

DOI 10.26886/2524-101X.10.1.2024.3

The Impact of Reduced Tax Rate of Corporate Income Tax and Other Incentives in Foreign Direct Investments in Selected Balkan Countries

Bedri Peci*, Egzona Kozhani**

*Full Professor, Faculty of Law (Financial Law Department), University of Prishtina "Hasan Prishtina" (Agim Ramadani Str. pn, 10000 Prishtina, Republic of Kosovo) <https://orcid.org/0000-0003-4506-0069>

**Master of Law, University of Prishtina "Hasan Prishtina" (Agim Ramadani Str. pn, 10000 Prishtina, Republic of Kosovo) <https://orcid.org/0009-0007-8708-0312>

ABSTRACT

This paper analyze the nuanced relationship between corporate income tax (CIT) rate reductions as a tax incentive and foreign direct investments (FDI) across the Western Balkan countries. Additionally, it examines the extent to which they have progressed with their achievements during two decades (2000-2022). The transition of the Western Balkans from a closed and controlled economy to an open market economy has been challenging, but despite this, they have implemented certain policies to compete in the global market. For instance, they have reduced tax rates and offered tax incentives to attract foreign investors. This has had the effect of lowering the average tax rate, specifically in the year 2000, the average tax rate in corporate income tax was around 17%, while in 2023 the average tax rate in corporate income tax is 11%, or 6% lower. However, despite taking measures, the expected results have not been achieved. Privatization of public enterprises has been one of the main investments that these countries have attracted. The paper addresses the problems that have led to poor results and the inability of countries to convince investors for larger investments. In Kosovo, the issue of progress in this area is being overlooked by the government. It is important for Kosovo to recognize that neighboring countries are making significant progress, and therefore, it is critical to conduct research that not only highlights the current situation but also identifies potential solutions for the future.

CITATION

Peci, B., & Kozhani, E. (2024). The Impact of Reduced Tax Rate of Corporate Income Tax and Other Incentives in Foreign Direct Investments in Selected Balkan Countries. *LexPortus*, 10(1), 41–55. <https://doi.org/10.26886/2524-101X.10.1.2024.3>

KEYWORDS

tax rates, tax incentives, tax competition, Western Balkan Countries, tax reforms, tax reduction



The journal is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License

Introduction

The race between countries to attract as much foreign capital as possible has been going on for decades. In today's world, where countries are increasingly interconnected and dependent on each other's economies, it is essential to have favorable tax policies in place in order to attract and retain investment. Lowering tax rates and providing tax incentives have already been shown to yield positive outcomes. Therefore, reforming tax policies plays a crucial role in promoting economic growth and stability. Initially, the choice to apply measures in the fiscal system of the state was completely the choice of the state, but, with the increase in tax competition, the application of measures has become mandatory to some extent.

This study presents the changes made by the sample countries for two decades, starting from 2000 to 2022. The impact of these changes varied depending on the individual specifications of each country. This is because the results of undertaking such actions are related to socio-political dynamics, institutional sustainability, demographic dividends and infrastructural sustainability.

Developed and politically stable countries tend to attract more foreign investments, irrespective of tax rate reductions or tax incentives. However, underdeveloped countries with

less economic confidence are often left with no choice but to take more drastic measures to place themselves in a favorable position and attract foreign investments. Meanwhile, those in development, which enjoy less confidence, are forced to undertake more drastic actions in order to place themselves in a favorable position.

In this paper, not only the immediate effects of tax reforms on investment behavior are elaborated, but it highlights the areas that should be focused, such as taking measures to influence institutional strengthening, in order to aspire to sustainable and attractive development for investments. In essence, this paper tries to break down the reasons why in some countries the measures that have been shown to be successful, have the opposite effect in other countries, underlining the necessity of creating unique measures adapting to the needs of the country in relation to the resources and potential it has.

Tax reforms in the countries of the Western Balkans have been addressed on this basis. For these countries, the effect of tax reforms has been elaborated, but also the complications of the system beyond the reduction of tax rates, focus on social elements and their effect on achieving the goal, of attracting foreign investments. The paper highlights the corporate income tax as one of the taxes under focus, particularly the impact of reducing this tax rate as a way to attract foreign investments and promote a favorable business environment.

Methodology

In this analysis, in regard to data collection, we have conducted an extensive review of academic papers, reports and statistics from international organizations like OECD, UNCTAD, financial publications, and national bank reports to gather empirical data and expert analyses. We, also utilized official data and publications from governmental bodies and institutions in the respective countries under study to ascertain tax policies, investment trends, and economic indicators.

The analysis involved both quantitative evaluation of tax rate data across different time periods (2000–2022) and qualitative examination of investment trends and policy changes in the respective countries. Graphs and tables, sourced from credible institutions and reports, were utilized to visually represent investment trends post-tax rate reductions, aiding in clear visualization and understanding of the data.

The methodology focused on identifying patterns in investment behavior vis-à-vis tax policy changes. This involved understanding the drivers of successful investment attraction beyond tax incentives and deducing policy implications for nations seeking to enhance foreign investment inflows.

Literature Review

The application of tax incentives for capital withdrawal and not only, been applied for a long time now and it has existed for centuries. It is difficult to determine who was the first person to mention tax incentives as a concept.

The author who has contributed to this direction is Arthur Laffer, who developed Laffer Curve. This curve provides clarification on the relationship between public revenues from taxes and tax rates, which explains that a reduction in tax rates could lead to an increase in tax revenues (Ebrill, 1987). The theory of Arthur Laffer, concluded that a disproportionately high tax rate leads to a high split between gross and net wages, low production, low income, and, consequently, low tax revenue (Heijman & van Ophem, 2005). From this, we can say that if the government lowers the tax rates, it means that it will encourage economic growth, said in other words states should apply tax incentives for economic growth.

Also, Milton Friedman, an American economist who received the 1976 Nobel Memorial Prize in Economic Sciences, has contributed a lot in this field. His book "Capitalism and freedom" published in 1962 emphasizes that high tax burdens and a complex tax structure give individuals an incentive to misuse and misdirect resources and distort the investment of new savings. For economic growth and stability what we need is a reduction of government intervention, not an increase (Friedman, 2020). He believed that minimal intervention of government in the economy and low tax rates would lead to economic growth.

Applying tax incentives like tax reduction or others, involves the country in tax competition since these incentives create an attractive jurisdiction for foreign direct investment. Richard A. Epstein has written about the importance of tax competition in economic growth, also mentioning that if government intervention in the economy is reduced it will contribute to economic growth. Epstein supports the idea that flat rates should be applied to taxes. Increasing the overall tax burden will have profound negative effects on growth because increasing the amount of money in government hands can only reduce the return to productive labor (Epstein 2014).

Whereas, foreign direct investments are one of the crucial elements of a country's economic integration into the global market, because it reflects the level of a country's competitiveness in international markets and indicates the economic partnerships with other countries (Gaspareniene et al., 2022).

Even for the countries of the Western Balkans, several authors have contributed to the concrete problems that preoccupy these countries.

A series of studies have underscored the importance of various determinants influencing FDI inflows in transition economies, particularly focusing on the role of tax policies in attracting these investments. Silajdzic and Mehic (2022) elucidate that apart from traditional factors like market size and labor costs, institutional and policy factors significantly influence FDI decisions in transition economies. They highlight the critical role of favorable tax policies in the location decisions of Multinational Corporations (MNCs), emphasizing its importance in fostering economic growth and efficiency.

However, the relationship between FDI inflows and economic growth in Central and Eastern Europe remains a topic of debate. Increased FDI inherently leads to positive economic outcomes such as productivity growth, technology transfer, and employment generation, but the type of FDI is more important to this economic growth than the number of investments (Stosic et al., 2011).

Similarly, Vasa and Angeloska (2020) emphasize the significant developmental prospects associated with foreign direct investments in the Western Balkans, linking it to increased production, employment opportunities, exports, and long-term improvements in living standards.

But there are also authors who see tax competition in attracting foreign investments with a dose of skepticism.

According to Paun (2019), taxation represents the primary source of government revenue. Thus, an increase in revenue can only occur through an increase in tax pressure or an increase in the tax base. The tax competition could be beneficial for the countries, but it can also be harmful, leading to a 'race-to-the-bottom' with countries reducing their statutory corporate income tax rates.

Martinez-Vazquez and McNab (1999) focus on the inadequacies in markets and tax administrations in transition and developing countries. They argue that poorly developed tax systems in these economies, coupled with tax incentives, could inadvertently lead to reduced revenue collections due to evasion and avoidance behaviors.

We support the idea that economic trends should be followed by all countries and the reduction of tax rates together with the application of tax incentives has shown success in many countries of the world by strengthening the economy and solving various problems such as unemployment. However, such measures should be undertaken after studies and accurate assessment of the state's needs. Reducing tax rates by not focusing on solving a problem and not measuring the impact on public revenues may have undermined the country's economy, as has happened to many countries that have been sent to state bankruptcy. Therefore, small countries like these in the Western Balkans with developing economies should be encouraged to take steps towards creating a suitable environment for investors but with special care to the long-term results of these measures. Through the balancing of direct and indirect taxes, higher tax competition will be enabled and at the same time, the financing of social needs will be enabled (Peci, 2016).

1. Tax Rate Reduction of CIT as a Tax Incentive

It is no longer optional for states to reduce tax rates, as it has become a mandatory decision. Both developed and developing states, regardless of their size, are lowering tax rates to create a more appealing environment for businesses. Some countries are taking measures to retain existing investors, while others are trying to attract new investments.

The outcome of taking certain actions varies from state to state. However, the success of such actions is heavily dependent on various socio-political and developmental factors. Countries that exhibit political stability, maintain good neighborly relations, and guarantee peace are considered more reliable for investment. These countries are attractive to investors, despite not necessarily offering tax breaks. Additionally, countries with favorable demographics, such as a young and well-educated workforce, are also attractive to potential investors. Furthermore, countries that offer essential infrastructural amenities, like continuous electricity supply and drinking water, present an advantage over those that do not. The latter cannot create a suitable and safe environment for foreign investments.

A noticeable trend worldwide is the reduction of corporate income tax rates. This is also observed in Europe where there is a significant decrease in tax rates, especially in corporations. Large European countries with higher tax rates have had to adjust to the trend of reducing the corporate income tax rate. In the 2000s, the corporate income tax rate was about 36 % among the highest tax rate states. However, due to tax rate cuts, the average rate is now around 22 % in 2023, which is 14 % lower.

To examine the impact of tax rate reductions on the countries listed in Table 1, we will consider Germany, one of Europe's strongest economies, and Portugal, the least powerful economic nation among the countries in Table 1. Official data shows different outcomes in Germany and Portugal.

Table 1. Corporate income tax in countries with the highest rates in Europe 2000–2022 (OECD 2022 and PwC. Created by the authors)

Countries	2000	2010	2020	2023
Germany	40 %	15 %	15 %	15 %
France	33 %	33 %	31 %	25 %
Italy	41 %	31 %	24 %	24 %
Spain	35 %	30 %	25 %	25 %
Portugal	35 %	25 %	21 %	21 %

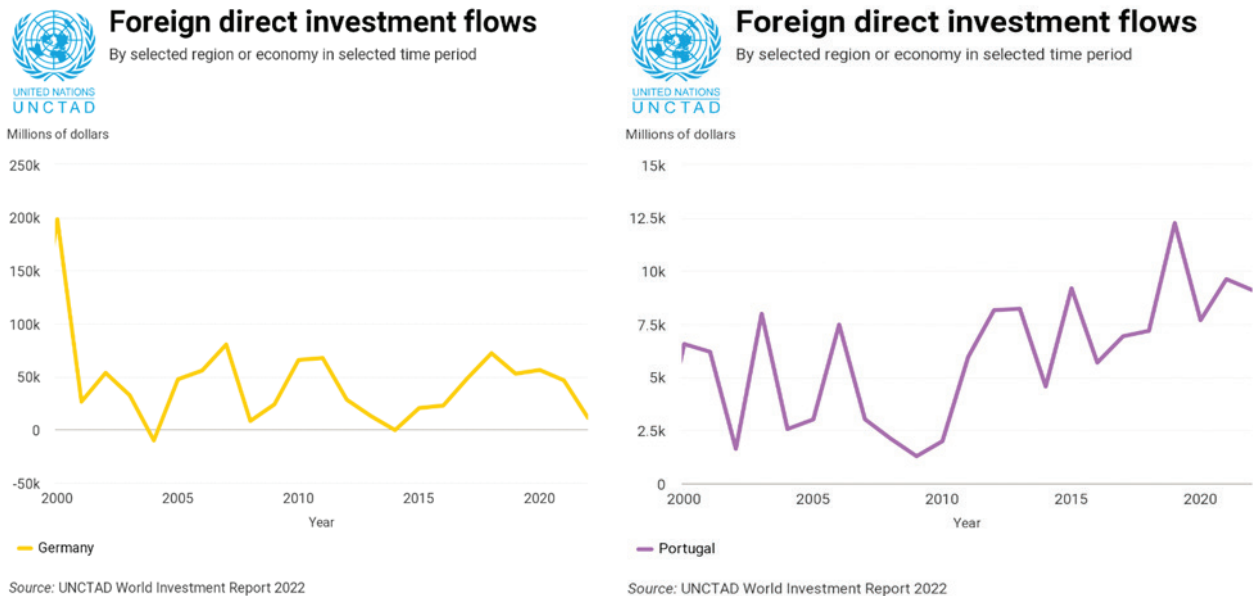


Figure 1. Curve of investment changes in Germany and Portugal after the reduction of corporate income tax rates (UNCTAD)

Based on Figure 1, it is evident that after the reduction of tax rates, Germany experienced a decrease in foreign investments, but the trend has been stable since 2000. This decline may have been influenced by the reduction in investment value as a result of the reduced tax rate, leading to lower tax liability. However, it is undeniable that there has also been a genuine decline in investments. In 2022, over 135 billion euros of foreign direct investment flowed out of the country (Martin & Patrica, 2023). In contrast, the efforts made have yielded positive outcomes for Portugal. Despite experiencing occasional declines, the country has shown an upward trend in the last two decades. Reports from the OECD indicate that Portugal has one of the highest levels of inward foreign direct investment stocks in comparison to other OECD member nations, amounting to 71 % of GDP in 2021 (OECD, 2023).

Based on the examples provided, it can be concluded that a reduction in tax rates does not always lead to an increase in foreign investments. Powerful countries like Germany are obligated to reduce tax rates in order to preserve foreign investments, but not necessarily to increase investments. This is because even with the reduction in tax rates, countries like Germany are able to provide peace, stability, equal treatment, human potential, and infrastructural conditions for successful business operations, which are attractive to foreign investors. On the other hand, for relatively developed countries that have less to lose, a reduction in tax rates, despite reducing revenues, has a positive effect on the increase of investments.

The Western Balkan countries have been affected by the need to harmonize tax rates. In 2000, the average tax rate in corporate income tax was around 17 %, while in 2023 the average tax rate of this tax is 11 %, or 6 % lower.

In the year 2000, Albania had the highest tax rate at 23 %. Kosovo and Montenegro followed with 20 %. Over the years, tax rates have been significantly reduced in some countries, causing economic difficulties that led them to return to higher rates. Albania and Serbia are the only two countries that have taken this action, and Serbia has even increased its tax rate more than

before the initial reduction, currently standing at 15 %. Montenegro has also made a drastic reduction, having the lowest tax rate in the region at 9 %.

Table 2. Corporate income tax rates in Western Balkan Countries 2000–2022 (OECD 2022 and PwC. Table created by the authors)

Countries	2000	2010	2020	2023
Kosovo	20 %	10 %	10 %	10 %
Albania	23 %	10 %	15 %	15 %
Montenegro	20 %	9 %	9 %	9 %–15 %
North Macedonia	15 %	10 %	10 %	10 %
Serbia	14 %	10 %	15 %	15 %

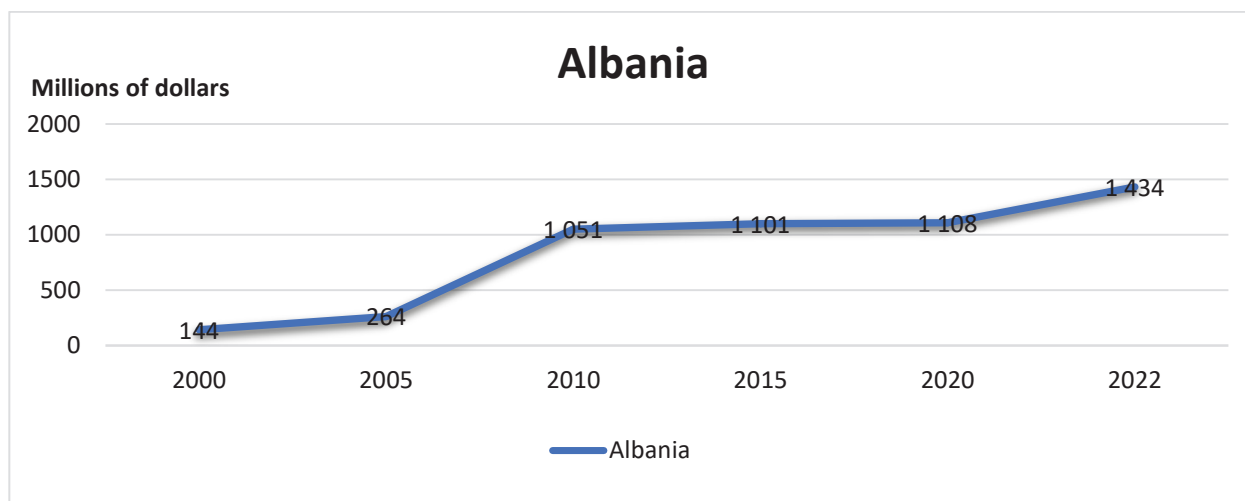
The Balkan countries reformed their tax system to attract foreign investment and become more competitive. However, Western Balkan countries with lower purchasing power are less attractive to investors. The lack of rule of law is a significant obstacle in these countries. Despite these challenges, these countries still attract considerable investment.

1.1. The Albania case

Table 2 shows that Albania had the highest corporate income tax rate among the Western Balkan countries in 2000. In competition with other countries in the region lowering their tax rates, Albania also reduced its tax rate drastically, from 23 % to 10 %. Although this resulted in an increase in foreign investments between 2000 and 2010, the tax rate has since been increased to 15 %, because Albania's debts have also increased (Koleka, 2015).

Despite the tax rate increase to 15 %, Albania's trendline remains positive. According to Table 3, the first increases began after 2005, with foreign investments rising in 2007 and 2009 due to the privatization of companies such as Albtelecom and privatization of the banking system. Investments from EU countries, primarily Greece and Italy, have focused on the processing and footwear industries (Central Bank of Albania, Annual Report 2007).

Table 3. The impact of reduced tax rate on foreign direct investments in Albania (UNCTAD. Table created by the authors)



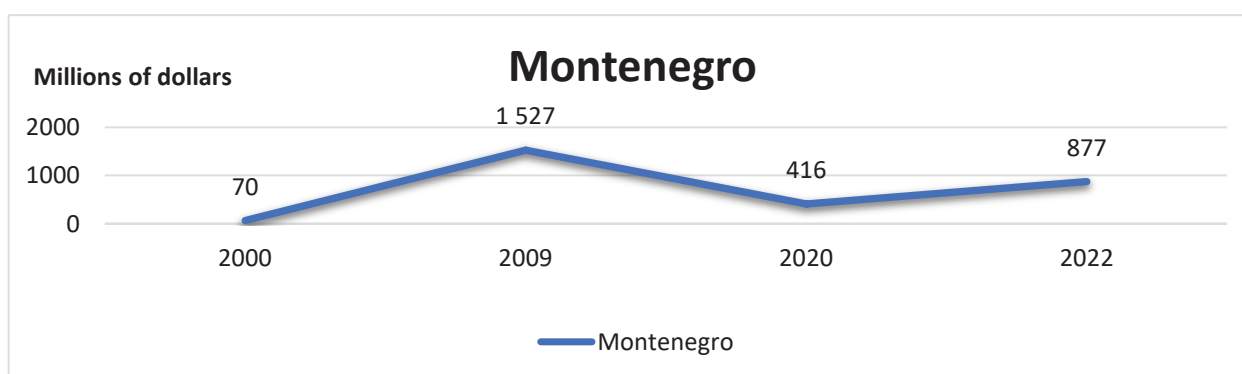
The investments made between 2010 and 2020 decreased in 2012 and 2015. In 2012, the decline in investment activity was caused by economic uncertainty, low-capacity utilization rate, weak demand, and tight lending policies which affected businesses (Central Bank of Albania, Annual Report 2012). Despite its favorable geography, Albania has not seen significant investment in any field other than privatization, which has limited the growth of investments and the overall strengthening of the economy. As a result, the country has remained on a relatively steady economic trajectory in the years following privatization.

It appears that reducing tax rate alone has not been enough to foster development in Albania. As a result, Albania needs to implement other policies that complement the reduction of tax rates. These policies should be aimed at attracting investments to industries that have the potential and motivation to grow and benefit the public.

1.2. The Montenegro case

Montenegro is an interesting case among the Western Balkan countries, as it has the lowest tax rate in the region and one of the lowest in the world. In the year 2000, Montenegro had one of the highest rates at 20 %, but this was drastically reduced to 9 %. In 2022, the country presented a progressive rate in corporate income, ranging from 9 % to 15 %.

Table 4. The impact of reduced tax rate on foreign direct investments in Montenegro (UNCTAD. Table created by the authors)



Based on UNCTAD's data, it is evident that Montenegro witnessed high growth in 2009 following a reduction in tax rate. However, this growth was short-lived and did not lead to any significant increase. On the other hand, in 2022, after the implementation of the progressive tax system, there was a slight increase in growth, which was the highest since 2009.

Similar to what happened in Albania, privatization involvement played a significant role in boosting the investment curve.

In 2002, the privatization of Jugopetrol brought about the first significant increase in foreign investments to Montenegro, with a 75 % rise (Central Bank of Montenegro, Annual Report 2003). However, the following year, there was a decrease in investments, indicating that Montenegro failed to establish an investment-friendly environment outside of privatization. This pattern repeated in 2009, which marked the peak of investments. Fast forward to 2019, the Electric Company of Montenegro (EPCG), was sold to Italian company, A2A, and recapitalized (Central Bank of Montenegro, Annual Report 2009). Nonetheless, the year 2010 saw another significant drop in investments. In other words, for a decade, Montenegro remained unattractive to foreign investors, with no improvement in sight.

The case of Montenegro shows that even with a flat tax rate, it does not necessarily lead to the expected investment. It has been proven once again that merely reducing the tax rate doesn't necessarily attract investors. Montenegro has abundant resources and potential in renewable energy sources such as wind, solar, biomass, and vegetable waste (Central Bank of Montenegro, Annual Report 2021). Policies should be geared towards the utilization of this potential. It is also advisable to specialize in a particular field to create a competitive edge that will make it less replaceable, even if global economic trends change.

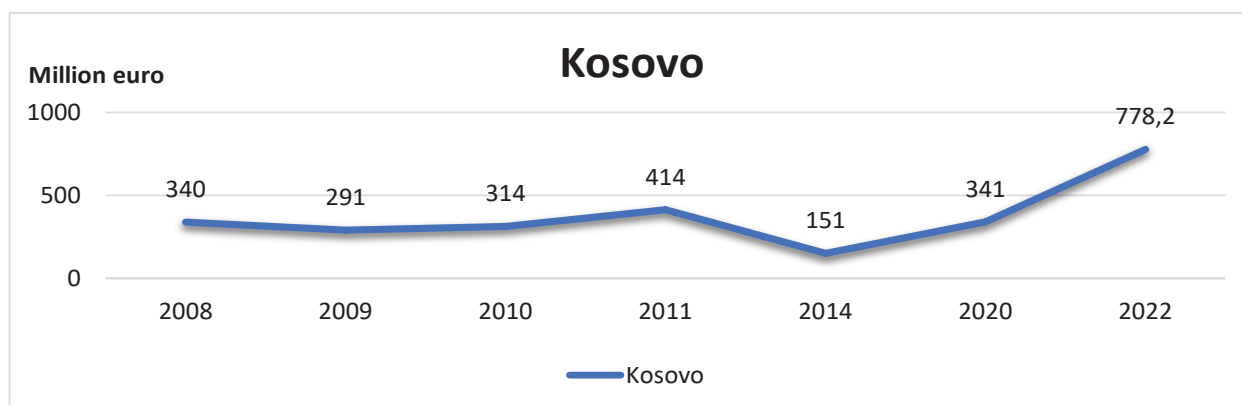
1.3. The Kosovo case

Unfortunately, there is no available data on Kosovo's foreign investments from the year 2000. Even if there were any, it wouldn't have been relevant to this paper. Kosovo declared independence in 2008 and established its institutions internationally. Despite the passing of 15 years, obtaining data about Kosovo from international organizations is still very challenging. Accurate data is presented through various channels. Scientific papers, like this one, contribute greatly.

Before 2008, more than half of the foreign direct investments were made through privatizations. However, in 2008, there was a stagnation in investments due to the halt in privatization (Central Bank of Kosovo, Annual Report 2008). The reduction in investments continued in 2009, when the tax system was reformed and tax rates were lowered, including the corporate income tax rate which was reduced from 20 % to 10 %.

Table 5 shows that there was a slight increase in investments after 2009. In 2011, the highest value of investments was recorded, with approximately 414 million euros, which was a close to 21 % increase from 2008. Kosovo did not experience this level of investment again until after 2020.

Table 5. The impact of reduced tax rate on foreign direct investments in Kosovo (Central Bank of Kosovo. Table created by the authors)



This growth in 2011 was driven by investments from two life insurance companies (Central Bank of Kosovo, Annual Report 2011). As the investment values were not high, each investment had a significant impact on the trend curve for foreign investment.

The reduction of tax rate in Kosovo did not have a long-lasting effect. After 2011, investments decreased, and in 2014, a significant drop was observed. Despite the tax rate remaining at 10 %, Kosovo lacked other fundamental factors that are crucial for investment. Although there are no official reports on the decline of investments, one of the reasons could be the level of development of Kosovo. Kosovo's economy is highly sensitive to international economic changes, and the Eurozone crisis may have had an impact.

It should be considered that Kosovo, a newly independent country, faced several challenges that have been long-standing issues in European society. One of the primary factors that hindered the creation of a stable investment environment was the lack of trust in Kosovo's institutions due to high levels of corruption. Additionally, the judicial system was inefficient, leading to delays in resolving disputes and unequal treatment of parties. Despite having a young population, the education system had not yet reached satisfactory levels, and nepotism was prevalent. Most importantly, Kosovo lacked political stability, which made it an unattractive and unreliable country in the eyes of investors. Therefore, Kosovo's policies in the upcoming years will focus on regulating these issues. Without addressing them, tax reductions and incentives will not be effective.

After 2014, there was a continuous rise and fall, while after 2020 until 2022 there was only an increase in investments, although in relatively small values. After the COVID-19 pandemic, there has been growth in all investment sectors. Investments during 2022 have reached over around 778.2 million euros. Meanwhile, in 2020, foreign direct investments in Kosovo were 341 million euros, or 42 million euros less than in 2021 (Central Bank of Kosovo, Annual Report 2022).

In addition to the reduction of tax rate, there are other factors that have contributed to the growth of foreign investments in Kosovo. These factors will be discussed in more detail in the section where other tax incentives are discussed. However, it can be said that the sectors with the most investments are financial activities, energy, real estate, while production and technology have lower participation (Central Bank of Kosovo, Annual Reports 2020, 2021, 2022).

Investment in these sectors affects low levels of industrial exports. To boost exports, Kosovo needs to focus on attracting investments that can affect the production sector. Even though the level of foreign direct investments was high in 2011, only 12.6 % of those investments were directed towards production (Central Bank of Kosovo, Annual Report 2011). As a result, most of the investments are being made in sectors that have little impact on the country's economic growth. The real estate and construction sectors attract the majority of investments, while sectors such as manufacturing and technology, which have the potential to drive growth, are not receiving much investment. Therefore, Kosovo must come up with strategies to increase investments in these sectors to achieve economic growth and stability.

While the countries that invest the most in Kosovo are Germany, Great Britain, Switzerland, the USA, Turkey, etc. These are countries where the Kosovar diaspora is mostly located, which has a role in the presence of investments in Kosovo.

Despite the advantages that one country may have over the other, the problems are similar due to their shared political and economic background. For all these countries, the first steps to attract investments have been the reduction of tax rates, and the first and only investments for some times have been privatization. However, none of these countries has managed to increase the public benefit from these investments to satisfactory levels. This is because privatization does not always bring benefits, as the private sector operates according to its interests and not the states.

In the case of these three countries, further action is necessary to achieve success. Since these countries are not very wealthy, reducing tax rates would decrease revenue, making it difficult to finance public goods. Therefore, instead of reducing tax rates, tax incentives should be applied based on the country's interests, potential, and problems that need to be solved. For instance, if a country has natural potential, such as fertile land, and high unemployment rates, tax breaks should be given to businesses that work on these lands and employ people from that specific country. This will attract more investment and make it more effective.

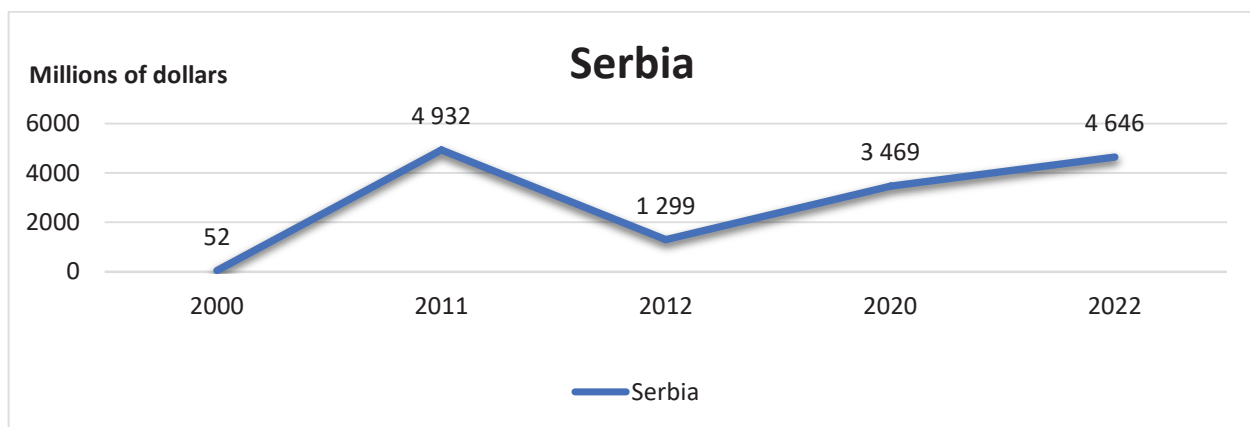
2. Other Tax Incentives

Apart from reducing tax rates, the Western Balkan countries have also implemented also other tax incentives. Two examples of such incentives are Serbia and North Macedonia. Serbia has been successful in attracting foreign investments by offering tax incentives. On the other hand, North Macedonia has implemented various tax incentives, which will be discussed in detail below.

2.1. The Serbia Case

Serbia is the country that attracts the most strategic investments compared to other countries in the Western Balkans. Serbia's foreign direct investment only in December 2022 were 482.2 million USD (CEIC Data, 2022).

Table 6. The impact of reduced tax rates on foreign direct investments in Serbia



During the 2000s, Serbia had a low corporate income tax rate of 14 %, which gave it an advantage over other countries. However, after other countries reduced their tax rates, Serbia also lowered its rate to 10 %. Unfortunately, this reduction did not last long, as Serbia increased the rate to 15 %. As a result, Serbia is the only country that raised its tax rate more than it had in the beginning, while other countries were trying to reduce their rates.

The table shows that when the tax rate was reduced to 10 %, Serbia experienced a significant increase in investments, surpassing the investment levels of all previous years. However, this increase was followed by a sharp decline due to the eurozone crisis and the departure of foreign investors, as reported by the national bank. Fortunately, this decline was short-lived, as positive momentum began the following year and continued to increase every year, except for 2020 due to the COVID-19 pandemic.

Serbia has implemented several reforms in its tax competition policies. However, these reforms are primarily focused on providing incentives or tax breaks rather than reducing tax rates. The reason behind this approach is that the use of tax incentives has made tax competition less harmful. As a result, there is no pressure on state revenues, particularly on corporate income tax. Main focus was on the application of facilities to invest in less developed regions, facilities to invest in certain industry sectors, tax facilities for exporting companies, tax facilities for doing business in tax-free zones, tax incentives to encourage employment, tax incentives to encourage the establishment of small and medium-sized enterprises, tax incentives for corporate income tax and personal income tax incentives (Marjanovic, 2018). The tax incentives applied to the corporate income tax gave the

greatest results, which brought about 35.2 % of investments, being considered the most important factor (Mirjanovic, 2018).

Serbia has used the Tax Holiday, where companies are exempt from corporate income tax for 10 years, starting from the first year in which they realize taxable income if they invest in fixed assets an amount exceeding 600 million Serbian dinars and during the investment, period employ at least 100 additional employees for an indefinite period. Likewise, the tax holiday is also applied to concessions. Enterprises involved in activities subject to a concession, e.g., exploration or exploitation of natural resources may be exempt from corporate income tax for up to 5 years (Simovic & Zaja, 2010).

It also supports social policies through tax incentives. This is because, in the case of employment of young people or persons with disabilities, the tax is credited for two years, provided that during this period the number of young and disabled workers does not decrease. Importance is also given to the use of undeveloped areas, where for the business that extends its activity in these areas, for two years, tax credits are made depending on the income (Simovic, Zaja, 2010).

The biggest investors in Serbia in terms of project amounts are Germany at 10.8 %, Italy at 10.2 %, the USA at 10.1 %, France at 9.5 %, Austria at 8.8 %, China at 8.7 %, and the Czech Republic at 6.7 %. American investments in Serbia alone reach about 4.8 billion dollars and are growing. On the other hand, Serbia exports to the USA FIAT automobiles, tires, frozen fruits, nuts, hunting rifles, and ammunition. In May 2022, Serbia was ranked 132nd among US export destinations and 94th among US importers. Whereas the sectors in which the most investments are made are the automotive industry at 19 %, agriculture at 11.8 %, textiles at 8.2 %, electrical and electronic equipment at 7.1 %, construction at 5.3 %, machinery at 5.2 %, and metallurgy and metal work with 4.3 % (Development Agency of Serbia, n.d.).

Serbia presents a good example of how measures towards tax competition should be managed. The government has analyzed the problems and created incentives for their development. Although a relatively small country proves that through an adequate combination of tax policies it is possible to stimulate investments.

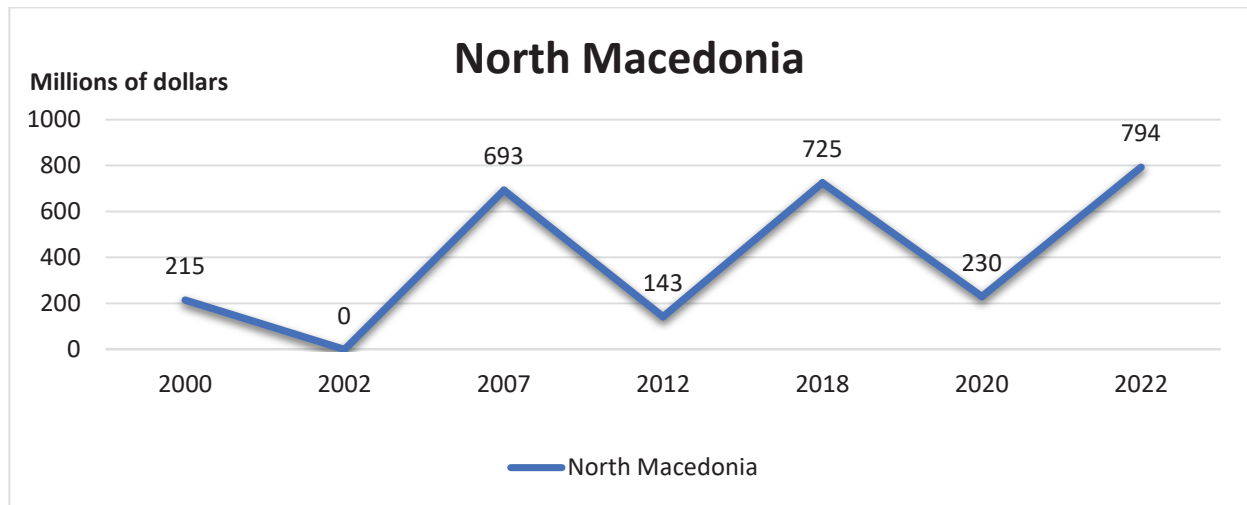
2.2. The North Macedonia case

North Macedonia is one of the countries that for a long time has been working on reforming the tax system and experimenting. As can be seen from table 7, the curve does not indicate a stable trend because there are constant ups and downs that are very different from each other.

With tax reforms and strategies, North Macedonia is an attractive and stimulating country for investment and economic growth, aiming to become a tax haven in the Balkans. This initiative has been supported by financial experts, who assume that it will increase employment in the financial and legal sectors (Marusic, 2014).

Due to such changes, it is difficult to say precisely what has influenced the growth and decline of such investments, because the process has been accompanied by tax incentives. However, it is obvious that despite the one-by-one falls, the growth is visible, despite the failures that may have come from certain measures. However, revenues have decreased due to the reduction of rates, but the decrease has also been caused by tax evasion. This means that the tax administration must necessarily be strengthened to be able to collect taxes because the reduction of rates and the inability to collect taxes undermine the state.

In addition to some classic incentives, North Macedonia has also applied some more special incentives. One of the incentives, which can be called common, is the application of the tax holiday.

Table 7. The impact of reduced tax rates on foreign direct investments in North Macedonia

North Macedonia applies a tax holiday for 10 years as a free zone, where investors who invest in free zones are exempt from corporate income tax and personal income tax. Investors are exempt from paying value added tax for importing and trading goods in free zones. Also, investors are exempted from paying customs duties for equipment, machinery and spare parts. This means that the country does not gain anything in exchange for the use of free economic zones.

Meanwhile, some more special incentives are the creation of high-tech free zones and the orientation of tax policies towards the protection of the environment.

North Macedonia considering that there are few qualified young people in the field of IT, so in order to stop the brain drain and to create an international business zone, it has created Technological Industrial Development Zones. In these areas, investors who wish to invest enjoy several benefits, such as up to 10 years exemption from personal and income tax and support up to 25 % of the investment (Technological Industrial Development Zones, North Macedonia) through which the reduction of unemployment is also aimed.

2.3. The Kosovo case

There are other incentives that have been undertaken, but the incentive to create a high-tech free zone is a good example that should be taken into account by Kosovo. This is because, like North Macedonia, Kosovo also faces a brain drain of people specialized in various fields, with special emphasis on medicine and IT. Therefore, policies should be oriented towards reducing the brain drain and creating new opportunities for professionals in these fields and not only.

Kosovo should take into account the advantages it has and design tax incentives in coordination with them. For example, Kosovo has advantage, in addition to the low tax rate, are the young population, the euro currency, the low cost of labor, the knowledge of foreign languages, and the developed banking system. Moreover, the Law on the Commercial Court, where the Division for Disputes between Foreign Investors has been created within the Department of Economic Affairs, will have a positive impact on the investment issue because it will create security and will be more efficient in resolving disputes arising with foreign investors. Kosovo, also established a state agency with the aim to attract foreign direct investments and to assist foreign investors during investment process. Despite this Kosovo still does not offer financial incentives to use this potential.

Kosovo's poor performance in attracting foreign direct investment that affects production is attributed to the unfavorable stimulus regime and the lack of fiscal relief. While Kosovo lacks financial incentives for foreign tax investments, neighboring countries are offering employment-related subsidies, subsidies to cover investment costs, incentives for research and development, and other stimulus packages that are resulting in investment attraction.

The lack of foreign direct investments is also affected by limited international recognition, which then creates logistical and operational problems. The advantage for Kosovo remains the young population, which means that there is a labor force, but the shortcoming is that the labor force is relatively unqualified, therefore it is not always considered as an advantage. The lack of incentives and tax facilities is a big obstacle. Even those facilitating policies that have been created have failed, e.g. the creation of economic zones and industrial parks have not shown success. Kosovo should design tax incentives as soon as possible, but it is essential to keep in mind that it is more important to focus on the type of investment than to attract as many investments as possible. Investments should be export oriented, which play a role in economic growth. So, to design facilitating policies that navigate both productive and technological investments.

However, some steps have been taken towards creating a more suitable environment. Kosovo has invested large sums in infrastructure, which has influenced Kosovo to have positive elements toward the creation of a suitable environment for doing business. Also, favorable for Kosovo is the low cost of operation, which can be a very important indication of being chosen as a place to invest. Law no. 06/L-105 on Corporate Income Tax has also provided some facilities which have elements of being tax incentives, dividends were exempted from taxation and some other measures were taken. One of them is the additional deduction of new assets or assets that enter heavy machinery, where in addition to the depreciation deduction, a special discount of 10 % is offered. The deduction is allowed only if the property is new or has been put into use for the first time in Kosovo. Discounts for these tools are also allowed by VAT. This is to stimulate economic development through the agriculture sector. Crediting of foreign tax has also been foreseen, but several agreements have also been concluded for the elimination of double taxation.

To improve the climate of doing business in Kosovo, the Law on Strategic Investments was created, which was aimed at encouraging, attracting, and creating conditions for the realization of strategic investments. This law favors different sectors such as energy with infrastructure and mining; transport and telecommunications; tourism; processing industry; agriculture and food industry; health; industrial and technological parks; wastewater and waste management. To be considered a strategic investment, the volume of investments must be from 10 million euros to 30 million euros, depending on the sector in which the investment will be made. This law also foresees the use of the public or socially immovable property and the use of the property of the public enterprise by the investor, for the period they need but cannot exceed 99 years. From the annual reports issued by Kosovo Investment and Enterprise Support Agency (KIESA), it appears that there are interests to invest in Kosovo, where in 2018 there were 11 applications, in 2019 there were 26 applications and in 2020 there were 36 applications. However, Kosovo must work hard to create a reliable country for foreign direct investors, plan long-term fiscal policies, and channel its assets effectively.

Conclusions

The reduction of corporate income tax rates emerged as a predominant trend across Europe and the Western Balkans. However, its impact on attracting foreign investments varied significantly between countries. The reduction in tax rates is not a one-size-fits-all solution

for increasing foreign investments. The outcomes differ based on each country's economic, political stability, and development factors. That is why countries in the Western Balkans have shown varying levels of progress, with some advancing earlier than others. Tax incentives have played a significant role in driving this difference in progress.

Lowering tax rates in Western Balkan countries aimed to attract foreign investments. Kosovo, Albania, Montenegro, North Macedonia and Serbia experienced varied impacts, showcasing that tax cuts alone don't guarantee increased investments. While tax reductions remain pivotal, focusing solely on reducing rates might not suffice. Nations must employ targeted incentives aligned with their unique potentials and challenges. Strategies encompassing sector-specific investments, infrastructure development, and industry-oriented tax breaks could effectively stimulate economic growth and attract investments.

In 2000, the average tax rate in corporate income tax was around 17 %, while in 2023 the average tax rate of this tax is 11 %, or 6 % lower. Among six states of this region, Montenegro has the lowest corporate income tax with 10 %, whereas Albania and Serbian have the highest with 15 %. Beside tax reduction, these countries applied different tax incentives. Among the incentives that dominate in this region are tax holiday, free economic zones, administrative relief and exemption from customs duty for some products with the aim of developing some industries, etc.

Kosovo's case illustrated that tax rate reductions alone were insufficient to drive substantial and sustained investment. Challenges related to institutional trust, political stability, and economic diversification persisted, indicating the necessity for multifaceted reforms beyond fiscal measures. Kosovo's economic landscape heavily relied on privatization endeavors to attract investments. Sustainable growth necessitates a shift toward broader industry investments beyond privatization. The sporadic nature of Kosovo's investment trends, particularly the fluctuations post-2011, underscores the need for long-term policy frameworks.

In essence, Kosovo's challenges extend beyond tax policies, demanding holistic reforms across political, economic, and social spheres. Addressing institutional inefficiencies, fostering educational advancements, diversifying industries, and cultivating a reliable and attractive investment climate stand as critical imperatives for Kosovo's sustained economic growth.

REFERENCES

- CEIC Data. (2022). *Serbia Foreign Direct Investment*. <https://www.ceicdata.com/en/indicator/serbia/foreign-direct-investment>
- Central Bank of Albania. *Annual Reports (2007, 2012)*. https://www.bankofalbania.org/Publications/Periodic/Annual_Report/?rpp=1&msv=&ser=57&crd=0,15,14,1,0,11400&ln=2
- Central Bank of Kosovo. *Annual Reports (2008, 2011, 2020, 2021, 2022)*. <https://bqk-kos.org/statistikat/serite-kohore/> [in Albanian].
- Central Bank of Montenegro. *Annual Reports (2003, 2009, 2021)*. <https://www.cbcbg.me/en/publications/regular-publications/central-bank-of-montenegro-annual-report>
- Development Agency of Serbia. (n.d.). *Serbia has attracted over €42 billion of inward foreign direct investment since 2007*. <https://ras.gov.rs/en/invest-in-serbia/why-serbia/join-the-pool-of-the-successful>
- Ebrill, L. P. (1987). 7 Evidence on the Laffer Curve The Case of Jamaica and India. In *Supply-Side Tax Policy*. International Monetary Fund. <https://doi.org/10.5089/9780939934911.071>
- Epstein, R. A. (2014). *We need a real tax flat tax*. Hoover Institution. <https://www.hoover.org/research/we-need-real-flat-tax>
- Friedman, M. (2020). *Capitalism and freedom*. The University of Chicago Press.
- Gaspareniene, L., Kliestik, T., Sivickiene, R., Remeikiene, R., & Endrijaitis, M. (2022). Impact of Foreign Direct Investment on Tax Revenue: The Case of the European Union. *Journal of Competitiveness*, 14(1), 43–60. <https://doi.org/10.7441/joc.2022.01.03>
- Heijman, W. J. M., & van Ophem, J. A. C. (2005). Willingness to pay tax: The Laffer curve revisited for 12 OECD countries. *The Journal of Socio-Economics*, 34(5), 714–723. <https://doi.org/10.1016/j.socec.2005.07.013>

- Koleka, B. (2015, November 18). *REFILE-Albania's 2016 budget sees 3.4 pct growth, lower deficit*. Reuters. <https://www.reuters.com/article/albania-budget-2016/refile-albanias-2016-budget-sees-3-4-pct-growth-lower-deficit-idUSL8N13D32G20151118/?fbclid=IwAR1rheuD5B4tMtAx-jvV6vq1MmJXr46CjdW1PyoarjhxvWd-J0o-LAyx1PPg>
- Law no. 06/L-105 on Corporate Income Tax*, article 18.2. <https://gzk.rks-gov.net/ActDetail.aspx?ActID=20988> [in Albanian].
- Law no. 55/2015 on Strategic Investments in the Republic of Albania*, article 8. <https://qbz.gov.al/eli/ligj/2015/05/28/55> [in Albanian].
- Marjanovic, D. M. (2018). Competitiveness of the Serbian Economy through the Prism of Tax Incentives for Foreign Investors. *Economic Analysis*, 51(3–4), 95–104. <https://doi.org/10.28934/ea.18.51.34.pp95-104>
- Martin, A., & Patrica, N. (2023). Germany's failure to attract business investments alarming, say economists. *Financial Times*. <https://www.ft.com/content/2e3dcd37-954d-49b9-aab5-a2947598d2a4>
- Martinez-Vazquez, J., & McNab R. M. (1999). *Tax Systems in Transition Economies*. https://scholarworks.gsu.edu/cgi/viewcontent.cgi?article=1058&context=econ_facpub
- Marusic, S. J. (2014, July 18). *Macedonia plans to set up a tax haven*. Balkan Insight. <https://balkaninsight.com/2014/07/18/macedonia-plans-becoming-tax-heaven/>
- Ministry of Industry, Entrepreneurship and Trade. *Annual reports of 2018, 2019 and 2020*. Kosovo Investment and Enterprise Support Agency (KIESA). <https://kiesa.rks-gov.net/page.aspx?id=1,112> [in Albanian].
- OECD. (2022). *Table I.1. Statutory corporate income tax rate*. https://stats.oecd.org/index.aspx?DataSetCode=TABLE_I11
- OECD. (2023). *Trends and impacts of foreign direct investment in Portugal*. <https://www.oecd-ilibrary.org/sites/e97f0263-en/index.html?itemId=/content/component/e97f0263-en>
- Paun, D. (2019). Tax competition and factors influencing the gross domestic product and foreign direct investments of CEE countries. *Economic Research-Ekonomska Istraživanja*, 32(1), 876–893. <https://doi.org/10.1080/1331677X.2019.1585896>
- Peci, B. (2016). Tax reforms in Selected Balkan Countries: The Case of Kosovo. *Applied Economics and Finance*, 3(4), 168–178. <https://doi.org/10.11114/ae.v3i4.1783>
- Peci, B. (2017). *Science on Finance and Financial Law*. University of Prishtina “Hasan Prishtina”.
- Silajdzic, S., & Mehic, E. (2022). How effective is tax policy in attracting foreign direct investments in transition countries? *Central European Business Review*, 11(1), 19–39. <https://doi.org/10.18267/j.cebr.274>
- Simovic, H., & Zaja, M. M. (2010). Tax Incentives in Western Balkan Countries. *World Academy of Science, Engineering & Technology*, 42.
- Stosic, I., Nikolic, D., & Dukic, M. (2011). Attractiveness of Serbia for Foreign Direct Investments: Tendencies, obstacles and perspectives. In M. R. Markovic, S. Redzepagic, J. S. Andrade, & P. Teixeira (Eds.). *Serbia and the European Union: Economic Lessons from the New Member States*. (pp. 47–60).
- UNCTAD. (2022). *World Investment Report*. <https://unctad.org/publication/world-investment-report-2022>
- Vasa, L., & Angeloska, A. (2020). Foreign direct investment in the Republic of Serbia: Correlation between foreign direct investments and the selected economic variables. *Journal of International Studies*, 13(1), 170–183. <https://doi.org/10.14254/2071-8330.2020/13-1/11>

Печі Б., Кожані Е. Вплив зниженої ставки податку на прибуток підприємств та інших стимулів для прямих іноземних інвестицій у деяких Балканських країнах. – Стаття.

У статті аналізуються особливості взаємозв'язку між зниженням ставки податку на прибуток підприємств (СІТ), як податковим стимулом, та прямими іноземними інвестиціями (FDI) у країнах Західних Балкан. Досліджуються їх досягнення у цій сфері упродовж двох десятиліть (2000–2022). Перехід країн Західних Балкан від закритої і контрольованої економіки до відкритої ринкової був складним, але, незважаючи на це, ними було реалізовано політику забезпечення конкуренції на світовому ринку. Наприклад, було зменшено податкові ставки та запропоновано податкові пільги для залучення іноземних інвесторів. Це призвело до зниження середньої ставки податку, зокрема, у 2000 р. середня ставка податку на прибуток підприємств становила близько 17 %, тоді як у 2023 р. вона склала 11 %, що на 6 % нижче. Проте, незважаючи на вжиті заходи, очікуваних результатів досягнуто не було. Приватизація державних підприємств була однією з головних інвестицій, яких залучили ці країни. У статті розглядаються проблеми, що призвели до негативних результатів і неспроможності країн переконати інвесторів у необхідності збільшення інвестицій. У Косово розвиток цієї сфери залишається поза увагою уряду. Для Косово важливо визнати, що сусідні країни досягли у цій сфері значнішого прогресу, а отже, надзвичайно важливим є проведення дослідження, яке не лише висвітлить поточну ситуацію, але й окреслить потенційні рішення на майбутнє.

Ключові слова: податкові ставки, податкові пільги, податкова конкуренція, країни Західних Балкан, податкові реформи, зниження податків.