IMPACT OF THE BUSINESS ENVIRONMENT AND TAX INCENTIVES ON NEW INVESTMENTS: EVIDENCE FROM DEVELOPING COUNTRIES

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Abstract

This research aims to measure the impact of the business environment and tax incentives on new investments in Kosovo. A questionnaire created especially for this study was submitted to 104 companies that have invested in Kosovo during the period 2018–2020. It is designed to be as comprehensible and accessible as possible and is divided into an introduction that provides demographic data of the respondent, and types of surveyed businesses, to go through the questions related to new investments, and business environment, and the last section contains questions related to tax incentives. The reliability of the questionnaire is measured by Cronbach's alpha. In terms of the methodology, a multifactorial regression model and correlation analysis are employed. Based on the multiple regression model, the research results show that the independent variables, such as business environment and tax incentives, have a significant positive impact on the dependent variable, new investments. Furthermore, the correlation analysis between new investments and tax incentives also indicates a strong positive relationship. Additionally, the business environment and tax incentives are the main factors attracting new investments. The results of this study can help to enhance the business climate and boost tax incentives, demonstrating Kosovo's suitability as a location for new investments. There remains the duty of the government and policymakers to create mechanisms that ensure sustainable business conditions and applicable tax incentives.

Keywords: Business Environment, Tax Incentive, New Investments, Kosovo

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1. INTRODUCTION

The business environment is one of the factors of special importance that are taken into consideration by investors when investing in a country. The business environment presents all the external and internal factors that can be business opportunities and threats. The tax aspect is incorporated in the investment code of the respective countries and as such should be specified the facilities provided for new investors. Whether and how to use incentives is among the most important but least heralded issues facing national and regional policymakers worldwide. Tax incentives must be given in exceptional circumstances, where their benefits can be substantiated by collective data acquired from all decision-makers, including economists and financial analysts.

Moreover, incentive tax systems in the Western Balkan countries are different from each other. Tax incentives can be financial and non-financial aid and have both positive and negative impacts (Bastani et al., 2020). Leong et al. (2020) show that fixed tax payment gives slightly more incentive for taxpayers to pay tax compared to variable payment which is based on expected profits.

The main objective of the research consists of compiling incentive tax programs and their application to the policies that will be fruitful for attracting investors, especially in developing countries, such as Kosovo. As an instrument for data collection, a questionnaire designed specifically for the needs of this research was submitted to 104 businesses that have invested in Kosovo. The questionnaire is divided into four parts. The first part contains the demographic data of respondents, such as gender, age, place of living, education level, and business organization forms, to continue up with the second part containing questions about new investments related to the procedures for registering the business with the Kosovar authorities, corruption affects, political stability and workforce. The third part deals with business environments, such as low operating costs, access to the European Union (EU), infrastructure, geographical position of the country, and support from local and international organizations for new investment. Part four contains questions related to tax incentives, moreover, the impact that tax incentives have on new investment, agreements for the elimination of double taxation, dividend treatment, and favorable tax rates.

Moreover, the institutions of Kosovo have gained the right to act after receiving the powers from the United Nations Interim Administration Mission in Kosovo (UNMIK). Kosovo is an independent and sovereign state since 2008. Further, expresses continuous tendencies for improving the functioning of institutions and compliance with EU directives, as well as for fighting the informal sector that affects the country's economy.

Globally, policymakers are concentrating on developing strategies that promote economic growth and hasten improvements in the welfare of their nation's population (Hansson, 2021). The role and importance of the government in the implementation of suitable policies for the attraction of investments are fundamental. Redonda et al. (2019), in their research, examine three concrete policy proposals for the G20 members: First, governments should make tax benefits more transparent and G20 participants should lead on this with regular and thorough tax expenditure reports. Second, these countries should enhance tax incentive design to reduce the production of windfall profits and detrimental ripple effects within and across sectors (especially, in poorer countries), and third, Governments should gradually phase out tax expenditures that have a negative impact on the environment, such as tax breaks for fossil fuels and other programs that encourage the unsustainable exploitation of natural resources. Further, it is suggested that developing countries need a framework for assessing the value of tax incentives in light of the Sustainable Development Goals (SDGs) and each country should build this framework by taking into account the regional neighbors' customs to allow for the sharing of best practices (Mosquera Valderrama, 2020). Moreover, according to the findings of Svoboda (2017), tax incentives are a more effective form of research and development support than direct government funding. Evidence extracted from China's value-added tax reform examined that tax incentive has larger effects on firms that are less financially constrained, such as smaller firms and firms with a larger cash flow. The result is largely driven by responses of domestic private firms and is robust to specifications addressing the issue of anticipation (Zhang et al., 2018). Further, analysis of the key formation variables and systemization of the key mechanisms are necessary to create a favorable investment environment, (Irtyshcheva et al., 2020).

Furthermore, a key justification for this study is that there are not many studies that look at the effects of tax incentives and business environments in developing counties, specifically in Kosovo. In light of this, this study seeks to fill this gap in the literature.

The remainder of this paper is organized as follows. Section 2 provides a review of the literature. Section 3 contains the research methodology and data of the panel evidence. Section 4 provides the results. Section 5 provides the conclusion given by the authors.

2. LITERATURE REVIEW

Gani and Al-Abri's (2013) empirical results reveal that the time required to start a business, the time required to enforce a contract, the time required to register a property, and the time required to resolve insolvency is negatively and statistically significantly correlated with foreign direct investment (FDI) inflows. Their findings also confirm that political instability and the absence of democracy, in fact, encourage FDI inflows, also they conclude that the business environment strongly matters for FDI inflows into the Gulf Cooperation Council (GCC) countries. Matthew et al. (2021) found out that business climate, government stability, inflation, law and order, and socioeconomic condition significantly affect the inflow of foreign direct investment. According to Ohrn (2018), lower corporate tax rates and faster-accelerated depreciation each stimulate a similar increase in investment. Brada et al. (2019) point out that those countries, where corruption is at a lower level, are expected to have higher FDI. Further, Liu et al. (2022) analyzed the effect of the implementation of the environmental tax in China in 2018 on firms' environmental investments and the results show a significant increase in firms' environmental investments after the implementation of the tax.

Ozturk (2007) examined the effects of FDI on growth, emphasizing that free trade zones, trade policies, the level of human capital, financial market regulations, banking system, infrastructure standards, tax incentives, market size, regional integration frameworks, and economic and political stability are all significant factors that influence FDI and have a positive effect on overall economic growth. Further, states with higher per capita incentives tend to have higher state corporate tax rates (Slattery & Zidar, 2020).

Fiscal incentives have become a global phenomenon since governments around the world compete hard to attract multinational corporations. While industrial Western European nations allow investment allowances or accelerated depreciation, impoverished African nations depend on tax holidays and import duty exemptions. As indicated by the number of high-profile foreign investments, including Toyota in Northern France or Mercedes-Benz Group AG in the USA, Alabama, this trend appears to have significantly increased since the early 1990s. These have sparked intense discussion about whether governments provided excessively generous incentives to entice those businesses to invest in their region. However, the discussion surrounding the usefulness of tax incentives is not new and has a lengthy history (Morisset & Pirnia, 2002). Reforms for tax incentives should be implemented "bottom-up" rather than "top-down" (Bartik, 2005).

EU membership, macroeconomic stability, strategic location, favorable taxes, diverse economies, low labor costs, and relatively educated population are attractive for FDI in the Western Balkan Region (Egger & Raff, 2011). Nuţă and Nută (2012) found that tax incentives were in many cases the main reason for choosing a country and staying away from another. Munongo et al. (2017) point out that macroeconomic conditions, infrastructure, and strong institutions were found to be important non-tax factors that improve the attractiveness of an economy to FDI, while it was noted that the use of tax incentives to attract FDI might improve the welfare of individuals in the jurisdiction that apply the incentives but have external cost implications for residents in other competing jurisdictions that do not adopt tax incentives. Witkowska (2007) found that the business environment can be treated as an important location factor, as far as FDI is concerned, also business-friendly regulations may influence foreign investors' decisions to a much higher degree than other traditional location factors. Göndör and Nistor (2012) suggest that fiscal competition between governments for FDI is not necessarily a corporate tax rates competition, but a business environment one, which is determined primarily by fiscal policy. A predictable policy that promotes macroeconomic stability stimulates the FDI inflows, this is most often the case with trade policies and tax policies (Demekas et al., 2007). Four basic justifications in order to offer such incentives to promote business growth were examined by Rubin and Rubin (1987), namely, the process of growth, administrative capacity, financial hardship, and citizen needs.

Additionally, based on research issues, a literature review has resulted in two main objectives: 1) the identification of indicators that affect new investments in Kosovo and 2) the evaluation of the impact of the business environment and tax incentives on new investments in Kosovo. While, hypotheses have been raised to achieve the study objectives, which are as follows:

H1a: Business environment has an impact on new investments.

H1b: Business environment has no impact on new investments.

H2a: Tax incentives have an impact on new investments.

H2b: Tax incentives have no impact on new investments.

3. RESEARCH METHODOLOGY

Primary data are collected and analyzed by a questionnaire specially prepared for this research focusing on the business environment's impact and tax incentives on new investments in Kosovo. This questionnaire was sent to all business that has made new investments in Kosovo during the period 2018–2020. Additionally, it expresses the individual attitude of each participant according to their counterview, always avoiding external factors that may affect their answers. Also, it is designed to be as comprehensible and accessible as possible and it contains an introductory part that provides demographic data of the respondent, and types of surveyed businesses, to go through the questions related to new investments, business environment, and the last section contains questions related to tax incentives, namely, Kosovo. Arithmetic means, standard deviation, and percentages were used during the statistical analysis part of the data. The reliability of the questionnaire is measured by Cronbach's alpha coefficient, showing a result of 0.93%. Cronbach's alpha is a measure that is used to evaluate the internal consistency or reliability of a group of scale or test items. Also, it is most frequently used to assess the reliability of a scale made up of several Likert questions in a survey or questionnaire, which quantifies the level of agreement on a standardized 0 to 1 scale.

The multiple regression model was used for the econometric testing of the hypotheses:

$$NI = \beta_0 + \beta_1 BE + \beta_2 TI + \varepsilon \quad (1)$$

where,

- NI: New investments;
- β_0: Constant or intercept;
- β_1: Regression coefficient;
- BE: Business environment;
- TI: Tax incentives;
- ε: Error coefficient.

4. RESULTS

The first paragraph of the questionnaire contains the demographic data of the respondent related to gender, age, place of living, level of education, and experience in business, which are presented in detail through the table.

Table 1. Demographic data of respondents

Question	*Frequency*	*Percentage*
Gender	***N***	***%***
Male	40	38.46
Female	64	61.54
Age	***N***	***%***
18–30 years old	1	0.96
31–45 years old	25	24.04
46–50 years old	47	45.19
51–60 years old	26	25
+ 60 years old	5	4.81
Place of living	***N***	***%***
Rural	13	12.5
Urban	91	87.5
Level of education	***N***	***%***
Secondary education	4	3.85
Bachelor	55	52.88
Master	44	42.31
Doctoral	1	0.96
Experience in business	***N***	***%***
1–5 years	3	2.88
6–10 years	54	51.92
+ 10 years	47	45.19

Source: Authors' elaboration.

The table above presents the demographic data of the respondents, and based on the results presented, we have a total of 104 participants, the majority of them belong to the female gender (64 or 61.54%), as regards the age group respondents are from 46 to 50 years old (47 or 45.19%). The respondents are mainly from urban residences (91 or 87.5%), regarding the level of education out of 104 respondents, 55 or 52.88% of them have a bachelor's education level and have experience in business from 6 to 10 years (54 or 51.92%).

Table 2. Types of surveyed businesses

Types of business	*Frequency*	*Percentage*
Individual business	7	6.73
Partnership	2	1.92
Limited liability company	73	70.19
Corporation	22	21.15

Source: Authors' elaboration.

The table above presents the types of surveyed businesses classified into four categories, out of 104 businesses that were sampled, the largest part of them (73 or 70.19%) belongs to the limited liabilities company, the second type of businesses represent corporations, where 22 businesses or 21.15% participate in this type of business. However, we have less than 10% of the research sample in individual businesses and partnerships.

Table 3. Results of questions related to new investments

Question	*IB*	*Partnership*	*LLC*	*Corporation*	*Significant difference*
The procedures for registering your business with the Kosovar authorities (ARBK and TAK) have been easy	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	2	3	p = 0.332
Do not agree	2	0	1	10	
Agree	1	2	6	29	
Completely agree	4	0	13	31	
Corruption affects the level of new investments in Kosovo	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	1	3	p = 0.427
Do not agree	2	0	2	10	
Agree	4	1	19	47	
Completely agree	1	1	0	13	
Political stability affects the level of new investments in Kosovo	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	2	2	p = 0.495
Do not agree	1	0	1	13	
Agree	5	2	13	33	
Completely agree	1	0	6	25	
During the operation of your business, the workforce has been a problem	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	2	7	p = 0.991
Do not agree	1	0	3	10	
Agree	3	1	11	36	
Completely agree	3	1	6	20	

Note: IB is for individual business and LLC is for limited liability company.
Source: Authors' elaboration.

The table above presents a summary of the questions related to new investments, the data are presented in frequencies, where in addition to the presented frequencies, a test was also executed for the difference between the answers according to the type of business, the applied test is chi-square. Based on the results given by this test, there are no significant statistical differences in the four statements posed regarding new investments. The first statement: "*The procedures for registering your business with the Kosovar authorities (Business Registration Agency (ARBK) and Tax Administration of Kosovo (TAK)) have been easy*" and the second one, respectively, "*Corruption affects the level of new investments in Kosovo*", out of 104 businesses surveyed, 86 have compatibility. Regarding the statement "*Political stability affects the level of new investments in Kosovo*", 85 businesses have compliance in the last attached statement.

Table 4. Results of questions related to the business environment

Question	*IB*	*Partnership*	*LLC*	*Corporation*	*Significant difference*
Low operating costs and access to the EU	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	1	3	p = 0.885
Do not agree	0	1	3	13	
Agree	4	1	12	38	
Completely agree	3	0	6	19	
Infrastructure has been a problem during the operation of your business	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	2	3	p = 0.301
Do not agree	0	1	4	13	
Agree	6	0	8	25	
Completely agree	1	1	8	32	
New investments are attracted by the geographical position of Kosovo	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	1	6	p = 0.531
Do not agree	0	1	4	11	
Agree	3	1	13	39	
Completely agree	4	0	4	17	
Support from local and international organizations has an impact on making investment decisions	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	4	4	p = 0.076
Do not agree	0	1	2	16	
Agree	3	0	8	39	
Completely agree	4	1	8	14	

Source: Authors' elaboration.

The table above presents a summary of the questions related to the business environment, the data are presented in frequencies, where, in addition to the presented frequencies, a test was also performed for the difference between the answers according to the type of business, the applied test is chi-square. Based on the results given by this test, we have no significant statistical differences in the four statements posed regarding the business environment. In the attached statement "*Low operating costs and access to the EU*", 83 out of 104 businesses have compliance. In the second statement "*Infrastructure has been a problem during the operation of your business*" and the third statement "*New investments are attracted by the geographical position of Kosovo*", out of 104 surveyed businesses, 81 businesses have compliance. With the last attached statement "*Support from local and international organizations has an impact on making investment decisions*", 77 businesses agree.

Table 5. Results of questions related to tax incentives

Question	*IB*	*Partnership*	*LLC*	*Corporation*	*Significant difference*
Tax incentives have an impact on new investments	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	1	1	p = 0.599
Do not agree	1	1	2	8	
Agree	3	0	9	42	
Completely agree	3	1	10	22	
Agreements for the elimination of double taxation have an impact on new investments	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	2	5	p = 0.355
Do not agree	1	1	1	4	
Agree	4	1	14	36	
Completely agree	2	0	5	28	
Dividend treatment has an impact on new investments	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	2	2	p = 0.107
Do not agree	1	1	0	7	
Agree	2	0	16	43	
Completely agree	4	1	4	21	
Favourable tax rates have an impact on new investments	***N***	***N***	***N***	***N***	***Chi-square***
Do not agree at all	0	0	1	6	p = 0.422
Do not agree	1	1	3	4	
Agree	2	1	11	38	
Completely agree	4	0	7	25	

Source: Authors' elaboration.

The table presents the questions related to tax incentives, the data are presented in frequencies, where in addition to the presented frequencies, a test was also executed for the difference between the answers according to the type of business, the applied test is chi-square. Based on the results given by this test, we do not have significant statistical differences in the four statements posed regarding tax incentives. In the first statement, "*Tax incentives have an impact on new investments*" and in the second statement "*Agreements for the elimination of double taxation have an impact on new investments*", 90 out of 104 businesses have compliance. In the third statement, "*Dividend treatment has an impact on new investments*", out of 104 businesses surveyed, 91 businesses have compliance. In the last attached statement "*Favorable tax rates have an impact on new investments*", 88 businesses have compliance.

Table 6. Descriptive statistics of the variables

Variable	*Obs.*	*Mean*	*Std. Dev.*	*Min*	*Max*
INV	104	7.44	2.1	1	10
BE	104	7.3	2.15	1	10
TI	104	7.25	2.34	1	10

Note: INV — Investments.
Source: Authors' elaboration.

The respondents were asked about their assessment of the indicators presented above, where the assessment was from 1 (a little) to 10 (a lot), based on the presented averages of the three assessments, the investment variable has the highest assessment with an average of 7.44 then the second highest rating is the business environment with an average of 7.30, while tax incentives have the lowest rating of 7.25.

Table 7. Correlation analysis

Variable	*INV*	*BE*	*TI*
INV	1.00		
BE	0.81	1.00	
TI	0.76	0.82	1.00

Note: INV — Investments.
Source: Authors' elaboration.

The table above presents the correlation analysis in order to present the relationship between the variables of the study. Based on the results of this coefficient, the relationship between investments with the *BE* is positive ($r = 0.81$), and investments with *TI* also have a positive relationship ($r = 0.76$). So, the growth of these two indicators has an impact on the growth of investments.

Table 8. Regression analysis

Variable	*Coeff.*	*St. Error*	*t*	*P > t*	*[95% Conf. interval]*	
BE	0.56	0.13	4.13	0.000	0.29	0.83
TI	0.29	0.14	2.07	0.041	0.01	0.58
Constant	1.72	0.88	1.95	0.053	-0.02	3.48
N = 104						
R^2 = 68.69%						

Source: Authors' elaboration.

Through their respective p-values, the relevance of the independent variable on the dependent one is made abundantly clear by the regression analysis. Tax incentives have a p-value of 0.041 and a coefficient of 0.29, while the business environment has a 0.000 p-value and a coefficient of 0.56. Moreover, the business environment and tax incentives have a significant effect on new investments, through regression analysis.

Table 9. Questionnaire reliability results

Questionnaire reliability form	*Results*
Number of items in the scale	15
Scale reliability coefficient	0.93

Source: Authors' elaboration.

The table above presents the results of Cronbach's alpha test, which was used to test the consistency of the questionnaire, based on the data of the table, which included 15 developmental statements of the questionnaire, the test result is 0.93, which shows that we have very high reliability in the questionnaire, so the data obtained from the questionnaire have high reliability.

5. CONCLUSION

Some additional points that can be added to this study are worth noting, consisting of policy recommendations taken into account, in order to implement measures to enhance Kosovo's business climate and tax incentives. Examples of effective policy initiatives include improving infrastructure, streamlining bureaucratic procedures, and offering tax incentives that are in line with corporate needs. Further, the study's limitations, such as the small sample size, lack of control over external factors, and the subjective nature of some data, should be acknowledged. Future studies should aim to address these limitations to strengthen the validity of their findings. The study highlights the important role that the government plays in creating a favorable business environment and offering tax incentives to attract new investment. Favorable government policies are considered crucial in investment decisions. While, the impact of cultural and social factors seems factors that influence investment decisions, cultural and social factors may also play an important role. Further, by identifying the factors that are most important to investors, investment promotion agencies can tailor their messaging and outreach to better attract new investment to the country.

From this research, we conclude that the business environment and tax incentives affect new investments in Kosovo. According to the results, two independent variables namely, business environment and tax incentives have a significant impact on new investments. Thus, an increase in the business environment and tax incentives variable affects an increase in new investments, and conversely, a decrease in the business environment and tax incentives coefficients will result in a decrease in new investments in Kosovo. Based on correlation analysis, we conclude that both independent variables, business environment, and tax incentives have a strong positive correlation with the dependent variable, new investments. The growth of these two indicators has an impact on the growth of investments.

Future research may include consideration of more variables, such as inflation, and credit rates, and also, recommended to increase the number of respondents in the questionnaire, in order to understand better, the factors that influence investment decisions in the country. Additionally, it is considered important to compare the results of this study to similar studies done in other regions or nations to see how the business environment and tax incentives affect new investment and whether there are any parallels or differences and do a longitudinal analysis to ascertain whether changes in the business climate and tax incentives affect new investments in Kosovo. Additionally, analyze specific industries or sectors to see if the effect of the business environment and tax incentives on new investment vary and determine which tax incentives are most beneficial in various situations by assessing their efficiency in luring new investment. Moreover, researchers can investigate how regulatory changes affect the business climate and how new investment is affected, especially in the context of emerging markets. The study's findings have important implications for economic growth in Kosovo. Attracting new investments can create jobs, increase productivity, and stimulate innovation, which can have a positive impact on economic growth. Therefore, policymakers should consider implementing policies that are designed to attract new investment to promote economic growth in the country. Moreover, the study's findings could be used to inform investment location decisions in Kosovo. Companies considering investing in Kosovo can use the study's insights to assess the potential impact of the business environment and tax incentives on their investment decisions.

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