

Competitiveness of the Serbian Economy Through the Prism of Tax Incentives for Foreign Investors

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ABSTRACT

In order to make Serbia the most attractive investment destination in relation to countries in the region, special attention should be paid to the current tax incentives granted to foreign investors. Hence, the aim of this paper is to find the opinion and attitudes of foreign investors in the relevant research and analysis regarding the importance of tax relief for their investment in Serbia. Tax incentives are one of the most important tax instruments that can play a decisive role on foreign investors when choosing an investment location, and therefore to increase the competitiveness of the Serbian economy. In this paper, special attention will be given to tax incentives in certain areas for the business of foreign investors, depending on the way foreign investors enter the Serbian market. The methodology of empirical research in this paper is based on a quantitative approach to the collection of primary data through the survey of relevant subjects, the comparison of collected data, and the analysis of the causality of the investigated phenomena. On the basis of the obtained results it can be concluded that the greatest influence on the investor when making a decision on investing in Serbia is tax incentives in corporate income tax.

Key words: *tax incentives, competitiveness, FDI, investors*

JEL Classification: E62, H20

INTRODUCTION

Fiscal policy is a very powerful instrument for attracting foreign investment. During the 1990s, Central Europe countries used "tax breaks" and other fiscal incentives for this purpose. As a result, there has been an increase in the volume and quantity of capital inflows, all of which has led to the growth of the economies of these countries, and thus to increasing their competitiveness. As it is known that taxpayers seek to lower their tax liability to the lowest possible level, they are interested in using the various tax incentives provided by the state in the process of tax competition. There is a conflict between the interests of the state, on the one hand, to attract as much investment (lower tax burden) and, on the other hand, to raise as much funds to finance public functions (higher tax burden).

With the increasing increase in the free movement of capital in the world market, the states have come in a position to compete with one another for the affection of business entities, with the aim of attracting as much investment as possible on their territory. As one of the most important forms of international capital movements, FDI play an important role in any economic system (Musabegović et al., 2015). A generally supported attitude is that fiscal policy is a very powerful instrument for attracting investment, that is, tax competition is one of the most important indicators of overall competitiveness. For this reason, it is very important for all

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countries to offer attractive conditions to investors, first of all through favorable tax treatment, and in this way try to secure as high a capital inflow. Under special tax treatment, it is understood, above all, to expand the tax base and/or reduce the tax rate of the corporate income tax. In creating tax policy, it is attempting to reduce the tax burden, which should contribute to entering new investments, i.e. preventing their outflow. The result of all this should be an increase in the volume and quantity of capital inflows, the growth and development of the economy, and the increase in competitiveness. Therefore, one state's goal is to provide a favorable ambience for investors, which are reflected in providing better conditions than competitive countries, and thus create an advantage that will lead to new investments. However, in this situation, usually it happens "race to the bottom", when individual countries, in order to be attractive to investors, compete in lowering tax rates by creating an attractive tax environment.

One of the instruments for increasing investments also relates to a stimulating tax environment in which the largest impact on companies and potential investors has a tax on profits, or tax incentives in the corporate income tax system (Domazet & Marjanović, 2018). Tax on profit is one of the most important tax instruments for stimulating economic activity in the domestic environment, but also for attracting the necessary foreign capital. Different tax incentives in the profit tax system have become a key determinant of tax competition in attracting foreign capital. Nowadays, the most successful ones are those countries that have undoubtedly realized a significant inflow of foreign capital precisely by providing investors with a preferential tax treatment with a series of reliefs, primarily in the corporate income tax system, but also providing the necessary economic and social conditions.

One of the key factors in starting the process of improving the competitiveness of the Serbian economy is, of course, also the fiscal system and fiscal policy. It is precisely for this reason that it is necessary to set the institutional foundations of the fiscal system, while simultaneously increasing the efficiency of the tax administration and creating a transparent control of public finances. In addition to institutional arrangements, for the competitiveness of the Serbian economy it is certainly necessary to make changes within the fiscal system that should be one of the factors of economic development (Domazet & Marjanović, 2017).

LITERATURE REVIEW

Competition is created in moments when individuals and companies get the choice. The greatest satisfaction of individuals and companies is the aspiration for a lesser degree of jurisdiction, i.e. the state in which individuals and companies conduct business (Keen & Konrad, 2012). The main reasons explaining the phenomenon of tax competition are increasing international trade flows and investments, increasing labor mobility between countries, and the ever-faster transfer of technology. In such an economic environment it is very difficult to maintain high tax rates. Freedom of movement of capital creates a kind of pressure on the state to reduce the tax rate, above all the profit tax, in order to maintain its attractiveness (Davies & Voget, 2008). Tax competition is fully in line with the fundamental tax reform. Among other things, the tax reform objective is a system with low tax rates in response to productive behavior, as well as a system in which income is taxed only once. Tax competition promotes tax reform by helping to reduce marginal tax rates as well as eliminating double taxation of revenues that has been saved and invested (Paraušić et al., 2017). When tax rates are in question, the most obvious negative effect of tax competition is a sort of "race to the bottom", precisely because countries and/or regions compete in reducing tax rates to create equally attractive business environments that would be favorable for foreign investments. Tax competition, by its impact on lowering tax rates, often involves lowering the tax base for tax collection, and hence the local government or government of the country has fewer resources to spend on public services, which should further be on a high level, i.e. in accordance with the preferences of its citizens (Hansson & Olofsdotter, 2003). If tax systems between countries differ significantly, companies and individuals will for the

place of capital investment and performing business activities choose the country where the total tax burden is lower. By shifting taxpayers to those countries where the tax burden is lower, automatically reduces tax revenues in countries that have a higher tax burden, causing difficult financing of public expenditures (Domazet & Marjanović, 2018). An economy is competitive if it does things that are likely to encourage economic growth (Makrevska & Nenovski, 2014). Observing the conditions where there is no competition, there are market conditions where there are little or insufficient bidders on the supply side who have the ability to determine market conditions, define prices as well as other factors which are in their favor, and not for individuals or companies (Marjanović et al., 2013; Round, 2009).

To the extent that economic integration between countries is gaining momentum, companies and individuals gain greater freedom to take advantage of the different economic opportunities offered to them, so their decision on capital investment, among others, is influenced by the tax factor. From the point of view of economic competition, the participants themselves take the initiative in seeking to realize their own interests and take a more favorable position in the global market, with the decisive role have market laws that determine the movement of supply and demand. In tax competition, however, the situation is different. She is caused by pressure from countries with low tax burdens, and other countries have to keep their tax pressures at a "reasonable" level, to discourage investors and workers from moving their business activities into such favorable tax environment (Kalamov, 2013; Siedschlag et al., 2013). Modern technologies are the bearers of global development, but also a priority for each country whose goal is to attract as many foreign investments as possible. The motive for broad tax incentives granted to an investor who brings high technology to the country is that high technology is the highest level of production modernization. By improving the production processes using modern technologies, it contributes to the competitiveness on the world market and hence the dynamic struggle for achieving tax attractiveness for investors who are high technology carriers. (Patterson & Serrano, 1998) In the process of attracting foreign direct investment, it is necessary to take measures of tax policy ensuring that greater competition in the capital market. This is precisely the reason why the taxation systems introduced many changes, especially from the standpoint of tax incentives, exemptions and deductions (Domazet & Marjanović, 2018). The investment incentives are highly effective in attracting foreign investments. However it is necessary to note, that to give the investor tax holidays is nowadays not enough. The country has to have a well-developed system, which will help the investor to realise his project within the investment scheme fast and without additional administrative costs (Porter, 2003).

RESEARCH METHODOLOGY

For the purposes of this empirical research, a quantitative approach has been used, which is based on the collection of numerical data, their mutual comparison, and the identification and analysis of the interrelationships between them. On the one hand, it was necessary for the sample to be representative, and on the other hand, through adequate approach and implementation of the research, qualitative and quantitative data were obtained on the basis of which it was possible to make certain conclusions. Therefore, this survey covered the 300 largest foreign investors that have invested capital in Serbia over the last 15 years. Considering that 88 investors took part in the survey, the response rate of 29.33% is considered to be quite satisfactory for all the criteria for this kind of research.

In order to determine the impact of tax incentives on foreign investors when choosing Serbia as an investment destination, a quantitative approach was applied in the survey using the method of testing, or survey technique via e-mail. This technique has been selected from the perspective of the quality and quantity of data that can be obtained by eliminating every form of bias of the person performing the research, as well as the benefits of this type of survey research for testing the selected target group. Therefore, the questions were of a closed type, since in this way it was

possible to get more detailed and clearer answers, which can be coded and analyzed at a later stage. The research involved exclusively owners of companies, general directors or managers who are in charge of investments or operations in foreign markets.

Depending on the way of entry foreign investor to the market of Serbia, this research shows the importance of tax incentives in certain areas for the business of foreign investors in Serbia. Basic characteristics of the company who participated in the research are shown using schedule frequencies and percentages.

Table 1. Mode of entry foreign investors on the market of Serbia

Direct investment		Indirect investment	
Frequency	Percentage	Frequency	Percentage
47	53,4	41	46,6

Source: authors' calculations

The first segment of the research was related to graphic presentation of all dependent variables and descriptive statistics, given that they made it possible visual presentation of results and calculation of frequencies, percentages, average estimates, standard deviation and variance. In the second segment, attention is focused on the analysis of differences in dependent variables, based on the subgroup of independent variables. More precisely, it was necessary to link the dependent and independent variables, since in this way it was possible to determine whether there were statistically significant differences in the evaluation of the investigated issues among different groups of foreign investors (the difference between three and more groups of respondents). For that purpose a single-factor analysis of the variance of different groups was used. (1)

$$\eta^2 = \frac{\sum_{i=1}^k N_i (\bar{X}_i - \bar{X})^2}{\sum_{i=1}^k \sum_{j=1}^{N_j} (X_{ij} - \bar{X})^2} \quad (1)$$

$$\eta^2 = \frac{t^2}{t^2 + (N_1 + N_2 - 2)} \quad (2)$$

In a situation where it is necessary to compare the differences between two groups of respondents, for calculate the value statistically significant differences It was used t-test of independent samples. (2)

RESEARCH RESULTS

The results that have been achieved through the conducted empirical research, which were supposed to give an answer on the significance of tax incentives in certain areas for the business of foreign investors, first shown graphic, and after that through descriptive statistics and analyzes the differences between foreign investors depending on their individual characteristics in evaluation the significance of tax incentives in certain areas.

In order to determine the competitiveness of Serbian economy through the prism of tax incentives for foreign investors, the focus in empirical research was related to the establishment of the importance of tax incentives in certain areas for the business of foreign investors in Serbia, and depending on the way foreign investors entered the Serbian market. Consequently, attention

is focused on tax incentives for investing in underdeveloped regions, tax incentives for investing in certain branches of industry, tax incentives for exporting companies, tax incentives for doing business in free zones, tax incentives for hiring new workers, tax incentives for the establishment of small and medium enterprises, tax incentives in corporate income tax and tax incentives for citizens' income tax.

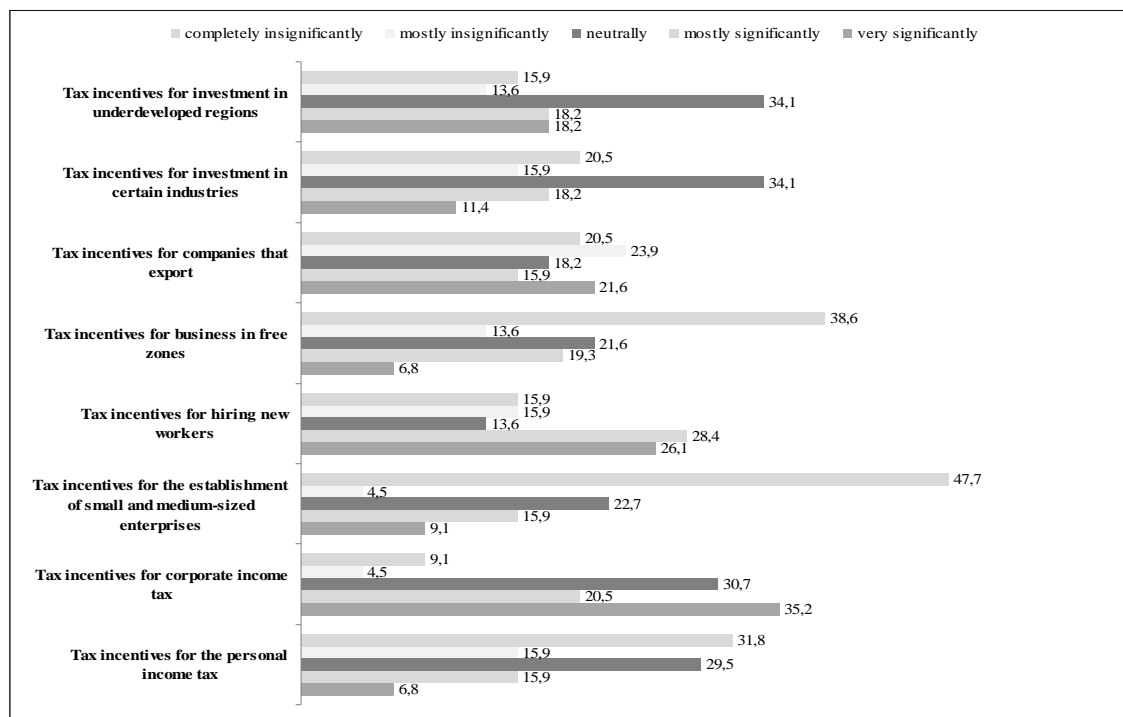


Figure 1. The importance of tax incentives in business activities of foreign investors in Serbia
Source: authors' calculations

According to the conducted survey, the largest number of foreign investors marked tax incentives in corporate income tax (35.2%) as the most significant and determining factor for investment and business in Serbia. After that, tax incentives for recruitment of new workers (26.1%), tax incentives for exporting enterprises (21.6%), tax incentives for investing in underdeveloped regions (18.2%), tax incentives for investing in certain (11.4%), tax incentives for the establishment of small and medium enterprises (9.1%), tax incentives for personal income tax (6.8%) and tax incentives for business in free zones (6.8%).

After the graphic presentation, the descriptive statistics (Table 2) show the views of foreign investors, ie how the investors assessed the impact of tax incentives in certain areas on their business in Serbia.

Table 2. The importance of tax incentives in business activities of foreign investors in Serbia

	Degree of evaluation					M	SD	V
	1	2	3	4	5			
	f(%)	f(%)	f(%)	f(%)	f(%)			
Tax incentives for investments in not sufficiently developed regions	14 (15,9)	12 (13,6)	30 (34,1)	16 (18,2)	16 (18,2)	3,0909	1,30107	1,693
Tax incentives for investments in certain industry branches	18 (20,5)	14 (15,9)	30 (34,1)	16 (18,2)	10 (11,4)	2,8409	1,26751	1,607
Tax incentives for exporting companies	18 (20,5)	21 (23,9)	16 (18,2)	14 (15,9)	19 (21,6)	2,9432	1,44920	2,100
Tax incentives for doing business in free zones	34 (38,6)	12 (13,6)	19 (21,6)	17 (19,3)	6 (6,8)	2,4205	1,35377	1,833
Tax incentives for the employment of new employees	14 (15,9)	14 (15,9)	12 (13,6)	25 (28,4)	23 (26,1)	3,3295	1,42814	2,040
Tax incentives for setting up small and medium-sized enterprises	42 (47,7)	4 (4,5)	20 (22,7)	14 (15,9)	8 (9,1)	2,3409	1,43748	2,066
Tax incentives in paying corporate income taxes	8 (9,1)	4 (4,5)	27 (30,7)	18 (20,5)	31 (35,2)	3,6818	1,25529	1,576
Tax incentives in paying income tax by citizens	28 (31,8)	14 (15,9)	26 (29,5)	14 (15,9)	6 (6,8)	2,5000	1,27757	1,632

Source: authors' calculations

The existence of statistically significant differences between foreign investors in assessing the significance of tax incentives in certain areas for the business of foreign investors in Serbia was investigated through the t-test of independent samples.

The results of the t-test of independent samples on the existence of statistically significant differences between foreign investors entering the Serbian market through direct investment and foreign investors entering the market of Serbia through an indirect investment in assessing the significance of tax incentives in certain areas are shown in Table 3.

Table 3. Differences between foreign investors in evaluation the degree of significance of tax incentives in certain areas, and depending on the mode of entry to the market of Serbia

	M (SD)		MD	95% CID		t	p*
	DI, N = 47	II, N = 41		Lower	Upper		
	Tax incentives for investments in not sufficiently developed regions	3,5106 (1,17718)		2,6098 (1,28215)	0,90088		
Tax incentives for investments in certain industry branches	2,9362 (1,35782)	2,7317 (1,16242)	0,20446	-0,33534	0,74427	0,753	0,454
Tax incentives for exporting companies	3,1064 (1,41781)	2,7561 (1,47954)	0,35029	-0,26436	0,96493	1,133	0,260
Tax incentives for doing business in free zones	2,7021 (1,36597)	2,0976 (1,28072)	0,60457	0,04083	1,16830	2,132	0,036
Tax incentives for the employment of new employees	3,4681 (1,41192)	3,1707 (1,44745)	0,29735	-0,30952	0,90423	0,974	0,333
Tax incentives for setting up small and medium-sized enterprises	2,8298 (1,46435)	1,7805 (1,19399)	1,04930	0,47776	1,62084	3,650	0,000
Tax incentives in paying corporate income taxes	3,5957 (1,32959)	3,7805 (1,17286)	-0,18474	-0,71964	0,35015	-0,687	0,494
Tax incentives in paying income tax by citizens	2,9149 (1,29933)	2,0244 (1,08369)	0,25726	0,37909	1,40192	3,461	0,001

* statistically significant difference occurs at the level $p < 0,05$

Source: authors' calculations

The results of the t-test of independent samples showed that there are the following statistically significant differences between foreign investors:

In assessing the impact of tax incentives for investing in underdeveloped regions, $t(86) = 3,435$, $p = 0,001$, $MD = 0,90088$, 95% *CID*: from 0,37958 to 1,42218 between foreign investors who entered the Serbian market with a direct investment ($M = 3,5106$, $SD = 1,17718$) and those who entered the Serbian market with an indirect investment ($M = 2,6098$, $SD = 1,28215$). The size of the difference between these two groups of foreign investors expressed by the eta square is $\eta^2 = 0,120$ and can be considered as a big difference. Accordingly, foreign investors entering the Serbian market through direct investment have given greater importance to the impact of tax incentives for investing in underdeveloped regions compared to those entering the Serbian market through an indirect investment.

In assessing the impact of tax incentives for business in free zones, $t(86) = 2,132$, $p = 0,036$, $MD = 0,60457$, 95% *CID*: from 0,04083 to 1,16830 between foreign investors who entered the Serbian market with a direct investment ($M = 2,7021$, $SD = 1,36597$) and those who entered the Serbian market with an indirect investment ($M = 2,0976$, $SD = 1,28072$). The size of the difference between these two groups of foreign investors expressed by the eta square is $\eta^2 = 0,050$ and can be considered a small difference. Accordingly, foreign investors entering the Serbian market through direct investment have given greater importance to the impact of tax incentives for business in free zones in relation to those who entered the Serbian market through an indirect investment.

In assessing the impact of tax incentives for the establishment of small and medium-sized enterprises, $t(86) = 3,650$, $p = 0,000$, $MD = 1,04930$, 95% *CID*: from 0,47776 to 1,62084 between foreign investors who entered the Serbian market with a direct investment ($M = 2,8298$, $SD = 1,46435$) and those who entered the Serbian market with an indirect investment ($M = 1,7805$, $SD = 1,19399$). The size of the difference between these two groups of foreign investors expressed by the eta square is $\eta^2 = 0,134$ and can be considered as a big difference. Accordingly, foreign investors entering the Serbian market through direct investment have given greater importance to the impact of tax incentives for the establishment of small and medium-sized enterprises in relation to those who entered the Serbian market through an indirect investment.

In assessing the impact of tax incentives on citizens' income tax, $t(86) = 3,461$, $p = 0,001$, $MD = 0,25726$, 95% *CID*: from 0,37909 to 1,40192 between foreign investors who entered the Serbian market with a direct investment ($M = 2,9149$, $SD = 1,29933$) and those who entered the Serbian market with an indirect investment ($M = 2,0244$, $SD = 1,08369$). The size of the difference between these two groups of foreign investors expressed by the eta square is $\eta^2 = 0,122$ and can be considered as a big difference. Accordingly, foreign investors entering the Serbian market through direct investment have given greater importance to the impact of tax incentives on citizens' income tax in relation to those who entered the Serbian market through an indirect investment.

CONCLUSION

The aim of this research is to identify potential problems that can negatively affect the decision of a foreign investor when investing capital in Serbia. That is, which are tax incentives and to what extent is significant for foreign investors, which in the coming period can contribute to the improvement of the business environment in Serbia. The results of the conducted research were clearly and unequivocally pointed out, that for foreign investors, tax incentives is very important, with special emphasis on tax incentives in corporate income tax. When it comes to these tax incentives, it is primarily thought to reduce tax rates, tax holidays or investment incentives. The very low rates of corporate income tax have a positive impact on investments, and therefore on the competitiveness of Serbia internationally. Multinational companies most closely match low tax rates, given that the main benefits relate to the simplicity and transparency of the cost of

fulfilling the tax obligation, the generality, the horizontal character of the relief, and neutrality in relation to other tax incentives.

Given that foreign investors have certain expectations regarding the business environment in Serbia, it is more important that the significance of tax incentives be adequately pointed out in the next period. Therefore, it is extremely important that economic policy creators in Serbia in an adequate way executed implementation those tax incentives which foreign investors expressed through this research. If one looks at the obtained results, it is clear that in the coming period there are good prospects for increasing the inflow of foreign capital. Therefore, it is very important to investors to offer a broader spectrum of tax incentives, where special attention should be paid to those tax incentives which investors categorized as less important in this survey. Of course, in no case should be neglected other indicators that have a certain impact on investors when choosing Serbia as an investment destination. In this way it is possible to improve the business environment as a factor of competitiveness of the Serbian economy.

From all of the foregoing, it is clear that the results of this research are primarily intended for the creators of tax policy in Serbia. It is very important to spot the weakness of the tax system in time, and then implement the implementation of all requirements that are expressed through this research. In this way, a clear signal will be sent to investors that the Serbian economy is open to the inflow of fresh capital. Especially this will be expressed if new tax incentives is introduced with appropriate corrections of already existing tax incentives. If all necessary activities are carried out in the forthcoming period, primarily regarding the selection and implementation of adequate tax incentives, Serbia will come into position to be a leader in the region when it comes to competitiveness and, therefore, a very attractive investment destination.

ACKNOWLEDGEMENTS

This paper is a part of research projects numbers III47009 (European integrations and social and economic changes in Serbian economy on the way to the EU) and OI179015 (Challenges and prospects of structural changes in Serbia: Strategic directions for economic development and harmonization with EU requirements), financed by the Ministry of Science and Technological Development of the Republic of Serbia.

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Article history:	Received: November 3, 2018
	Accepted: December 20, 2018