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THE INTERPLAY OF TAX INCENTIVES AND GLOBAL INVESTMENTS IN A DYNAMIC ECONOMIC LANDSCAPE

In the changing scenarios of global economics, the utilization of tax incentives has emerged as a strategic instrument, particularly in the realm of mobile activities. Positioned as potential "beggar-thy-neighbor" tools, tax incentives hold the promise of influencing the global investment landscape. However, the translation of their impact into a substantial surge in worldwide investments is not a foregone conclusion. Instead, a noteworthy outcome could be the relocation of investments across different jurisdictions. This phenomenon prompts a crucial realization that the effectiveness and adoption of tax incentives extend beyond their design parameters.

These trends could be attributed to changes in government preferences, but evidence suggests that governments strategically respond to shifts in tax policy within other jurisdictions [1, 2, 3]. The rising use of income-based tax incentives is occurring alongside a global decrease in CIT rates, often referred to as a "race to the bottom" (Chart 1).

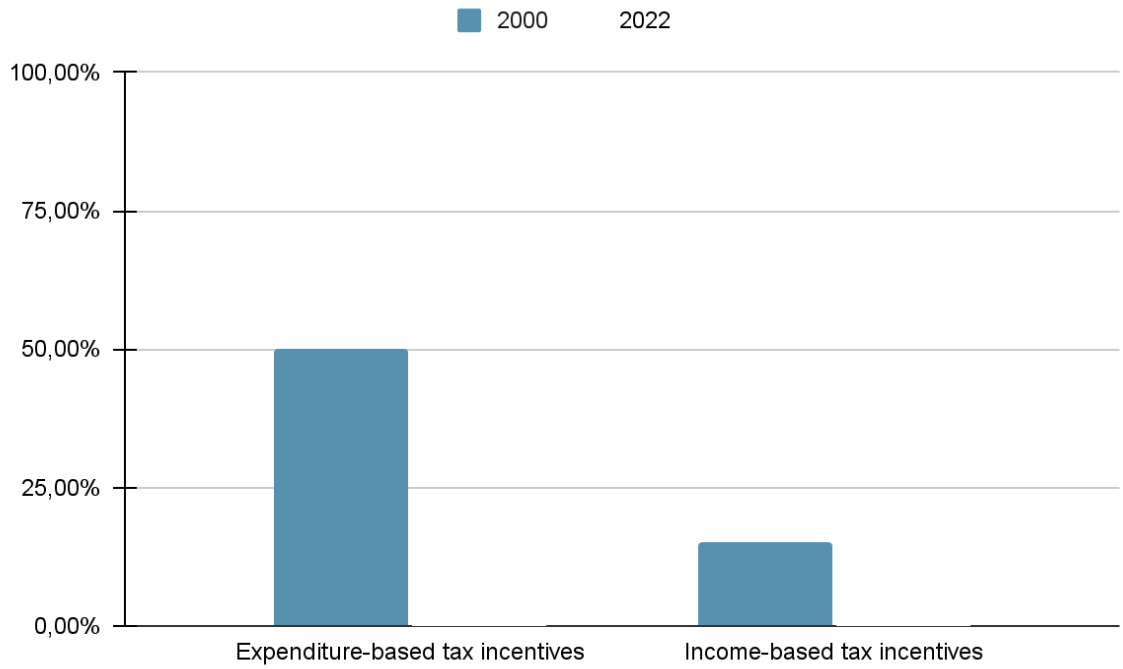

Chart 1 -- Increasing use of tax incentives for innovation among OECD countries
Source: OECD R&D tax incentives database [5]

Research indicates that the effectiveness of tax incentives for investment heavily relies on their design and the specific context in which they are implemented. Empirical evidence underscores the significance of comprehending the design of tax incentives in evaluating their effectiveness, efficiency, and their contribution to sustainable development outcomes.

Evidence supports the superior performance of expenditure-based tax incentives over income-based incentives. Expenditure-based incentives, such as accelerated depreciation or

investment allowances, directly target investment expenses and have a higher likelihood of stimulating additional investment. Conversely, income-based incentives, like exemptions or reduced tax rates, are tied to a firm's profit rate and primarily benefit successful companies, potentially providing advantages to firms that would invest even without preferential treatment. Some studies have indicated limited investment responses to income-based incentives in developing economies [1].

Accelerated depreciation and immediate expensing have proven effective in boosting investment in OECD countries. Similarly, among developed countries, there is more conclusive evidence regarding the effectiveness of expenditure-based research and development (R&D) tax incentives compared to income-based incentives, which can result in tax-driven behaviors [2]

In a global context, particularly concerning mobile activities, tax incentives can act as "beggar-thy-neighbor" instruments, leading to no significant increase in global investment but rather a relocation of investment across different jurisdictions. Apart from incentive design, other framework conditions such as political and institutional stability, infrastructure availability, and a skilled workforce influence the effectiveness and adoption of tax incentives. In the absence of an attractive economic environment, tax incentives may have limited cost-efficiency and effectiveness. Countries with unfavorable investment climates are unlikely to attract additional investment, even with generous incentives [4, 2] indicates that FDI are less responsive to taxation in countries with unfavorable investment climates.

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