

The Role of Tax Incentives and Wage Dynamics in Shaping Foreign Direct Investment: A Cambodian Perspective (2009-2023)

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Article Info

Article history:

Received 2025-06-13

Revised 2025-06-28

Accepted 2025-08-05

Keywords:

Foreign Direct Investment inflows

Minimum Wage

Qualified Investment Project

Tax Exemption

Tax on Income

ABSTRACT

This study examines the impact of tax incentives—specifically those related to Tax on Income (ToI) exemptions—and minimum wage dynamics on foreign direct investment (FDI) inflows in Cambodia, with a focus on the role of Qualified Investment Projects (QIPs). Using descriptive statistics, one-way ANOVA, Tukey’s post hoc test, and multiple regression analysis, the research reveals significant variability in FDI inflows. The results strongly support Hypothesis 1, confirming that tax exemptions (5%, 10%, or 15%) are positively associated with higher FDI, although benefits diminish beyond a 5% exemption. Contrary to Hypothesis 2, a strong positive correlation ($r = 0.950$, $p < 0.001$) was found between the minimum wage and FDI, suggesting that rising wages may reflect economic stability and labor quality, thereby encouraging investment. Regression analysis ($R^2 = 0.931$, $p < 0.001$) reveals that both tax exemptions and minimum wage are positively related to FDI; however, only minimum wage demonstrates individual statistical significance ($B = 11.586$, $p = 0.002$). These findings offer partial support for Hypothesis 3, indicating that while tax incentives are relevant, wage levels play a more influential role in attracting FDI. The study concludes that a combination of higher minimum wages and generous tax exemptions yields the highest predicted FDI inflows, emphasizing the need for balanced economic policy.

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1. INTRODUCTION

Cambodia's economic transformation over the past three decades has been significantly influenced by its strategic efforts to attract foreign direct investment (FDI). Since transitioning to a market-based economy in the early 1990s, the government has introduced numerous reforms, particularly in investment and labor policy, to improve its global competitiveness and support sustainable development. Among the most critical tools used to attract foreign investors are tax exemptions and preferential wage structures,

which together form a cornerstone of Cambodia's economic policy framework. A central institution in shaping and managing Cambodia's investment landscape is the Council for the Development of Cambodia (CDC). Established following the enactment of the Law on Investment (LoI) in 1994, the CDC has overseen several iterations of policy reform aimed at improving the ease of doing business in Cambodia. A pivotal development occurred in 2003 with the introduction of the Qualified Investment Project (QIP) status. This designation enables eligible foreign and domestic investors to access a range of tax incentives, making Cambodia an attractive destination for investment, particularly in manufacturing and export-oriented industries. The evolution of Cambodia's investment framework culminated in the revised Law on Investment in 2021, which reflects the country's intent to align with modern global economic standards and attract higher-value industries. This updated law streamlined investment categories and introduced a more transparent and predictable incentive structure. It divides investment benefits into three main categories: basic, additional, and special incentives. The basic incentives offered to Qualified Investment Projects (QIPs) are especially appealing to international investors. These include exemptions from income tax (TOI) for a period that typically ranges between 6 and 9 years, depending on the sector and scale of investment.

Additionally, QIPs can opt for accelerated depreciation as an alternative to income tax exemptions. Other basic benefits comprise exemptions from minimum tax, prepayment of income tax (PTOI), and export duties. Production-related inputs also benefit from waived customs duties, specific taxes, and value-added tax (VAT), particularly when used in manufacturing or construction related to export-focused projects. Additional incentives further support investor operations by offering enhanced deductions and exemptions. For example, firms investing in research and development (R&D), worker training, or employee welfare programs are entitled to a 150% tax deduction on associated costs. Inputs sourced locally for production purposes can also be eligible for VAT zero-rating, thereby encouraging the development of the domestic supply chain. The policy also covers customs and tax exemptions for importing materials used in the construction of worker accommodation, signaling a broader commitment to improving labor conditions alongside investor support. While tax exemptions have proven effective in increasing FDI inflows, Cambodia's minimum wage policy complements these efforts by maintaining a cost-competitive yet regulated labor environment [1]. The garment and textile industries—Cambodia's most prominent export sectors—have been the primary beneficiaries of this dual policy approach. Investors are drawn by a combination of low labor costs and generous tax incentives, particularly in Special Economic Zones (SEZs), where infrastructure and administrative support are also provided. However, Cambodia has gradually raised its minimum wage levels over the years to balance investor interests with social equity. For instance, the minimum monthly wage for garment workers has increased incrementally through tripartite negotiations among the government, employers, and labor unions. This ensures that wage adjustments are based on economic performance, inflation, and living standards, rather than political pressure. Although these increases have a slight impact on Cambodia's cost competitiveness, they help promote labor stability and reduce worker turnover, factors that ultimately benefit long-term investment.

2. LITERATURE REVIEW

Cambodia has achieved notable success in attracting foreign direct investment (FDI), primarily driven by its open trade policies, bilateral investment treaties, and facilitation tools, such as the Qualified Investment Project (QIP) scheme [2]. These elements have enhanced its image as a favourable destination for investors within the ASEAN region. The country's welcoming stance toward foreign capital, combined with a cost-competitive labor force and preferential trade access to markets in the European Union and the United States, has supported steady economic growth over the past two decades. The QIP structure has played a pivotal role in attracting investors by offering incentives such as exemptions from Tax on Income (ToI), customs duties, and value-added tax (VAT). However, despite these developments, several gaps and structural limitations remain in the country's FDI model, which may hinder the long-term developmental impact of foreign investment. While FDI inflows have certainly supported wage growth and job creation, especially in the manufacturing sector, these benefits have not been evenly distributed. Helble and Takeda [3] note that gender-based wage disparities persist, with female workers receiving significantly lower pay than their male counterparts.

Furthermore, most investment continues to be channeled into low-tech, labor-intensive industries such as garments and footwear, with limited spillovers into higher-value sectors. This pattern of investment has led to a form of economic growth that, while robust, may not be sustainable or inclusive in the long term. Additionally, the concentration of FDI in urban and coastal areas, particularly Phnom Penh and Sihanoukville, has contributed to regional disparities, leaving rural provinces with limited access to the benefits of foreign investment.

One key instrument intended to address regional inequalities is the establishment of Special Economic Zones (SEZs). These zones are designed to decentralize investment and promote industrial development in less-developed areas. However, the full potential of Cambodia's SEZs has yet to be realized [4]. Infrastructural bottlenecks, bureaucratic inefficiencies, and inadequate coordination among government agencies have limited their effectiveness. Without a strategic plan to develop supporting infrastructure, enhance labor mobility, and improve administrative efficiency, SEZs are unlikely to achieve their intended impact. This reflects a broader issue within Cambodia's FDI policy framework: while incentives are generous, they are not sufficiently targeted or supported by complementary policies that promote equitable and sustainable development. Du et al. [5] analyze China's FDI development and emphasize the significance of adopting strategic and adaptable tax policies. China implemented aggressive tax reforms, including reducing the corporate tax rate for foreign enterprises to 15%, compared to 33% for domestic firms. These reforms, coupled with China's accession to the World Trade Organization (WTO) and a 9.4% reduction in average tariff rates, significantly enhanced the country's attractiveness to foreign investors. What distinguished China's approach was not only the generosity of its incentives but also their alignment with broader industrial and technological upgrading goals. Cambodia's existing incentive framework, by comparison, does not differentiate between sectors and lacks targeted measures to promote high-tech industries, environmentally friendly technologies, or innovation-driven industries.

Investments. Moreover, Cambodia does not currently evaluate the cost-effectiveness of its tax incentives in a systematic way. There is little empirical evidence demonstrating whether exemptions under the QIP framework led to meaningful outcomes in terms of innovation, skills development, or technology transfer. Without such data, it is difficult for policymakers to determine whether the fiscal cost of these incentives is justified. This gap is particularly concerning given that tax expenditures represent forgone public revenue that could otherwise be invested in education, healthcare, or infrastructure.

Regional experiences also highlight the significance of cross-border dynamics in influencing investment flows. A spatial econometric analysis in Africa found that reductions in corporate income tax led not only to increased FDI in the host country but also in neighboring countries, due to regional spillover effects [6]. Cambodia, situated in a strategically important position within the ASEAN Economic Community, has yet to capitalize on these dynamics fully. Collaborative efforts with neighboring countries like Thailand, Vietnam, and Laos to harmonize tax incentives and coordinate SEZ development could enhance regional competitiveness and attract investment into underdeveloped border regions. Human capital development is another area where Cambodia could improve the alignment of its tax policies with developmental goals. Edo et al. [7] found that in Nigeria, education-related taxes, such as the Tertiary Education Tax, had a positive influence on FDI by signaling the government's commitment to workforce development. Cambodia's 2021 Law on Investment includes provisions for additional tax incentives related to workforce training and research and development (R&D), including a 150% tax deduction for qualifying expenditures. However, these incentives are often underutilized due to a lack of awareness among investors, limited enforcement, and weak linkages between the private sector and educational institutions. Strengthening these connections could enhance the developmental quality of FDI and contribute to a more skilled and adaptable workforce. Finally, the broader literature on tax burden and FDI, as reviewed by Kiburi et al. [8], reveals that the effectiveness of tax incentives varies significantly depending on the institutional context, administrative capacity, and policy coherence. Some countries experience a strong inverse relationship between tax burden and FDI, while others see no significant correlation. This suggests that incentives alone are insufficient; they must be part of a comprehensive investment climate that encompasses regulatory transparency, judicial efficiency, infrastructure, and labor market flexibility. In Cambodia's case, persistent issues such as informal fees, opaque regulations, and limited dispute resolution mechanisms continue to undermine investor confidence.

Hypotheses and Research Framework

H1: Higher tax exemption percentages are associated with higher FDI inflows

H2: Minimum wage is negatively correlated with FDI inflows

H3: Tax exemption and minimum wage significantly predict FDI inflows

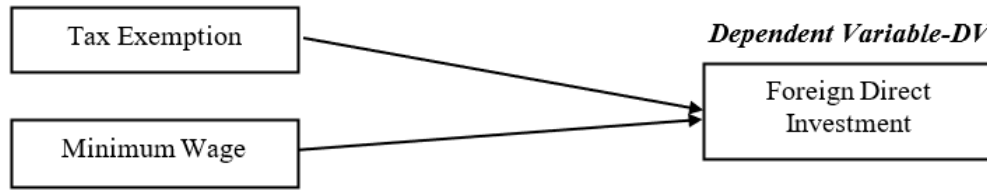


Figure 1. Research Framework

3. METHOD

Bringula et al. [9] employed a descriptive survey research design in their study. For the current analysis, data on FDI inflows, Tax exemption rates, and minimum wages were gathered from the UN Conference on Trade and Development (UNCTAD) and country-specific sources, as well as Cambodia's minimum wage data for the period from 2009 to 2023. One-way ANOVA is a statistical technique used to determine whether there are statistically significant differences among the means of three or more independent groups, each defined by a single categorical variable. It tests whether all group means are equal under the null hypothesis, while the alternative suggests that at least one group mean differs.

As noted by Aiken et al. [10], multiple regression analysis (MR) is a versatile method for exploring how a set of independent variables (predictors) is related to a single dependent variable (criterion). This method is effective in identifying the relationship between dependent and independent variables and is commonly used in both statistical analysis and machine learning to develop predictive models. Additionally, a p-value less than 0.05 ($p < 0.05$) indicates a statistically significant deviation from the baseline regression model, suggesting the presence of a threshold. On the other hand, a p-value greater than 0.05 ($p > 0.05$) implies a lack of sufficient evidence to confirm significant improvement over the baseline in that region [11]. To analyze the data, Pearson's product-moment correlation was applied [12]. Furthermore, a p-value above 0.05 suggests the correlation is not statistically significant, meaning there is inadequate evidence of a linear relationship between the variables [13], as assessed using SPSS version 26.

The empirical model used in this study was based on the work of Fuangfoo [14], as specified below.

$$\begin{aligned}
 \text{FDI_INFLOWS} = & \beta_0 + \beta_1 \text{GDP} + \beta_2 \text{MINIMUM_WAGE} + \beta_3 \text{POPULATION} \\
 & + \beta_4 \text{EXPORT_IMPORTS} + \beta_5 \text{EXTERNAL_DEBT_STOCKS} \\
 & + \beta_6 \text{INFLATION} + \beta_7 \text{GOVERNANCE} + \beta_8 \text{INTERNET_USERS} + \varepsilon \\
 & \dots\dots\dots (1)
 \end{aligned}$$

- β_0 = Constant (intercept)
- $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6, \beta_7, \beta_8$ = Regression Coefficients
- ε = Error term

Consequently, an augmented structural model is specified below:

$$\text{FDI} = \beta_0 + \beta_1 \cdot \text{Minimum Wage} + \beta_2 \cdot \text{D1} + \beta_3 \cdot \text{D2} + \beta_4 \cdot \text{D3} + \mu \dots\dots\dots (2)$$

Where,

FDI = Foreign Direct Investment inflows

Minimum Wage

β_0 = Constant (intercept)

$\beta_1, \beta_2, \beta_3$ = Regression Coefficients

D1=5%, D2=10%, D3=15% (Dummy variables = Tax Exemption Rate)

μ = Error term

4. RESULTS AND DISCUSSION

According to Table 1, a strong and generally upward trend in FDI inflows is evident over the 15 years, with inflows increasing from approximately USD 985 million in 2009 to nearly USD 3,959 million in 2023, representing a fourfold growth.

2009–2012: The initial period saw consistent growth, nearly doubling from USD 984.71 million in 2009 to USD 2,003.85 million in 2012. This suggests a period of increasing investor confidence, likely driven by recovery from the 2008 financial crisis and strengthening economic fundamentals.

2013–2015: Inflows plateaued and slightly declined during these years, dropping from USD 2,068.47 million in 2013 to USD 1,822.80 million in 2015. This stagnation may reflect temporary challenges, such as regional competition, political or regulatory uncertainties, or global economic slowdowns that impact investment flows.

2016–2019: A robust recovery and growth phase occurred, with inflows climbing sharply to USD 3,663.03 million by 2019. This period likely benefited from favourable policy reforms, infrastructure improvements, and diversification of the investment base.

2020–2021: The slight decline in 2020 and 2021 to USD 3,483.46 million is consistent with the global impact of the COVID-19 pandemic, which caused disruptions in international capital flows and economic activity. However, the relatively small drop indicates resilience compared to many economies.

2022–2023: Post-pandemic recovery is evident, with inflows rising again to USD 3,958.79 million in 2023, the highest in the series. This suggests renewed investor confidence and possibly the emergence of new economic opportunities in the country.

Furthermore, Table 1 shows that the trajectory of minimum wages in Cambodia over the 15 years from 2009 to 2023 reveals a significant upward adjustment, reflecting the country's broader socio-economic development and labor market dynamics.

In 2009, the minimum wage was USD 50 per month, consistent with Cambodia's status as a low-income country heavily reliant on labor-intensive industries, such as textiles and garments. The initial period from 2009 to 2012 saw relatively modest wage growth, with the minimum wage rising to USD 61, suggesting a cautious approach by policymakers to balance labor cost competitiveness with workers' welfare.

Beginning in 2013, there was a marked acceleration in wage increases: from USD 61 in 2012 to USD 80 in 2013, and continuing to USD 100 in 2014. This period coincides with Cambodia's efforts to improve living standards, reduce poverty, and respond to both domestic labor movements and international pressures advocating for fair wages.

The subsequent years witnessed sustained and relatively rapid wage growth, with the minimum wage reaching USD 128 in 2015, USD 140 in 2016, and USD 153 in 2017. This upward trend aligns with Cambodia’s economic growth, increased productivity, and the government’s commitment to social protections and labor rights, especially within the garment sector—a key driver of exports and employment.

From 2018 onwards, wage growth persisted but at a slower pace, increasing from USD 170 in 2018 to USD 200 in 2023. This moderation may reflect the balancing act between ensuring living wage improvements and maintaining the competitiveness of Cambodia’s export sectors in the face of regional competition and evolving global market conditions.

Table 1. Annual FDI Inflows, Tax Exemption Rates, and Minimum Wage

<i>Years</i>	<i>FDI Inflows (Mil-USD)</i>	<i>Tax Exemption %</i>	<i>Minimum Wage (USD/month)</i>
2009	984.71	0	50
2010	1,404.32	0	61
2011	1,538.88	0	61
2012	2,003.85	0	61
2013	2,068.47	0	80
2014	1,853.47	0	100
2015	1,822.80	0	128
2016	2,475.92	0	140
2017	2,785.73	0	153
2018	3,212.63	5	170
2019	3,663.03	5	182
2020	3,624.65	10	190
2021	3,483.46	10	192
2022	3,578.83	15	194
2023	3,958.79	15	200

Source: UN Trade and Development (UNCTAD)

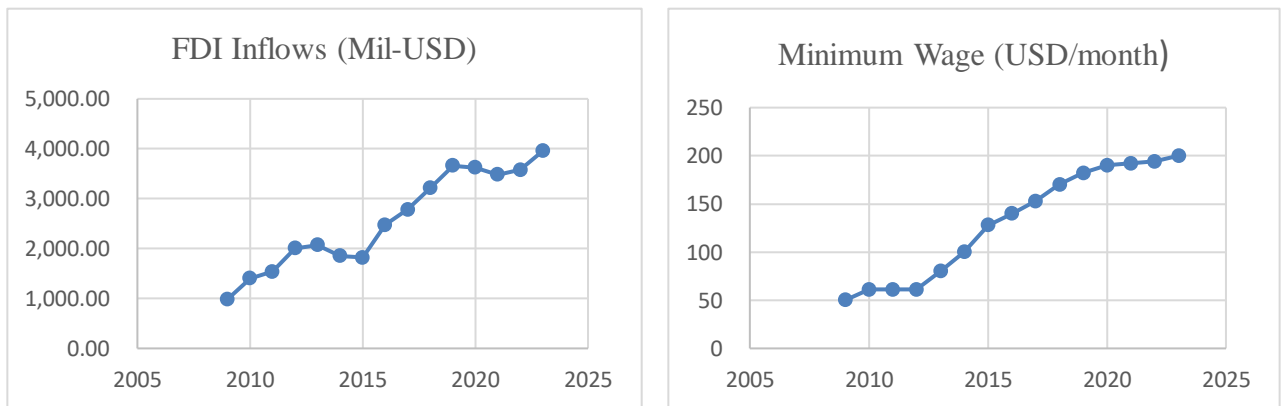


Figure 2. Annual FDI inflows and Minimum Wage

Table 2 presents the descriptive statistics for the key variables examined in this study: FDI inflows, tax exemption rates, and minimum wage levels, covering the period from 2009 to 2023 (N = 15). The results indicate that FDI inflows ranged from \$984.71 million to \$3,958.79 million, with a mean value of \$2,563.97 million and a standard deviation of \$968.60. This suggests substantial variation in FDI over time, potentially influenced by both domestic policy and external economic conditions.

The average tax exemption rate during the period was 4.00%, with a minimum of 0% and a maximum of 15%. The standard deviation, which is relatively high at 5.73%, indicates considerable variability.

Minimum wage levels showed a progressive increase from \$50/month to \$200/month, with a mean of \$130.80 and a standard deviation of \$56.98.

Table 2. Summary of Descriptive Analysis

	<i>N</i>	<i>Min</i>	<i>Max</i>	<i>Mean</i>	<i>SD</i>
<i>FDI Inflows</i>	15	984.71	3958.79	2563.9693	968.60165
<i>Tax Exemption %</i>	15	0	15	4.00	5.732
<i>Minimum Wage</i>	15	50	200	130.80	56.978
<i>Total</i>	15				

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

One-Way ANOVA Analysis

HI: Higher tax exemption percentages are associated with higher FDI inflows.

Table 3 shows a statistically significant impact of tax exemptions on FDI inflows, $F(3, 11) = 15.160$, $p < 0.001$.

- The high F-value (15.160) and low p-value (< 0.001) indicate that at least one tax exemption group differs significantly from the others in terms of average FDI inflows.

Table 3. One-Way ANOVA Results for FDI Inflows by Tax Exemption Levels

<i>Source</i>	<i>Sum of squares</i>	<i>Df</i>	<i>Mean Square</i>	<i>F</i>	<i>Sig.</i>
Between Groups	10,576,621.204	3	3,525,540.401	15.160	0.000
Within Groups	2,558,027.011	11	232,547.910		
<i>Total</i>	<i>13,134,648.215</i>	<i>14</i>			

Table 4 demonstrates that the one-way ANOVA, along with Tukey's post hoc test, offers strong support for this hypothesis. Specifically, the results show that countries offering 0% tax exemption have significantly lower FDI inflows compared to countries offering 5%, 10%, and 15% tax exemptions (mean differences ranging from approximately -1,556 to -1,887 million USD, all p-values < 0.01).

However, the differences in FDI inflows between the 5%, 10%, and 15% tax exemption groups were not statistically significant ($p > 0.05$). This suggests that while the introduction of tax exemptions is associated with higher FDI inflows relative to no exemption, increasing the exemption beyond 5% does not yield statistically significant additional gains in FDI.

Table 4. Tukey HSD Post Hoc Test for Differences in FDI Inflows Between Tax Exemption Groups

<i>Group Comparison</i>	<i>Mean Difference</i>	<i>Sig.</i>
0% V.S 5%	-1,555.81333*	0.008
0% V.S 10%	-1,672.03833*	0.005
0% V.S 15%	-1,886.79333*	0.002
5% V.S 10%	-116.22500	0.995
5% V.S 15%	-330.98000	0.900
10% V.S 15%	-214.75500	0.969

These results strongly support *H1*, suggesting that higher tax exemption rates are indeed associated with increased FDI inflows. The post hoc Tukey test further confirms that FDI inflows at 0% exemption were significantly lower than those at 5%, 10%, and 15% exemption levels (all $p < 0.01$), though differences between the higher exemption levels (5%, 10%, 15%) were not statistically significant [15].

Correlation Analysis

H2: Minimum wage is negatively correlated with FDI inflows.

Pearson Correlation Analysis

Table 5. Pearson Correlation Matrix for FDI Inflows and Minimum Wage

		<i>FDI Inflows</i>	<i>Minimum Wage</i>
<i>FDI Inflows</i>	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	15	
<i>Minimum Wage</i>	Pearson Correlation	0.950**	1
	Sig. (2-tailed)	0.000	
		15	15

According to Table 5, the Pearson correlation analysis was conducted between minimum wage and FDI inflows using data from 15 years (2009–2023). The results show a strong and statistically significant positive correlation between minimum wage and FDI inflows, $r = 0.950$, $p < 0.001$. Although the correlation is high, multicollinearity is not a concern, as only one independent variable was used in the regression model. The Variance Inflation Factor (VIF) was 1.000, confirming the absence of multicollinearity.

This finding directly contradicts *Hypothesis 2*, which predicted a negative correlation between the variables. Instead, the results suggest that higher minimum wages are strongly associated with higher levels of FDI inflows. This finding aligns with the result of Silva et al. [16].

Multiple Linear Regression

H3: Tax exemption and minimum wage significantly predict FDI inflows.

Table 6, summarized below, shows that the multiple regression model significantly predicts FDI inflows, $F(4,10) = 33.517$, $p < 0.001$, explaining 93.1% of the variance.

Among the predictors, minimum wage was the only statistically significant variable ($B = 11.586$, $p = 0.002$), suggesting that higher wages are associated with increased FDI. While the dummy variables representing tax exemption levels (5%, 10%, and 15%) had positive coefficients, none reached statistical significance at the 0.05 level, indicating that tax exemption alone may not significantly predict FDI when minimum wage is controlled for. Therefore, *Hypothesis 3* is partially supported: the model is significant, and the minimum wage is a significant predictor; however, the tax exemption variables are not individually significant within this model.

Table 6. Multiple Linear Regression Results on the Effect of tax exemption and minimum wage on FDI inflows

<i>Variables</i>	<i>Unstandardized Coefficient (B)</i>	<i>Standard Error</i>	<i>t-value</i>	<i>Sig.</i>
<i>Constant</i>	808.362	271.968	2.972	0.014
<i>Minimum Wage</i>	11.586	2.727	4.249	0.002
<i>D1</i>	590.296	327.628	1.802	0.102
<i>D2</i>	532.728	357.209	1.491	0.167
<i>D3</i>	677.966	369.645	1.834	0.097

R = 0.965
R Square = 0.931
Adjust R Square = 0.903
F = 33.517

Regression Equation

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

$$\text{FDI} = 808.362 + 11.586 \times \text{Minimum Wage} + 590.296 \times \text{D1} + 532.728 \times \text{D2} + 677.966 \times \text{D3}$$

This equation estimates the level of FDI inflows based on Cambodia's minimum wage and the level of tax exemption offered [17].

Thus, the equation indicates that both higher minimum wages and tax exemptions (especially 15%) are associated with higher FDI inflows. The largest boost comes from increasing wages and offering a 15% exemption.

5. CONCLUSION

This study provides compelling evidence on the influence of tax incentives and wage dynamics on FDI inflows in Cambodia. Descriptive statistics show notable fluctuations in FDI, highlighting the sector's sensitivity to policy and economic conditions. The results support Hypothesis 1, with one-way ANOVA and Tukey's post hoc test confirming that countries offering tax exemptions (5%, 10%, or 15%) attract significantly more FDI than those offering none. However, benefits diminish beyond the 5% threshold, suggesting that there are limited marginal returns from higher exemption rates. In contrast, Hypothesis 2 is not supported; rather than a negative association, a strong positive correlation ($r = 0.950$, $p < 0.001$) was found between minimum wage and FDI, indicating

that higher wages may reflect broader macroeconomic stability, enhanced labor quality, or increased market attractiveness. Multiple regression analysis further underscores these findings: while the overall model strongly predicts FDI inflows ($R^2 = 0.931$, $F(4,10) = 33.517$, $p < 0.001$), only minimum wage remains individually significant ($B = 11.586$, $p = 0.002$). This suggests Hypothesis 3 is only partially supported, with wage levels playing a more influential role than tax incentives when considered together. The highest FDI inflows are predicted under scenarios combining elevated minimum wages with generous tax exemptions.

However, the study is limited by its Cambodia-specific focus, the use of secondary data over a narrow timeframe, and the exclusion of other influential factors. Notably, critical variables such as political stability, infrastructure quality, and labor productivity were excluded, which may limit the model's explanatory power and the broader applicability of the results. Future research should address these gaps by conducting cross-country or longitudinal studies, incorporating a more comprehensive set of variables, and employing qualitative methods or simulations to gain a deeper understanding of the underlying mechanisms that shape FDI decisions.

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