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THE IMPACT OF TAXATION ON THE INVESTMENT LOCALIZATION DECISION IN THE CONTEXT OF GLOBALIZATION

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Abstract

This paper presents the impact of the tax policy on the enterprises decisions about the location of investment in the context of globalization. We study this aspect for the European Union, seen like a successful answer to the globalization provocations.

First of all we define the globalization and secondly we find that the changes of economic environment (the creation of Single Market and of the Monetary Union) have added a greater relevance for the tax policy in the investment decision making process, because the fiscal competition (through lower tax levels and fiscal facilities) can determine the investment' "delocalization" (geographically moving the location of an investment).

Finally, we conclude that the taxation plays an important role in the investment decision making process, but an enterprise must take into consideration also other aspects (the infrastructure, the available labour, the legislation, the quality of the local services, etc.) if it wants to be efficient.

Key words: globalization, European Union, taxation, enterprise investment decisions, investment' "delocalization".
JEL classification: E62, F36, G38, H32.

1. Introduction

We define the globalization like the process through which the humanity tends toward an entity with common features and a social liberal global nature system. From the economic point of view, the globalization determines the multiplication and strengthening of interaction between the components of the global economic system.

The globalization is accompanied by advantages and disadvantages for the big corporations and the final consumers. Between the advantages we can remark the investment opportunity, in that way that the production be more competitiveness from the point of view of quality and price. But, the globalization is accompanied by disadvantages too, because the poor countries will be attractive for foreign direct investment only if it will present considerable advantages for workforce and natural resources.

In this paper, we'll establish the relation between one of the most important financial instruments of the Government, which is the tax policy, and the enterprise investment decisions. In the second paragraph we present the European Union, seen like a successful

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answer to the globalization provocations. In the third paragraph, we present the tax policy and investment decisions concepts and the relation between them. Continuing, we study the impact of tax policy of different states of EU on the enterprise decision about the location of its investments. Finally, we present the conclusions of our study.

2. UE in the context of globalization

Globalization describes the economic reality of our times. Indispensable to this concept is factor mobility. Economic policies can have a great influence on decisions about where it is best to do business, and especially, investments. A globalizing world means governments, national as well as regional and local jurisdictions, are forced to compete to attract and to hold these increasingly mobile factors of production. Some specialists say that globalization diminish or even eliminate the political choice. Globalization is having a beneficial impact on fiscal decision-making. In a world where capital moves across borders more freely than ever, globalization heightens tax competition among nations.

In the past 20 years, national tax systems from almost all over the world have suffered major changes. Thus, each country has radically restructured the tax system. While a few decades ago almost all countries were adopted a progressive taxation of incomes of individuals and companies, with marginal tax rates reaching 80-90%, today most countries have abandoned such punitive rates for other more moderate. Years ago, governments manage their tax systems by encouraging or discouraging a wide variety of social and economic behaviour. Today, experts consider that tax systems should be as neutral from an economic point of view.

Globalization can be associated with the strong pressure put on states to modernize their practices of fiscal management in order to achieve better fiscal transparency and adopt common tax rules. Concerning the applicability of common tax rules can be more issues:

- Will succeed such tax rules based on fiscal transparency, to lead to a better coordination of fiscal policy across countries?
- If it is so, the support of macroeconomic policies will move from the fiscal policy to the monetary one in terms of stabilization?
- The implementation of this regime of transparency will lead to harmonization of individual policies? (taxation of companies, public services, total expenditures);
- Despite globalization pressures, will be different tax rules for countries at different stages of development?

Globalization brings with it increased competition at local level, diminish the role of state and of national policies, many problems cannot be properly resolved only at the international level, and therefore must find new ways leading to their resolution. In this sense, the process of European integration is a response to the challenges of globalization

In the European Union, tax policy is a symbol of national sovereignty [European Commission, 2000] and part of a country’s overall economic policy, helping finance public spending and redistribute income. In the European Union, responsibility for tax policy mainly lies with the member states, who may delegate some of it from central to regional or local level, depending on the constitutional or administrative structure of government.

The EU ensure that national tax rules are consistent with the Union’s overarching goals of job creation and that they do not give businesses from one country an unfair advantage over their competitors in another country. So, EU tax policy is about upholding the principles of the single market and free movement of capital [Taxation, underpinning of the single market, 2009].

3. The concept of investment decision and the influence of the and tax policy

The investment decision can be considered one of the most important decisions taken by financial managers, if not the most important one. The investment decision making process influence the enterprise affirmation in the business environment and increase its market share. Investment decision concerns the issue of capital allocation for fixed assets or financial assets; central place returns to fixed assets, acquired as a result of capital investment. By this decision, financial resources at its disposal are allocated efficiently to the acquisition, construction, modernization of fixed assets and the accumulation of material stocks, in the appropriate volume and adequate structure for its function at the highest parameters. Also, the available liquidities may be placed respecting the efficiency criteria on the capital market, to purchase financial assets. Regardless of the selected variants, the investment decision should be subordinated to accomplish the performance objectives at long-term, established by the general policy of the enterprise.

In another approach [Bucataru, 2002, 22], investment decisions are those concerning the conversion of capital money in material form such as machinery, equipment, buildings, through operations of acquisition of these assets.

Financial decisions, such as the investment decision, and the decision making process is influenced by a number of internal and external factors, among which we mention (Figure 1):

- *Internal factors*: the enterprise interests and objectives; the involvement of the managers and employees in the submission of a maximum effort in order to achieve the objectives; the nature of the products or services offered by the enterprise; the technical characteristics of the enterprise units; the units interdependence in achieving objectives.
- *External factors*: the distributors of products or services; the suppliers of materials, equipment and labour; the competitors to customers and suppliers; *the tax legislation*; the improvement or creation of new products through the introduction of new technology.

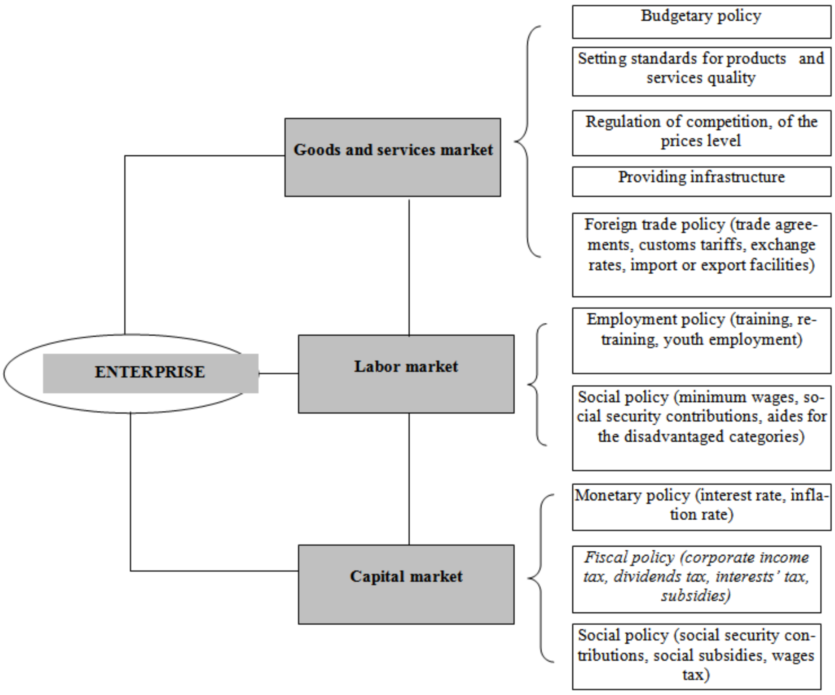

Figure no. 1. The importance of tax policy in determining the enterprise decisions

Among these factors we notice in particular fiscal policy, in general and specially, taxation (the level of corporate tax income, the various tax incentives). At enterprise level, through taxation we understand not only corporate income tax, but also wage tax, social security contributions, local taxes. The most important factor which can influence the enterprise's investment decisions is the fiscal policy, described in our study in a restrictive sense as a tax policy.

Before the presentation of these influences it is necessary a clarification of the fiscal policy concept, because it is often presented with different shades. Usually is accentuated its side of taxes promoted by a state or another. Thus, Balanescu R. considers that fiscal policy represents "all regulations on the taxes establishment and levying, characterizing the state options in terms of taxes" [Balanescu, 1994, 27]. In view of Corduneanu C., fiscal policy includes "all fiscal decision taken by the tax authorities, to ensure financial resources for public needs and the purpose of achieving economic and social objectives" [Corduneanu, 1998, 379].

Thus defined, fiscal policy includes all options aimed only to purchase financial resources available to tax authorities, through tax, fees and contributions. In this sense, fiscal policy is presented as a tax policy, like an independent process of their spending, which prints a very restrictive sense.

Professor Gheorghe Filip defines fiscal policy as "all activities, methods, forms, techniques, tools, and specific institutions through which are purchased the tax resources available to state and, in general, to public authorities and also their distribution for the public needs" [Filip, Onofrei, 2000, 179]. Thus, fiscal policy includes aspects regarding taxes and also regarding public expenditures. But although we agree with the last approach, our study focuses on the impact of fiscal policy, seen in the restricted sense of tax policy, on the enterprise investment decisions.

In the investment decision making process of an enterprise, one cannot neglect this factor. In this respect, on the one hand, in the moment in which the decisional authorities establish the dimension of the obligatory prevailing from the enterprises, one must take care of the fact that over a certain level, limiting the possibilities of performing the investments can have negative effects over the economic growth.

On the other hand, although the enterprise makes independently the financial decisions, it must comply itself with the existent juridical framework imposed through the decisions of public authorities, materialized in the fiscal legislation existent at a given time.

The changes of economic environment (the free movement of capital, the creation of Single Market and of the Monetary Union) have added a greater relevance for tax policy in the decision making process of the enterprises, becoming the cause of the distortions which affects the fiscal neutrality and which prevent the efficient allocation of resources.

Due to the number increase of the European Union member states, the disparities between the tax systems seem to influence more and more the decisions connected to the allocation of funds in the different member states and their agreements for the administration of trading activities, although in the event of an investment, the decision to place it in a location or from the European Union should be as less distortional as possible from the tax policy. This will take place because the coordination of the economic policy will allow the member states to make use of their fiscal regulations in order to influence the decisions regarding the localization of the investments and of the resources from European Union.

To illustrate this we present the tax level in EU countries in the table below, and we can observe the differences between the lowest level of 10% in Bulgaria and Cyprus and the higher level of 33.99% in Belgium (regarding the corporate income tax).

Table no.1- Income tax rates in the EU countries

Country	**Income tax**	
	Corporate	**Individual**
Austria	25%	21%-50%
Belgium	33.99%	25-50%
Bulgaria	10%	10%
Cyprus	10%	20-30%
Czech Rep.	20%	15%
Denmark	25%	38-59%
Estonia	21%	20%
Finland	26%	7-30.5%
France	33.33%	5.5%-40%
Germany	30-33%(effective)	14-45%
Greece	25%	0-40%
Hungary	16%	18% and 36%
Ireland	12.5%	20-41%
Italy	31.4%	23%-43%
Latvia	15%	23%
Lithuania	20%	15%/20%
Luxemburg	21%	0-38%

Malta	35%	15-35%
Netherlands	20-25.5%	0-52%
Poland	19%	18%/32%
Portugal	25%	0-42%
Romania	16%	16%
Slovakia	19%	19%
Slovenia	21%	16%-41%
Spain	30%	24-43%
Sweden	26.3%	0-57%
U.K.	28%	0-40%

Source: [Tax Rates around the World]

At the beginning of 2005, Romania adopted a flat income tax reduced for individuals and for companies, which level is situated at 16%. However, Romania is not the only European country which adopted such tax policy measures. The other European countries which made the same option are presented below:

Table no.2- Flat tax in Europe

Country	**Tax rate (%)**	**Year of enforcement**
Estonia	26	1994
Georgia	12	2005
Latvia	25	1995
Lithuania	33	1994
Russia	13	2001
Serbia	14	2003
Slovakia	19	2004
Ukraine	13	2004

This orientation towards a flat tax is determined by the advantages it offers for the development of the business environment, among which we have noticed:

- it encourages employment and investments;
- it can contribute to increase the budgetary incomes by increasing the tax base (according to the Laffer curve)
- it reduce tax evasion by decreasing the opportunity cost of such activities;
- it contribute to the increase of the attractiveness of the economic environment, with a positive impact towards attracting foreign investments.

One way of reducing the fiscal cost is represented by the orientation of the enterprise and it adopting a strategy of investments in tax free areas or in disadvantaged areas, for whose economic development enterprises benefit from tax deductions or considerable tax diminutions.

An enterprise can decide to pursue its activity in such an area precisely in order to avoid elevated tax costs. It is necessary that fiscal authorities ensure an efficient system of taxes by ensuring the long term stability of the Tax Code stipulations regarding these tax incentives. Thus, certain fiscal decisions considered as beneficial as some point may prove to be no longer effective for the enterprise in the case of subsequent law modifications. For this reason, the enterprise has to consider a multitude of factors when it decides to invest, since the latter could have a substantial influence upon the enterprise's future situation.

In these circumstances, tax decrease for disadvantaged areas or the granting of certain tax incentives should not represent a sufficient reason for the company to decide to direct its interests towards that particular area. It takes a comparative analysis of deducted tax costs by reporting them to the disadvantaged area and to the possible supplementary costs that the company would incur as a result of basing its activities in the respective area. These supplementary costs may be related to transport, supply, etc., which could exceed the value of tax cost reductions.

Although, the fiscal facilities used by authorities for stimulating the investments represent another factor which can determine the localization of an investment in a country. In the context of EU, a study from 2004 [Sanz Sanz, Romero Jordán, Álvarez García, Chocarro Garbayo, Ubago Martínez, 2004] demonstrates that 12 of 25 EU member states (in 2004, when the study has been made, EU had 25 member states), use fiscal facilities with the mentioned purpose: Austria, Belgium, Denmark, France, Ireland, Latvia, Malta, Holland, Portugal, U.K., Spain and Hungary. The most used instruments are the tax deductions, fiscal credits and tax reductions.

Table no.3- Fiscal instruments of EU countries with an impact on investments

Country	Instruments of stimulating investments and development (I+D)
Austria	Deductions: 25% for I+D expenditures. Up to 35% for expenditures above the arithmetic mean of these expenditures made by the enterprise over the past 3 years. Since 2003, deductions of 15% for some research and investigation expenditures, carried out in the enterprise
Belgium	Deduction: 13.5% for technological innovations to protect the environment and for lower energy investments.
Czech Republic	-
Cyprus	-
Denmark	Deductions: I+D project costs.
Estonia	-
Finland	-
France	Deductions: since 31st December 2005, 50% of the difference between (a) I+D expenditures of the current year and (b) the average of the I+D expenditures of the past two years, adjusted with the consumption index. It cannot surpass 6.1 million euros.
Germany	-
Greece	-
Holland	Fiscal wage reductions for the firms having employees involved in an I+D activity. Wage reductions of 40% up to 90,756 euros and 15% for what goes above. Wage reductions cannot surpass 7,941,154 euros per employer. Free break-even for assets protecting the environment and for licenses.
Hungary	Fiscal facilities for enterprises investing at least 100 million HUF in projects aiming at the environment or specific Internet activities, if the results cause considerable changes of the products or in the production process.
Ireland	Instant break-even. Capital expenditures in scientific research break even in the year when they are incurred.
Italy	-
Latvia	Deductions: 40% of the total sum of an important investment project.

	All built or renovated buildings have to preserve their ownership status for at least 10 years after the end of the project and for at least 5 years in the case of technology and equipment.
Lithuania	-
Luxemburg	-
Malta	Differentiated tax quotas: a) for new companies, a reduced tax quota of 5% for the first 7 years, of 10% for the next 10 years and of 15% for the next 5 years; b) for the already existing firms 10% for 6 years and 15% for the next 5 years; c) other types of reductions for the reinvested profit. Deductions: for taxes below 65% for SMSE and 50% for other enterprises, whose credits are deduced from taxes.
Poland	-
Portugal	Credit for I+D: a basic fiscal credit of 20% of the expenditures of the current fiscal year and an additional credit of up to 50% for the part of the expenditures surpassing the expenditure average of the past 2 years.
Slovakia	-
Slovenia	-
Spain	Deductions: 30% of the expenditures of the respective fiscal year. If expenditures are above the expenditure average of the past 2 years, 30% is applied to a value equal to the average and 50% for what goes above.
Sweden	-
United Kingdom of Great Britain	It is allowed to write off a debt, representing I+D expenditures. There are special provisions for SMES.

Source: [Sanz Sanz, Romero Jordán, Álvarez García, Chocarro Garbayo, Ubago Martínez, 2004]

According to the European Commissioner for the fiscal and customs field, László Kovács [László Kovács] the persistent significant disparities between the direct taxation systems of the member states raise the danger of creating barriers against the integration process of the market in the disfavour of the European economy's competitiveness.

Decisions about the location of investment, business activities, jobs and earnings are sensitive to differences in national tax regimes and social welfare systems. With increasing mobility and differentials in tax bases, businesses can identify the components on which they are taxed (taxable bases) and shop around to find the country where tax is lowest. Such competition between Member States puts downward pressure on the tax level and contributions which may be damaging if it is not regulated, as it undermines the fairness and overall efficiency of tax systems" [European Commission, 2000].

In the above mentioned context, it is possible that the risk of "harmful" fiscal competition to increase. The preoccupation for the negative effects dragged along by the fiscal competition can be understood and a better coordination in this respect would have a positive impact, especially in the case of the direct taxes regarding the incomes from savings as well as in the case of the sales tax.

The differences between the existent fiscal systems of the member states, regarding the direct taxes, make the taxation be a differentiation element with a major influence over the decisions for establishing the economic activities' location; this increases the risk of "harmful" fiscal competition. In such situations, the income taxes should be neutral and this means that the dimension of the effective tax rate over the different forms of incomes generated by the capital (profit, dividends, interests) to be almost the same. This can be achieved through a higher level of fiscal harmonization.

In this respect it was adopted The Code of Conduct for Business Taxation that identifies a number of measures for the firms' taxation field that can have a considerable influence over the localization of the economic activity within the European Union. There are legislative or administrative measures that establish an effective taxation level inferior to the one usually practiced in the respective member state.

The fiscal competition is considered harmful if it influences or may influence the activity's "localization" of an enterprise. The main criteria taken into consideration for the identification of the "harmful" competition papers through taxes in restraint of the following aspects:

- If the fiscal advantages are given only to the non-resident taxpayers or for the operations performed with non-residents;
- If the advantages are isolated by the national economy and do not affect the taxable national income;
- If the advantages are given even when there is no real economic activity or substantial economic presence in the member state that offers those fiscal advantages;
- If the determination of the imposable profit realized by the multinational companies is performed according to other criteria than those accepted at an international level (OECD);
- If the fiscal measures lack transparency and especially if the legal dispositions apply at the administrative level with high risk and without transparency.

By applying this Code one is trying to avoid or eliminate these "harmful" measures that exist at the European level of the income tax and that have an incidence over the localization of the economic activities.

This Code of Conduct represents actually a political compromise made by the governments of the member states for eliminating the fiscal measures that bring prejudices due to the low taxation rate that influences the enterprisers in their decision regarding the location where they will perform the activity, as well as the compromise not to introduce new measures of this type.

The application of this Code was necessary due to the fact that the fiscal competition (manifested through the introduction by the member states of fiscal facilities or through the reduction of the taxation rate, being aimed the attraction of foreign investments) generated negative effects in the sense of influencing the decisions of the economic agents over the location where they should perform their activity. But this Code aims punctual aspects in respect to the direct taxation and it never imposes the intense coordination of the direct taxes, maintaining thus the option for fiscal competition.

4. Conclusions

Even if the fiscal factor plays an important role in the decision making process of an enterprise for establishing the place where it will perform its activity, its investments; it must take into consideration also other aspects, as the infrastructure, the available labour, the legislation, the quality of the local services, etc. If the enterprise decides to establish its activities where the fiscal charge is more reduced and not where the production costs are smaller, the production will be less efficient. The investment decision making process it's good to be based on efficiency criteria, because otherwise exist the risk that the enterprise establish its investment in a place with major costs because of the financial facilities provided by the authorities.

In present, the tax policy in EU – for both indirect and direct tax – constitutes a temporary solution and it is at transitional stage. In fact, the different tax systems in the SEM (Single European Market) are not in accordance with the current state of integration. On the other hand, the response to increasing economic integration and tax competition in Europe cannot be simply tax harmonization. As emphasized by the literature, in certain cases such a development would have negative welfare effects for some members and does not fully address the fiscal aspects of the integration process. However, it lays the foundation for closer co-operation in the tax field and paves the way for fiscal integration in the EU.

In this context, we conclude that the method of calculating the profit tax, both at national level and in some forms of economic integration as the European Union has a great impact on investment decisions since it can stimulate their volume and structure, becoming a good support of economic development of the country and of the European Union as a whole too.

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