.110
ALLRES_LF	35	0.457***	0.261**	0.163	0.089	0.103
RDPERS_LF	34	0.500***	0.312***	0.169	0.102	0.159
ALLRES_EM	35	0.446***	0.250**	0.148	0.072	0.099
RDPERS_EM	34	0.518***	0.323***	0.194	0.112	0.169
GII_OUTPUT	122	0.729***	0.533***	0.727***	0.534***	0.433***
ECONPAP	157	0.752***	0.560***	0.818***	0.613***	0.548***
JRN_ART	183	0.471***	0.300***	0.486***	0.305***	0.281***
JUDINDEP	154	0.532***	0.369***	0.445***	0.305***	0.250***
IMPART_C	154	0.580***	0.420***	0.513***	0.354***	0.288***
IMP_PUBL	152	0.480***	0.333***	0.413***	0.289***	0.221***
PROTPROP	154	0.556***	0.389***	0.495***	0.342***	0.287***
LEG_FORCE	154	0.448***	0.320***	0.401***	0.280***	0.251***
INFDI_GDP	181	0.027	0.015	0.108	0.071	-0.136*
BF_IMSRV	141	0.360***	0.267***	0.384***	0.280***	0.276***
KIBS_IMSRV	176	0.495***	0.351***	0.572***	0.410***	0.366***
PAT_NRES	143	0.168**	0.124**	0.174**	0.127**	0.049
INT_USER	189	0.657***	0.466***	0.522***	0.360***	0.288***
INTSECUR	192	0.610***	0.431***	0.489***	0.342***	0.251***
BBND_SUB	188	0.619***	0.441***	0.506***	0.360***	0.282***
ICT_CONTR	119	0.231**	0.151**	0.287***	0.185***	0.107*
LP_EMPL	121	0.748***	0.555***	0.645***	0.463***	0.408***
LP_HOUR	121	0.756***	0.564***	0.658***	0.471***	0.413***
FORGN_MV	154	0.167**	0.114**	0.149*	0.105*	0.045
STARTABUS	154	0.476***	0.331***	0.451***	0.320***	0.251***
BERD_GDP	38	0.542***	0.357***	0.267	0.181*	0.240**
BUX_GERD	38	0.439***	0.306***	0.243	0.181	0.212*
BFIN_HERD	38	0.045	0.061	-0.089	-0.041	-0.056
BRES_TOT	34	0.571***	0.405***	0.368**	0.266**	0.330***
HT_MFGEX	167	0.486***	0.337***	0.455***	0.320***	0.272***
IT_SERVEX	173	-0.034	-0.024	-0.016	-0.013	0.027
ITPROD_EX	174	0.367***	0.242***	0.346***	0.226***	0.173***
BF_SRVEX	145	0.535***	0.371***	0.493***	0.341***	0.296***
KBS_SRVEX	181	0.255***	0.171***	0.347***	0.235***	0.207***
PATP_GDP	38	0.373**	0.403***	0.669***	0.243**	0.240**
PATI_GDP	38	0.668***	0.471***	0.435***	0.317***	0.275***
PATB_GDP	38	0.614***	0.414***	0.393***	0.272**	0.206*

PATP_RES	136	0.278***	0.183***	0.309***	0.194***	0.169***
TM_DRES	142	0.138	0.079	0.192**	0.113**	0.07
TM_TOT	151	0.061	0.038	0.119	0.073	0.063

Table AIII.4 Rank correlation of extensive-margin knowledge-capital indicators with (outward and inward) FDI stock and with GDP, 2000-2020 period, full country sample, but without tax-sheltering countries

Indicator name	No. of country observa-tions	Rank corrrelation with outward FDI		Rank corrrelation with inward FDI		PM: Kendall rank corr. (tau-b) with own GDP
		Spearman's rho	Kendall's tau-b	Spearman's rho	Kendall's tau-b	
HERD_S	38	0.830***	0.690***	0.809***	0.650***	0.824***
HRES_S	33	0.636***	0.458***	0.594***	0.443***	0.705***
HPER_S	36	0.723***	0.527***	0.689***	0.518***	0.762***
HFTE_S	36	0.726***	0.533***	0.682***	0.518***	0.724***
FEMRES_S	32	0.678***	0.516***	0.606***	0.472***	0.770***
GII_MAIN_S	123	0.775***	0.576***	0.751***	0.552***	0.446***
GII_INPT_S	123	0.783***	0.581***	0.735***	0.536***	0.433***
GERD_S	38	0.834***	0.662***	0.760***	0.576***	0.795***
GOVERD_S	38	0.688***	0.508***	0.633***	0.457***	0.698***
TOTRES_S	33	0.698***	0.538***	0.603***	0.462***	0.754***
GVRES_S	33	0.471***	0.341***	0.420**	0.303**	0.595***
TOTPER_S	34	0.735***	0.551***	0.657***	0.497***	0.775***
GVPER_S	35	0.524***	0.375***	0.469***	0.324***	0.620***
TOTFTE_S	35	0.771***	0.593***	0.687***	0.529***	0.771***
GVFTE_S	35	0.485***	0.351***	0.425**	0.287***	0.597***
GII_OUTP_S	122	0.729***	0.533***	0.727***	0.534***	0.433***
PAT_R_S	136	0.732***	0.545***	0.799***	0.600***	0.635***
JRNART_S	183	0.835***	0.644***	0.881***	0.705***	0.755***
PAT_NR_S	143	0.757***	0.562***	0.799***	0.609***	0.634***
BERD_S	38	0.821***	0.642***	0.706***	0.539***	0.724***
BRES_S	34	0.782***	0.608***	0.681***	0.523***	0.718***
BPER_S	37	0.765***	0.592***	0.683***	0.523***	0.730***
BFTE_S	36	0.786***	0.606***	0.695***	0.521***	0.718***
PCTPAT_S	38	0.861***	0.684***	0.749***	0.570***	0.664***
ICTPAT_S	38	0.846***	0.556***	0.713***	0.747***	0.718***
BIOPAT_S	38	0.902***	0.747***	0.771***	0.610***	0.642***
TMDRES_S	142	0.800***	0.606***	0.875***	0.689***	0.744***
TM_TOT_S	151	0.786***	0.589***	0.861***	0.675***	0.757***

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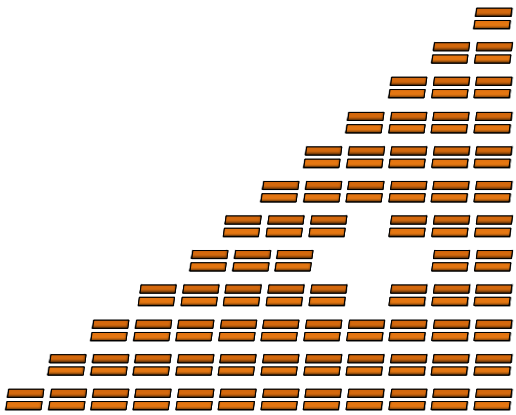

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